

Abstract

In the mid or late 19th century the first activities which could be regarded as Foreign Direct Investments (FDI) occurred. The FDI are related to the globalization of economic activities and thus are of great importance for countries due to the ongoing globalization process. Because of the relative fast saturation of its small market and its open connections with the rest of the world from time immemorial, the Netherlands has been an important player in the international process for a long time. It is therefore not surprising that over the last ten years the Netherlands has had more outward FDI than inward FDI. This is not the case in Spain, which has had many years with a bigger inward than outward flow of FDI since the nineties. Furthermore Spain continues to appeal foreign investors because of numerous advantages. Besides these facts it is known that for all the major European countries, excluding the United Kingdom, more than half of the FDI flows to other countries within Europe. This raises the question whether there is a relation between the FDI flows of the Netherlands and Spain and what this relation looks like. This topic is discussed in this thesis and furthermore the research has been specified on the relationship between the FDI flows of the Netherlands and Aragon, which is the Autonomous Community of the fifth largest city of Spain: Zaragoza.

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H1. Backgrounds and research goal

1.1 Foreign Direct Investments throughout the years

The increasing globalization of economic activities is a very complex phenomenon and often a subject of Economic Geography. Besides production and trade structures, Foreign Direct Investments (FDI) are related to the globalization of economic activities. Thus the increasing internationalization can be explained by the process of profit seeking behavior, which in turn can be explained by FDI. The Statistics of FDI are the most comprehensive indicator of activities of the multinational enterprise (MNE) and of the growth of international production (Dicken, 2003).

The first activities which could be regarded as Foreign Direct Investments occurred in the mid or late 19th century. Although the flows of financial capital were still dominated in the form of British portfolio investments, in 1914 the international production and Multi-National Enterprises (MNE) were established firmly as part of the global economy. At this time the United Kingdom was by far the most important source country of FDI followed by the USA, France and Germany. Almost all of the FDI originated from industrialized economies (Johnson, 2005). According to Dunning (1983) the most important motive for FDI during this period was resource seeking, through MNE exploitation of natural resources or agricultural production. FDI flows tended towards economies outside of Europe and North America because of the resource-seeking motives and existing colonial structure. But according to Wilkins (1988), the USA was the single most important host country for FDI, this because of its large markets, high tariffs and abundance of natural resources. During the First World War many of the interconnections in the global economy were severed and large amounts of real capital including a substantial share of the European stock of FDI were destroyed. However, during the inter-war period there was an increase in the number of MNE subsidiaries as well as an increase in the global stock of FDI. But until the 1930s the pre-war value of the global stock of FDI was not surpassed (Dunning, 1983). The Second World War also caused serious destruction of real capital but the end of the war resulted in a climate suitable for international business activities. During the mid-1940s several important institutions such as the IMF, the World Bank, GATT and the Bretton Woods system were created. The creation of these institutions resulted in an economic environment with stable currencies which helped to encourage international trade and production. After the war the United Kingdom was no longer the most important source country of FDI, the United States took over this position and emerged as the dominant Western power. Also after the Second World War the developing economies became less important as host countries for FDI. In 1960 two thirds of global FDI flowed to the developed economies while in 1938 close to two thirds of FDI flowed to the developing economies (Dunning, 1983). After the end of the Second World War the volume of FDI flows as well as trade flows increased strongly. During the high-growth period of the 1960s, flows of FDI grew twice as quickly as global GNP and 40 per cent faster than world exports. Furthermore the primary sector became less important as a destination for international investment and the decreasing importance of the developing economies as host countries for FDI continued. Instead, FDI tended to flow more and more between the developed economies.

Also during the 1970s there was an increasing diversity among the source countries of FDI (Dicken, 2003). The first small outward flows of FDI from the developing economies also started to appear during the early 1970s. During the 1970s and the first half of 1980s FDI grew on par, during the second half of the 1980s FDI grew rapidly at a rate of 28% per year. This period was also a period of intensified globalization and MNE grew in importance (Dicken, 2003). Table 1.1 shows the development of FDI from 1980 until 2003, and as you can see the total inward stock of FDI grew 1090% during this period (UNCTAD, 2004).

Table 1.1: Inward stocks of FDI, millions of USD (Source: UNCTAD, 2004).

Region	1980	1990	1995	2000	2003*	Change 1980-2003
World total	692 714	1 950 303	2 992 068	6 089 884	8 245 074	+1 090%
Developed countries	390 740	1 399 509	2 035 799	4 011 686	5 701 633	+1 359%
Developing countries	301 794	547 965	916 697	1 939 926	2 280 171	+655%
Least developed economies	4 119	8 949	16 518	37 503	56 821	+1 279%
Central and Eastern Europe	..	2 828	39 573	138 271	263 270	-

This increase in global FDI is the consequence of several changes of which the substantial liberalization of the FDI regimes since the 1990s and the substantial decrease in transport and communication costs are the most important. These changes also have improved the conditions for activities of MNE and because of this the volume of FDI also increased (Johnson, 2005).

Table 1.2 shows the distribution of FDI among the different type of host economies. The developed economies account for more the 69% of the world inward stock of FDI. During the 1980s the share of the total stock of FDI in the developing economies substantially decreased (UNCTAD, 2004).

Table 1.2: Percentage share of the total inward FDI stock (Source UNCTAD, 2004).

	1980	1990	1995	2000	2003
Developed economies	56.4	71.8	68	65.9	69.2
Developing economies	43.6	28.2	32	34.1	30.8

The FDI source countries have grown in the past three decades, although most of the FDI originate from developed countries and most of the world's FDI also goes to developed countries. Western Europe is a major magnet for inward investments. For all the major European countries, excluding the United Kingdom, more than half of the FDI flow to other countries within Europe. Furthermore this regional orientation has increased. (Dicken, 2003).

1.2 The Netherlands

In the 1960s the Netherlands were the biggest foreign direct investor, after the United States and the United Kingdom. In the year 2000 the Netherlands dropped to the 6th position. This occurred because the number of countries acting as significant sources of FDI has increased, but it must be emphasized that FDI still grew throughout the years. (Dickens, 2003). Also in 2004 the Netherlands were after United Kingdom, Mexico, United States, France, Portugal, the biggest investor in Spain with 7.67% of the total investments in Spain (DNB, 2005).

Thus the Netherlands has been an important player in the internationalization process for a long time. This is due to the fact that the market saturation in small countries occurs much faster than in relatively big countries. The worldwide competition forces countries with relatively small markets to internationalize, if they don't want to fall behind on the technological level of the world. Also the Netherlands have had open connections with the rest of the world from time immemorial (Leus, 1988).

1.3 Spain

An often used method to measure the relative importance of inward FDI is to compare it to a country's gross domestic product (GDP). Between 1990 and 1999 the percentage of share GDP for Spain increased from 13.4% to 20.5%. The European Union accounted for 55.90% of total investments (Dickens, 2003). The importance of inward investments to an individual host economy varies enormous from one country to another. FDI may have a number of possible effects to a host country, these may or may not concern host counties, according to their goals, ideologies and values. Furthermore the same effects of FDI may give rise to different policies in different countries, simply because the criteria by which governments judge is different in different countries. Faulty government policies provoke reactions by foreign companies which may themselves generate undesirable effects. In these cases, the remedy may be to change policies instead of forcing companies to behave in accordance to the policies. Counties may also change policies to attract more FDI, this is a difficult business, it is important to clearly formulate which goals are to be met and in what order of importance.

Spain continues to appeal to foreign investors, offering numerous advantages. As a member of the EU and the euro-zone, Spain offers an attractive market to foreign companies, both in terms of the wider EU and its own domestic market. The country has a broad industrial and technological base and a strongly developed services sector. Spain also has the second-biggest tourism market in the world, besides this Spain is a major motor vehicle manufacturer and chemicals producer. Furthermore it is the eighth-largest economy in the Organisation for Economic Co-operation and Development. Also Spain has excellent infrastructure, modern transport and telecommunications networks. Generally, labour costs are below the EU average, translating into lower production costs.

1.4 Zaragoza, Aragon

Spain is divided in seventeen autonomous regions, *comunidades autónomas*. Zaragoza is the capital of the east Spanish autonomous region Aragon. In the research the region Zaragoza is defined as Aragon, because much of the inward FDI's are not only concentrated in the city Zaragoza but also in the surrounding area. The evolution of the economy of Aragon during the year 2004, in a Spanish context, was very positive. In 2004 the gross regional product increased with 3.1%, while this is 2.9% for Spain as a whole. Also the unemployment rate in Aragon was 5.6% which was just below the countries average. Furthermore the balance of the total trade rate within Spain, in the region Aragon in 2004, was better than the average of Spain. But on the contrary the balance of the trade rate outside Spain, in the region Aragon in 2004, was worse than the average of Spain. Also the perception of foreign entrepreneurs on the investment climate in Aragon is relatively negative compared to other regions in Spain for all sectors, with the exception of the sector industry (Informe Económico de Aragón, 2004).

1.5 Defining the problem

In the region Zaragoza there are not many Foreign Direct Investments from the Netherlands. There is a heavy competition of other city regions like Barcelona and Madrid, which attract more FDI. For the economic development of the Autonomous Community of Zaragoza, Aragon, it is of importance that it will attract FDI, including those from The Netherlands. Through this research there will be an attempt to find out what the location factors of Aragon are to attract FDI. Furthermore how they can be improved.

1.6 Research objective

The object of the research is to find out what the current state of FDI flows is from the Netherlands, especially in Spain en the region Zaragoza. Furthermore what is the state of inward FDI in Spain and Aragon. Also the object is to find out what the contemporary economy of Aragon looks like and more important what the location factors are, of the Autonomous Community, for attracting FDI. Through all this it is possible to find out what is the relevance of these FDI. Furthermore how the location factors can be improved to attract more Foreign Direct Investment, especially from the Netherlands. Thus how the region Zaragoza can compete with other regions within Spain and with other regions of other countries.

1.7 Research questions

The results of the research objective are the following main questions.

- Who are the Dutch Foreign Direct Investors in Spain and the region Zaragoza, and what are the characteristics and size of these investments flows?
- What is the relevance of FDI, especially the Netherlands, for the host county Spain and the region Zaragoza?
- What are the location factors for FDI of Spain and the region Zaragoza?
- How can the location factors of the region Zaragoza be improved to attract more FDI, especially from The Netherlands?

1.8 Research approach

The research contains two approaches, the first is a literature study and the second an empirical research. The literature study illustrates definitions and theories which relates to FDI, what they are, why they take place, what are the location factors, etc. Besides this the current investments flows and specific characteristics of the source country and host country and region will be displayed. The empirical study will exist of interviews with Dutch companies in the region Zaragoza. This way the reasons for investing in the region Zaragoza will be clarified. Another purpose of the interviews is to find out what are to positive and negative experiences of investing and operating in the region Zaragoza.

Part I

Theoretical introduction

H2. Definitions

2.1 Foreign Direct Investment (FDI)

A 'Direct' investment is an investment by a company in another company, with the intension of gaining control over that company's operations. Furthermore the investment is a long-term relationship. 'Foreign' direct investments are investments, of a company from a particular country, in a company in another country or where a company of a particular country sets up a subsidiary, associate or branch in another country. Thus a FDI occurs across the national borders. Such investment involves both the initial transaction between the two entities and all subsequent transactions between them and among foreign affiliates, both incorporated and unincorporated. FDI may be undertaken by individuals as well as business entities (Dicken, 2003). FDI can be measured in two ways the first is the flow of FDI and the other is the FDI stock. The flow of FDI is capital provided (either directly or through other related enterprises) by a foreign direct investor to a foreign company, or capital received from a foreign company by a foreign direct investor. Foreign direct investments exist of three components. The first is equity capital which is the foreign direct investor's purchase of shares of an enterprise in another country. The second component is reinvested earnings; the direct investor's share (in proportion to direct equity participation) of earnings not distributed as dividends by affiliates, or earnings not remitted to the direct investor. Such retained profits by affiliates are reinvested. The third component are intra-company loans or intra-company debt transactions refer to short- or long-term borrowing and lending of funds between direct investors and affiliate enterprises. FDI stock is the value of the share of their capital and reserves (including retained profits) attributable to the parent enterprise, plus the net indebtedness of affiliates to the parent enterprise (UNCTAD 2003).

Furthermore there are two kinds of FDI. The first one is the so-called Greenfield investment; this is a direct investment in new facilities or the expansion of existing facilities. Greenfield investments are the primary target of the promotion of a host country because they create new production capacity and jobs, transfer technology and know-how, and they can lead to linkages to the global marketplace. On the contrary Greenfield investments often crowds out the local industry, because the multinationals are able to produce more cheaply. Also profits from production feed back to the source country of the multinational instead of to the local economy. The second kind of FDI is mergers and acquisitions, these are the primary kind of FDI and these occur when a transfer of existing assets from a local company to foreign company takes place. The cross-border mergers take place when the assets and operations of companies from different countries are combined to establish a new legal entity. The cross-border acquisitions take place when the control of assets and operations is transferred from a local to a foreign company. Hereby the local company becomes an affiliate of the foreign company (UNCTAD, 2005).

2.2 Transnational Corporation (TNC)

According to the World Investment Report (UNCTAD, 2003) a transnational corporation (TNC) is an incorporated or unincorporated enterprise that exists of a parent enterprise and their foreign affiliates. A parent enterprise is an enterprise that controls assets of other entities in foreign countries (countries other than its home country), usually by owning a certain equity capital stake. The threshold for the control of assets is an equity capital stake of 10% or more of the ordinary shares or voting power, or its equivalent for an unincorporated enterprise. A foreign affiliate is an incorporated or unincorporated enterprise in which an investor, who is resident in an economy of another country, owns a stake that permits a lasting interest in the management of that enterprise. Normally this is an equity stake of 10 per cent for an incorporated enterprise or its equivalent for an unincorporated enterprise. A subsidiary is an incorporated enterprise in the host country in which another entity directly owns more than half of the shareholder's voting power and has the right to appoint or remove a majority of the members of the administrative, management or supervisory body.

An associate is an incorporated enterprise in the host country in which an investor owns a total of at least 10 per cent, but not more than half, of the shareholders' voting power. A branch is a wholly or jointly owned unincorporated enterprise in the host country which can take one of the following forms (UNCTAD, 2003):

- A permanent establishment or office of the foreign investor.
- An unincorporated partnership or joint venture between the foreign direct investor and one or more third parties.
- Land, structures (except structures owned by government entities), and /or immovable equipment and objects directly owned by a foreign resident.
- Mobile equipment (for example ships, aircraft, gas/oil-drilling rigs) operating within a country, other than that of the foreign investor, for a minimum of one year.

It is important to mention that subsidiary enterprises, associate enterprises and branches are often referred to as foreign affiliates or affiliates (UNCTAD, 2003).

2.3 Multinational Enterprise (MNE)

The modern multinational enterprise (MNE) dates from the late 19th century but the definition of MNE did not appear until the 1960, at a conference at Carnegie Mellon University, and was defined by David Lilienthal (1960). The first definition of multinational enterprise (MNE) is: a company which was established in one country but which operate and live under the laws and customs of other countries as well. This definition excludes firms of multinational origins. Therefore the second, economist, definition of MNE is: a company which controls and manages income generating assets in more than one country, thus a company that engages in direct investment outside its home country (UNCTAD, 2003).

The term multinational enterprise (MNE) is preferred over multinational companies (MNC) because the former includes the incorporated business entities and corporate groups based on a parent-subsidiary relation alone and the latter does not. The distinguishes between MNC and TNC are the following (UNCTAD, 2005):

- *MNE*: Companies which own or control production or service facilities outside the country in which they are based, these are not always incorporated or private.
- *TNC*: Companies which are jointly owned and controlled by entities from several countries.

The most important characteristic of an MNE is the ability of one company to control the activities of another company located in another country. Multinational enterprises differ in their capacity (UNCTAD, 2005):

- To locate productive facilities across national borders.
- To organize their managerial structure globally according to the most suitable mix of division lines of authority.
- To exploit local factor inputs.
- To trade across boundaries in factor inputs, between affiliates.
- To exploit their know-how in foreign markets without losing controls over it.

H3. Internationalization of companies

3.1 Types of FDI

Dicken (2003) explains the internationalization of companies, by the aim of companies at making profit. Profit exists of two components the costs and the income, Dicken (2003) relates these to FDI. According to Dicken (2003) there are two types of FDI. The first are market-oriented investments, which have the purpose of serving a foreign market. This will lead to horizontal growth of a company. The second type are supply- or cost-oriented investments, here the transportation costs, labor costs and the location rents are of importance. This type of investment will lead to vertical growth of a company. The location specific factors in a foreign country are important for the decision of investing in a foreign country. Four factors are of mayor importance, these are: the size and character of a market, psychological distance, production costs, and influence of national governments.

Dunning (2002) typifies FDI in a different way than Dicken (2003), namely four types instead of two which are displayed in figure 3.1. Type A and B respectively market-seeking and resource-seeking investments, represent the two main motives for an initial foreign investment. Type C and D respectively efficiency-seeking and strategic-(created-) asset-seeking, represent the two modes of expansion by companies that already invested in a foreign country. These so-called efficiency-seeking investments often are done in order to increase efficiency of the regional or global activities of multinational companies by integration of its assets, production and markets. Strategic-(created-)asset-seeking investments are done in order to acquire resources and capabilities which the investing company believe will sustain increase their core competencies in regional or global markets. These strategic-(created-) asset-seeking investments are occasionally first-time investments as well. During the 1960s and 1970s, most FDI were (Natural) source-seeking or Market-seeking investments, while in the 1980s and 1990s, FDI has been increasingly efficiency-seeking and strategic-(created-) asset-seeking investments.

Figure 3.1: Four main types of FDI (Source: Dunning, 2002).

1. Mainly motives for *initial* FDI

- A) *Market-seeking*
 - Domestic markets
 - Adjacent (e.g. regional) markets

- B) *(Natural) source-seeking*
 - Physical resources
 - Human resources

2. Mainly motives for *sequential* FDI

- C) *Efficiency-seeking*
Rationalizing of production to exploit
Economies of specialization and scope
 - Across value chains (i.e. product specialization)
 - Along value chains (i.e. process specialization)

 - D) *Strategic- (created-)asset-seeking*
To advance regional or global strategy
 - Technology
 - Organizational capabilities
 - Markets
-

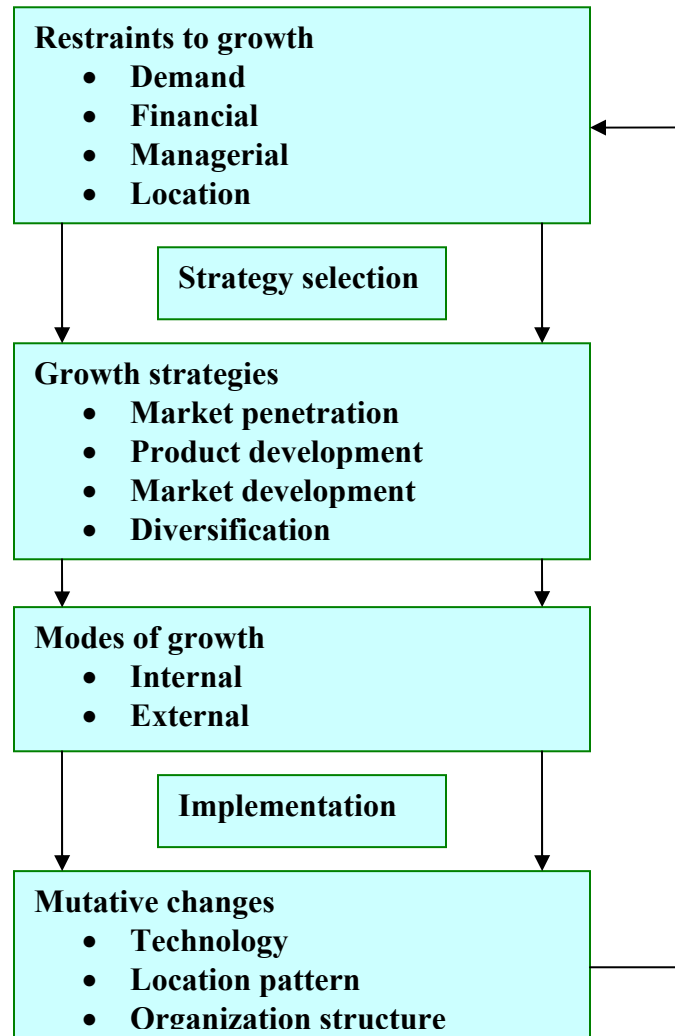
3.2 Grow motives

In the models that describe the development of companies most of the multinational enterprises start as a small single owner company. The point of departure of a company depends on the structural characteristics of the company. Lloyd and Dicken (1978) made the following classification of these structural characteristics.

- Structure of organization
- Degree of aim on a particular branch of industry
- Experience with the function on the international level

These three structural characteristics can be found in the model of Hakanson (1979) and they form the factors that are the result of the preceding strategically choices and decisions. The structural factors decide the way in which and in what degree a company develops and are reversed in the model as *mutative changes*.

Figure 3.2: Model of Hakanson (Source: Hakanson, 1979).



It is obvious that the growth of companies is not an autonomous process. There are three main motives for the growth of companies.

- *Financial and personal interest of the management*: power and salaries are being more influenced by size and growth of a company than the profit and returns.
- *Reducing uncertainty and risk*: growth is being considered as a security for continuity and a condition for survival.
- *Existence of unused resources*: economies of scale will occur if the available capacity is being used.

There are also barriers that stunt the growth of a company temporally or permanent. Hakanson (1979) makes a distinction between the following barriers.

- *Barrier of demand*: the degree of growth depends on the market situation. If the demand lags behind the growth of the market, a company will try to increase profit through efficiency and technological innovations.
- *Barrier of management capacity*: the degree of growth depends on the capacities of the management in order to achieve the goals and to react effectively on new developments.
- *Barrier of financial factors*: the degree of growth depends on the degree in which a company can have capital at its availability and on the degree in which it can attract new capital.
- *Barrier of location factors*: there are three location restraints:
 1. *Input access restraint*: lack of inputs to expand existing installations.
 2. *Market access restraint*: high costs to serve the markets
 3. *Intra-organizational access restraint*: high costs of transporting products, people and information.

3.3 Growth strategies

There are different ways in which a firm can grow and throughout the years many models for grow strategies are developed. The choice of strategy depends on the motives for growth and the barriers which have to be overcome. The most important distinction that has to be made is strategies based on market considerations or strategies based on the product lifecycle (Leus, 1988).

The market considerations based strategies, distinguishes four different ways in which a company can expanse product sales (Hakanson, 1979).

1. *Market penetration*: Expansion of product sales of existing products at existing markets.
2. *Production development*: Expansion of product sales of improved and different products at existing markets.
3. *Market development*: Expansion of product sales of existing products at new markets.
4. *Diversification*: Expansion of product sales of new products at new markets.

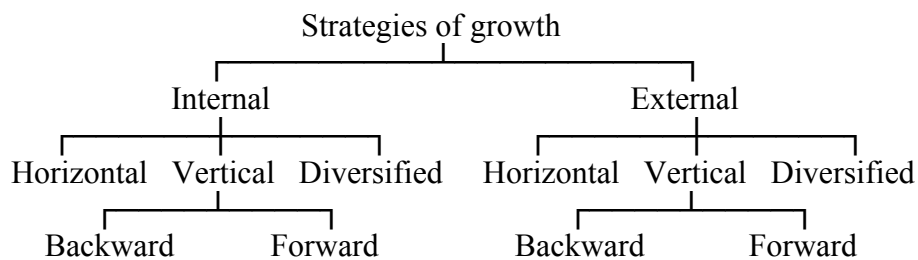
The other growth strategies are strategies based on the product lifecycle (Vernon, 1966). This proceeds from the theory that the more a production process of a product is standardized, the greater is the competition and the more important are the costs of production. To reduce the costs of the production process, companies move to countries where the labor costs are lower. The following phases in the product lifecycle can be distinguished:

1. *Innovation and introduction phase:*
 In this phase a company introduces a new product to the market. At this point there are no constant changes of the product or production process, in this case the company refers proximity of the center of decisions and R&D department. The consumers' market is located in the home country.
2. *Grow phase:*
 In the second phase there is a growth of the market, but a growth of the competition as well. The production process and product will be more standardized. After the domestic market is served companies will seek foreign markets to serve through export.
3. *Maturity phase:*
 At this point there is a saturation of the domestic market and the aspect of costs will play a more important role. The production will move to countries where the costs are the lowest.
4. *Stagnation phase:*
 In this final phase the sales of the product stagnate, the product will disappear slowly.

3.4 Way of growth

The application of a particular growth strategy can occur through two different ways of growth, internal and external growth. Internal growth refers to expansion of existing product or new products in the contemporary market, or of existing product or new products in new market areas which are created within the company. External growth refers to merging or taking over a company, this can be attractive because in this case the company can benefit from the current market, linkages, labor force etc. Internal and external growth can occur in three different ways. The first is horizontal growth. This refers to growth through expansion of the production and selling existing products at new markets, or obtaining a bigger share of the existing market. The second is vertical growth, which refers to growth through establishing a new company, merging or taking over a company which is active in the same production column. This aim for risk reduction can take place in two different ways, through backward linkages or forward linkages. The first refers to the provision of raw materials the later is with regard to the distribution system. The third type of growth is diversification this means entering new markets with new products (Dicken, 1986).

Figure 3.3: Strategies of growth (Source: Nijhuis & Romkema, 1988).



The changes in the structural characteristics of a company following the choice for a particular growth strategy, will lead to adjustments in the organizational structure, the technology which is used and the spatial pattern of a company (Dicken, 1986).

3.5 Investment decision

The investment decision is an important decision in the process of internationalization. A foreign investment decision is most of the times a decision which consists of two phases. The first phase relates to the reasons why companies want to produce in a foreign country. The second phase is more focus on the choice for a certain country and after that the location within a certain country (Leus, 1988). According to McKinsey (1978), there are two groups of factors which influence the decision of investment. The first group is that of the return factors, which have a quantitative character. This group contains three elements:

- *Market circumstances*: expected demand, market relations and market regulation.
- *Investments circumstances*: financial requirement, management requirements and government influence (non financial)
- *Operational circumstances*: availability and cost of resources, cost increasing factors and tax system.

The second group of factors which influence the choice of location is that of environmental factors. This group also contains three elements:

- *Social-political circumstances*: macro economic climate, social climate and administrative climate.
- *Circumstances of company*: quality management, dependency on labor and administration systems.
- *Personal circumstances*: surroundings, adjustment availability and personal taxes.

Notice that not only the objective value of the environmental factors is of importance. A decision to invest depends as well on the perception of a company on the environmental factors. It is also possible that a company does not have complete information of the return factors, this because often it is very hard to obtain and expensive. Furthermore the factors described above have different values for different companies, and the importance of the factors can differ throughout the time. Also for the choice of a county different factors play a different role than for the choice of a certain location within a country (Leus, 1988).

3.6 Multinational character of companies

The multinational character of companies can be determined by the amount of countries in which it has settlements. The degree of internationalization of a company is of importance for the quantity of FDI done by a company. This is because if a company has a higher measure of internationalization, the risks involved with the FDI decreases. Thus if a company has many experiences with FDI the preparing research process will be more formalized. An often used typology, based on Van den Bulcke (1975) is the following.

- Multinational Company (MNC): settlements in more than 20 countries.
- Multinational Focused Company (MNFC): settlements in 10-20 countries.
- Restricted Multinational Focused Company (RMNFC): settlements in 3-9 countries.
- Bi-National Company (BNC): settlements in 2 countries.

The risk involved with a FDI is felt relatively most by a company which is about to become a Bi-National Company. This is because the company which is about to become a Bi-National Company does not have any experience with investing in foreign countries. Therefore it is likely that it will encounter problems which a company with settlements in more than 2 countries does not encounter simply because this company is aware of the problems due to experience with earlier investments in foreign countries (Leus, 1988).

Part II

Source country

H4. FDI and the source country

4.1 Home Country Measures (HCM)

Developed countries have a pattern of inward and outward flows of FDI which is quite in balance. Many developed source countries have a wide range of unilateral policies and measures to promote outward flows of FDI. Traditionally source country measures have attracted little attention, instead of this the obligations of host countries to protect inward FDI was emphasized. But with the investment process involving source countries it is relevant to consider the source country measures to promote outward flows of FDI (UNCTAD, 2003). There are many types of source country measures that influence the magnitude and quality of FDI flows to host countries. According to UNCTAD (2001) there are the following home country measures (HCM) which are directly related to FDI and many of them are already undertaken by source countries:

- *Liberalizing outward flows*: the source country can remove obstacles to FDI outward flows.
- *Providing information*: the source country can assist in collecting and disseminating information, which is related to investments opportunities, through cooperation with investment promotion agencies, provision of technical assistance, organization of investments missions and seminars etc.
- *Encouraging technology transfers*: the source country can encourage and promote technology transfers by providing assistance to strengthen the technological base of a host country, its capacity to act as a host to technology-intensive FDI and its capacity in reaching specific technology-intensive goals.
- *Providing incentives to outward investors*: the source country can provide various forms of financial and fiscal incentives to outward investors or to support feasibility studies and environmental assessments.
- *Mitigating risk*: the source country can help to mitigate risk in several ways, for example by providing investment insurance against losses arising from political or other non-commercial risks that may not be covered through the private insurance market.

4.2 Impact of HCM

The measures by source countries could influence the volume and direction of FDI flows, but the presence of the wide range of the measures does not seem to have influenced any positive trends at the macro level. The influence of these so-called home country measures can be increased through tailor-made approaches and regional and country targeting. The effectiveness of the measures depends on the formulation and administration of measures and the extent to which they complement host country measures. It is important to create a greater awareness and deeper understanding of measures which are taken by the source countries, their functioning, identification of best practices, as well as their influence on the decisions of potential investors. (Sahmah, 2003)

The source countries can also choose to restrict outward FDI for example to stimulate investments in their own economy. There are the following ways to restrict outward FDI (Razin et al., 2004).

- Manipulate tax rules to encourage investments at home and create jobs.
- Limit outflows to control balance of payments (explicit capital flows control).
- Prohibit firms from investing in certain countries with political ideology contrary to national interest, for example Cuba, North Korea, Iran.

4.3 Possible effects of FDI in a source country

The possible effects of FDI on the source country have been discussed for several decades. The global liberalization of trade and investments and regional integration have led to a renewed attention to this subject because these processes will lead to change in the pattern of international investment, with not only consequences for the host country but for the source country as well (Razin et al., 2004). In figure 4.1 the possible positive and negative effects are summarized and these will be clarified in this section.

Figure 4.1: Possible positive and negative effects of FDI in a source country (Source: Razin et al., 2004).

Possible positive effects:

- Improves balance of payments for inward flow of foreign earnings which result from foreign subsidiary.
- The subsidiary creates a demand for exports of capital equipment and complementary products.
- The increased export demand can create jobs.
- Increased knowledge from operating in a foreign country.
- Consumer benefits through lower prices.
- Frees up employees and resources for higher value activities.
- Increased productivity.
- Technology and knowledge transfer.
- Spillover effects.
- Rent effects.

Possible negative effects:

- Exports are reduced if the product is now produced by the foreign subsidiary.
- Negative effect on the balance of payment because the initial MNE uses the foreign subsidiary to sell back to home market. Thus the parent company uses the foreign subsidiary as a substitute for direct exports.
- Potential loss of jobs.

A possible positive effect of outward FDI is the improvement in the balance of payment. This can occur as a result of inward flows of foreign earnings, positive employment effects when the subsidiary in a foreign country creates demand for source country exports and the benefits from a reverse transfer effect (Sahmah, 2003).

Whether production in a foreign country tends to add exports or reduce export in the source country depends on the relationship of foreign operations with the operations in the source country. This relationship can be either horizontal or vertical. Furthermore the addition or reduction of source country's exports depend on the extent to which foreign operations are in goods production or services, are in developed or developing countries, or are in industries with plant level or company level economies of scale. Horizontal FDI tends to substitute for parent exports, at least in manufacturing, if not in services. This export substitution effects on the current account along with the initial capital outflow and the potential loss of jobs to foreign operations will lead to an adverse balance of payments effects. But it is important to mention that by moving away parts of the production process to a foreign country, the overall profitability and competitiveness of a company can be improved, this would secure and strengthen the home base. Vertical FDI tends to add exports for the source country. The foreign activities may not take away activities of the parent company because they are done by the parent company to supply the affiliate. But the foreign operation may also include activities that are not done by the parent company, because they are provided by the home country's infrastructure or by a network of outside suppliers that does not exist in the host country. Furthermore changes in the allocation of types of production can influence source country demand and factor prices; it can alter the composition of the home employment. For example a multinational can allocate the more labor-intensive production to the affiliates in countries which have relatively low wages and concentrate the capital-intensive or skill-intensive production in the source country. The possible shift of activities from the parent company to affiliates is also referred to as MNE transfer (Lipsey, 1994).

The export from and to foreign affiliates by a company is called intra-firm trade (IFT), this gives an indication of the role affiliates play in relation to the company in the source country. The patterns of IFT dependent on the various types of investment market-seeking, (natural) source-seeking, efficiency-seeking, strategic- (created-) asset-seeking), furthermore on the sector composition of investment. The patterns of IFT also may change substantially over time. According to Grey (1999) the efficiency-seeking FDI is the most important explanation for IFT and furthermore the IFT mainly takes place among nations with different factor endowments. Low transportation costs and low tariffs will boost IFT further and considerations of risk minimization, for political risks in particular, will always influence IFT (Gray, 1999).

As mentioned before the FDI can influence the employment in a source country. But it is important to notice that even when there are negative short term employment effects, in the long term these jobs would likely be lost in any case to foreign competitors. Moving production to foreign countries can free up resources and people for other jobs where their value added is greater, and may prove a net benefit to consumers that now have access to less expensive products (Razin et al., 2004).

The spillover effects take place as a MNE cannot reap all benefits of their activities in a foreign location, this because of the public good characteristic of the ownership specific advantages of a company. The productivity effects for a host country are already mentioned, the similarity with source country effects is arguably very significant. The presence of a home plant of a MNE or the rise in the number of companies that engage in outward FDI can lead to knowledge transfer to other companies (spillovers of FDI to local companies) in the source country. The transferred knowledge can be in the form of technology, marketing, foreign market related information, information that will make it easier for other companies to become multinational etc. Thus the production facilities in foreign countries give a company access to new insights, techniques or ways of organizing the work; this can be of benefit for the source country's base (Vahter and Masso, 2005). Besides the previous mentioned technology transfer from the parent company to its subsidiary, the subsidiaries in a foreign country can also transfer technological knowledge and host market and foreign linkages related knowledge to the parent company as well. This is especially the case if the affiliates are located in innovative intensive places. Furthermore there can exist reverse knowledge spillovers that effect the source country as well. These are spillovers from domestic companies in the host economy to the affiliate of a MNE. This reverse technology transfer can not only lead to upgrading of knowledge or technology in the MNE affiliate in the host country, but can make the MNE source country company's productivity rise as well. As a consequence of the outward FDI, they increase also the potential for spillovers to other firms in the source country (Driffield and Love, 2003).

In the same manner as the host country effects the source country effects can be divided into two parts. The first part is the effect of making outward FDI (or receiving inward FDI) on the performance characteristics of the subsidiary (or the home firm) of the MNE, this effect is the own-firm effect. The second part is the horizontal or vertical spillover effects from the presence of multinational companies on the performance of other local companies and other MNE active in the source economy, these effects are the so-called various external effects. Important to mention is that the magnitude of the spillover effects are heavily dependant on the absorptive capacity of the companies in the host or source country (Driffield and Love, 2003).

The effect of outward FDI on the overall profits of the investing company or the share of profits that remain in the source country, are the so-called rent effects. In the case of profit-maximizing firms normally it can be expected that the rent effect of a company is positive, if this was not the case the company would not invest abroad. But it has to be taken in account that whether the positive profit effect for the company will translate into a rent effect for the home country, depends on several conditions. For example it is known that multinationals use transfer pricing to move taxable profits between counties, this means that the overall benefits for the company will not necessarily lead to profits for the source country.

H5. The Netherlands

5.1 Introduction

The Netherlands has been an important player in the internationalization process for a long time. One explanation for this is that the market saturation in small countries occurs much faster than in relatively big countries. The worldwide competition forces countries with relatively small markets to internationalize, if they do not want to fall behind on the technological level of the world. Also the Netherlands have had open connections with the rest of the world from time immemorial. During the 1970s the internationalization of the Netherlands rapidly increased. This occurred because the Dutch economy was in the mature phase, and because of overcapacity in the process- and assembly-sectors, for these reasons economic activities moved to foreign countries. The high exchange rate of the guilder also made it relatively easy to penetration foreign markets through participation or by taking over the market (Leus, 1988).

A vital and competing business is a motor of a healthy economy. Every country tries to support the business within the countries as well as exports and investments in foreign countries. Exports and foreign investments contribute to a high GNP and for a relative small country as the Netherlands exports and foreign investments are of great importance (FDI magazine, 2005). In the figure below the ten biggest Foreign Direct Investments made by Dutch companies are displayed. As you can see four of these ten biggest investments were made in the financial sector (FDI magazine, 2005).

Figure 5.1: Top-ten biggest FDI by Dutch companies (Source: FDI magazine, 2005).

1. **Fortis General de Banque SA** 14.2 billion dollar: Belgium.
 2. **Akzo Nobel Courtaulds Plc** 3.7 billion dollar: United Kingdom.
 3. **ABN Amro Banco Real SA** 3 billion dollar: Brazil.
 4. **Koninklijke Ahold Giant Foods Inc.** 2.7 billion dollar: US.
 5. **Royal Dutch/Shell Group Joint venture Raffinaderij** 2.3 billion dollar: China.
 6. **Verenigd Bezit VNU ITT World Directories Inc.** 2.1 billion dollar: US.
 7. **ING Groep BHF-Bank** 1.5 billion dollar: Germany.
 8. **Randstad Holding Strategix Solutions** 850 million dollar: US.
 9. **Philips Electronics ATL Ultrasound** 800 million dollar: US.
 10. **Fortis John Alden Financial Corp.** 600 million dollar: US.
-

5.2 Dutch FDI

The direct investments of Dutch multinationals in foreign countries have become more and more important for the Dutch economy. While in 1985 the Dutch multinationals invested 59 billion euro, about 31% of the GNP, in foreign countries this amount had increased up till 378 billion euro, about 87% of the GNP, in the year 2002 (Wiertma, 2003).

As displayed in table 5.1 the flow of outward Dutch FDI and the flow of FDI that were made in the Netherlands show fluctuations in the period 1995-2005. With the exception of 1998 and 2001 the balance in this period has always been positive in the sense that there were relatively more outward than inward FDI and in the year 2005 the balance was the highest in the whole period (DNB, 2006).

Table 5.1: Flow of outward Dutch FDI and inward FDI in the Netherlands in million euros, 1995-2005 (Source: DNB, 2006).

Year	1995	1996	1997	1998	1999	2000
Dutch FDI	14,697	24,559	21,709	32,847	54,074	82,094
FDI in the Netherlands	8,965	12,747	9,859	33,252	38,676	69,307
Balance	5,732	11,812	11,850	-405	15,398	12,787
Year	2001	2002	2003	2004	2005	
Dutch FDI	56,537	34,022	39,146	13,918	97,162	
FDI in the Netherlands	58,029	26,604	19,264	356	35,604	
Balance	-1,492	7,418	19,882	13,562	61,558	

The EU-15 is the most important region for the Dutch foreign direct investments. Within this region the country in which the Netherlands had the biggest stock of FDI in 2005 was in the United Kingdom followed by Spain, Italy and Belgium. Among the European countries which are not a part of the EU-15 the biggest stock of FDI in 2005 in was Switzerland. The United States is the most important single country for the Dutch FDI (DNB, 2006).

Thus Spain is an important country for outward flows of FDI by the Netherlands and as you can see in table 5.2 both the total Dutch FDI and the FDI in Spain have been fluctuating in the period 1995-2005. In the year 2005 5,85% of the total flow of Dutch FDI was invested in Spain which was the highest percentage in ten years. The flow FDI which was invested in Spain in 2004 is negative this means that there was a disinvestment of 6 million in Spain in 2004. This means that Dutch investors have written off 6 million of the investments in Spain or have sold the investments to other countries (DNB, 2006).

Table 5.2: Flow of total Dutch FDI and Dutch FDI in Spain, million euros, 1995-2005 (Source: DNB, 2006).

Year	1995	1996	1997	1998	1999	2000
Dutch FDI	14,697	24,559	21,709	32,847	54,074	82,094
Dutch FDI in Spain	373	724	910	158	1,056	1,471
Percentage	2.54	2.95	4.19	0.48	1.95	1.79
Year	2001	2002	2003	2004	2005	
Dutch FDI	56,537	34,022	39,146	13,918	97,162	
Dutch FDI in Spain	2,524	84	1,524	-6	5,687	
Percentage	4.46	0.25	3.89	-0.04	5.85	

The flow of FDI in the Netherlands has increased as well, in 1985 the amount of inward flow of FDI in the Netherlands accounted for 30 billion euro, while this amount had increased up till 393 billion in 2005. These inward investments were made mainly by the EU-15, the United States, Japan and Switzerland. But the value of the Dutch outward FDI is bigger than the inward FDI in the Netherlands, although the difference is getting smaller (Wierstma, 2003). Table 5.3 shows that this is not completely true for the Netherlands and Spain. In the period 2002-2004 Spain has invested more in the Netherlands than the Netherlands in Spain. Besides this the differences between the incoming and outgoing flow of FDI fluctuated over the last decade and in 2005 the difference between these flows was even bigger than before (DNB, 2006).

Table 5.3: Flow of Dutch FDI in Spain and Spanish FDI in the Netherlands, 1995-2005 (Source: DNB, 2006).

Year	1995	1996	1997	1998	1999	2000
Dutch FDI in Spain	373	724	910	158	1,056	1,471
Spanish FDI in the Netherlands	67	-40	80	133	22	363
Balance	306	764	830	25	1,034	1,108
Year	2001	2002	2003	2004	2005	
Dutch FDI in Spain	2,524	84	1,524	-6	5,687	
Spanish FDI in the Netherlands	1,350	408	2,706	255	97	
Balance	1,174	-324	-1,182	-261	5,590	

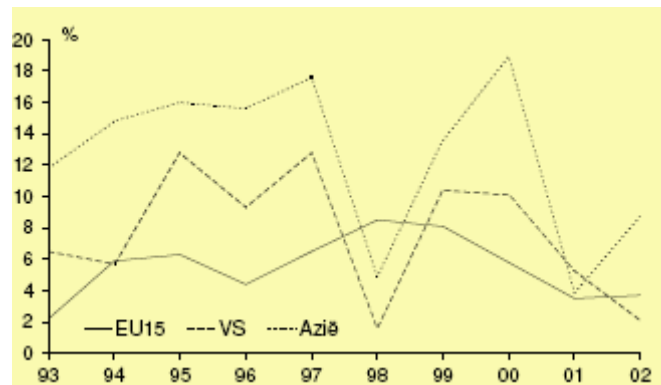
As you can see in table 5.4 most of the FDI from the Netherlands is invested in the service sector followed by the industry sector. Within the service sector most of the FDI were done in the sub-sector trade followed by finance and insurance industry. Within the industry sector most of the FDI were done in mineral extraction, oil and chemical industry. What is striking is that all these facts account for Spain, Europe and the whole world (DNB, 2005).

Table 5.4: Stock of Dutch FDI per sector in Spain, Europe and world, 2004 (Source: DNB 2006).

	Agriculture and Fishery	Industry	Construction	Services
Spain	0	6104	6	11778
Europe	108	94162	1975	162554
World	162	175640	2799	258489

The average profit of investments differs between countries, because of differences in risk profile, differences in investment motives or differences in the age of the investments (DNB, 2003). As shown in the figure below the average profits are the highest in Asia and the lowest in the EU-15 countries (DNB, 2003).

Figure 5.2: Profits of outward Dutch FDI 1993-2002 (Source: DNB, 2003)



Part III

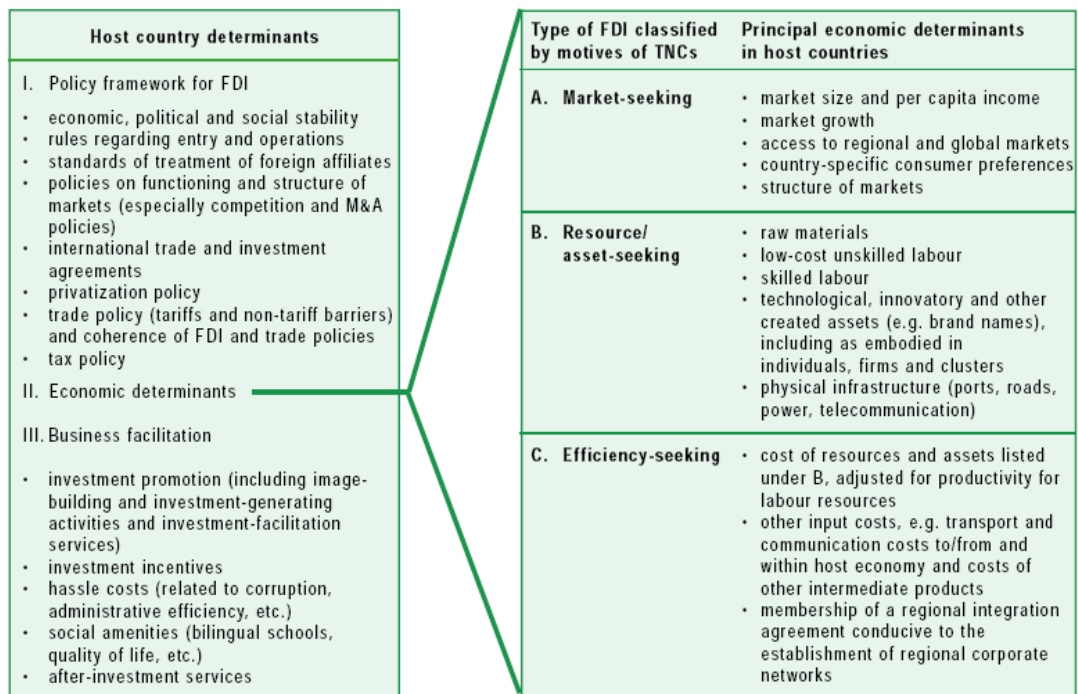
Host country

H6. FDI and the host country

6.1 Host country determinants

The determinants of a host country can be divided in three groups of determinants. As you can see in the figure 6.1, these three groups exist of a policy framework, economic determinants and business facilitation. Among these determinants of FDI the economic factors are predominant, and they are classified in three of the four types of FDI according to Dunning (2002) that are mentioned before. The principal economic determinants of market-seeking FDI (A) are: market size and per capita income; market growth; access to regional and global markets; country-specific consumer preferences; and structure of markets. The principal economic determinants of resource-seeking FDI (B) are: raw material; low-cost unskilled labor; skilled labor; technological, innovatory and other created assets; and physical infrastructure. The principal economic determinants of efficiency-seeking FDI (C) are: cost of resources and assets listed under B; other inputs costs; and membership of a regional integration agreement conducive to the establishment of regional corporate networks. Even though the economic factors are predominant the national policies are key for attracting FDI, they can increase benefits of FDI and reduce the negative effects of it. National policies are also decisive determinants for preventing FDI entering a country. But the economic determinants become dominant once an enabling FDI regulatory framework is in place. If this is the case the regulatory regime can still make a location more or less attractive for foreign direct investors (UNCTAD, 2003).

Figure 6.1: Host country determinants for FDI (Source: UNCTAD, 2003).



6.2 National FDI policies

Many national policies affect FDI, but not all of them are directly related to FDI. Some of the policies that are directly related are for example setting entry conditions for foreign direct, improving standards of treatment, and enhancing benefits from FDI and dealing with the less desirable effects of FDI. Nowadays attracting FDI is highly competitive and having an open door policy to attract them is not enough. It requires stronger location advantages and promotion is an important element. Once foreign direct investors are attracted into a country, policies are crucial for ensuring that FDI brings more benefits. Policies can for example induce faster upgrading of technologies and skills, secure more reinvestments of profits, raise local procurement, protect the environment and consumers etc. Furthermore they can help counter the potential dangers of FDI, for example preventing foreign companies from crowding out local companies. Strategic objectives of foreign companies may not match the objectives of the host government in this case setting policies brings FDI more in line with those objectives. Thus governments have an important role and they can influence FDI in various ways and with different degrees of intervention, control and direction (UNCTAD, 2003).

6.3 Attracting FDI

Pursuing sound macro management, having stable and non-discriminatory rules on business entry and exit, promoting competition, building human capital, supporting innovation are all market-friendly policies. The developed countries have moved towards these so-called market-friendly policies, but they must apply promotional measures as well to attract foreign direct investors. Countries can promote FDI selectively by focusing on activities, technologies or investors but they can promote FDI inflows in general as well, without trying to attract particular kinds of investments. The economic attractiveness of a particular country for FDI depends primarily on its advantages as a location for investors. A large and growing market attracts market-seeking investors, availability of natural resources attracts resource-seeking investors and a competitive and efficient base for export attracts efficiency-seeking investors. More general factors like political stability, low business transaction costs, a sound macro economic framework, adequate skills, good infrastructure etc., affect all prospective host economies. Given these factors it is still useful to apply promotional policies to attract investors. This is especially the case if the competition for FDI is high and foreign direct investors become choosier. As mentioned before, the perception of a company on the environmental factors is of importance and companies do not always have complete information of the return factors. FDI requires substantial fixed costs of identifying an efficient location, acquiring knowledge of the local regulatory environment, and coordination of suppliers. If a company has access to better information about some host countries it may make FDI to that location more likely to occur. In this case good promotion and marketing can make a difference. Furthermore a host country can create conditions that make investments more viable, instead of simply marketing what they already have.

This may be for example creating new skills, infrastructure or support institutes. The quantity of promotion needed depends on the basic attractions of a host country. A relatively small and less dynamic economy needs to promote itself more than a large dynamic economy. Besides this the quantity of promotion needed depends on the kind of FDI (UNCTAD, 2003).

The general trend in ways countries have sought to attract FDI is to reduce obstacles, create investor-friendly settings and promote FDI. Because location advantages differ, the costs of some measures are relatively higher and governments differ in perceptions of how best to attract FDI, the nature and balance of policies applied by countries varies. Often the drive to attract FDI extends to the sub-national level, with different regional authorities pursuing their own strategies and own compilation of incentives to attract new investments. Various reforms and strategies have been implemented, with mixed results (UNCTAD, 2003). According to the World Investment Report the main ways countries have sought to attract FDI are the following:

- *Reducing obstacles to FDI*: by removing restrictions on admission and establishments, and on the operations of foreign affiliates as well.
- *Improving standards of treatment of foreign investors*: by granting them non-discriminatory treatment that is not been given domestic or other foreign investors. For example providing targeted fiscal incentives, such as specific subsidies and tax concessions.
- *Protecting foreign direct investors*: this through provisions on compensation in case of nationalization or expropriation, on dispute settlement and on guarantees on the transfer of funds.
- *Promotion of FDI inflows*: this through measures that improve the image of a country, providing information on investments opportunities, facilitate FDI by institutional and administrative improvements, offer location incentives and render post-investment services, improve domestic infrastructure, promoting local skill development and engaging in international governing arrangements.

Some of these measures are critical of the high costs of these initiatives, therefore many people argue that it is more rewarding to improve the general business environment of a country.

6.4 Increase benefits of FDI

To ensure that a host country derives full economic benefits only attracting FDI may not be enough. Policies might be needed if a free market cannot lead foreign direct investors to transfer enough new technology or to transfer it effectively and at the depth which is desired by a host country. Policies can induce investors to act in a way that enhance the development impact, for example by building local capabilities, using local suppliers and upgrading local skills, technological capabilities and infrastructure (UNCTAD, 2003). According to the World Investment Report the main policies and measures for increasing benefits of FDI are:

- *Increasing the contribution of foreign affiliates to a host country through obligating measures*: this objective can be achieved by prescribing what foreign affiliates should do to raise exports, train local workers or transfer technology. In this case it is of importance that the performance requirements are used.
- *Increasing the contribution of foreign affiliates to a host country by encouraging them to act in a desired way*: in this case it is of importance that incentives are used to influence the behavior of foreign affiliates. Furthermore of particular importance is enticing foreign affiliates to transfer technology to domestic firms and to create local R&D capacity.

6.5 Possible positive effects of FDI in a host country

There are many possible positive effects of FDI, as you can see in the figure 6.2 there is a distinction between possible positive effects on an enterprise level and on a local and regional level. In the following section these possible positive effects of inward FDI will be clarified.

Figure 6.2: Possible positive effects of FDI in a host country. (Source: Pavlínek, 2004).

Enterprise level

- Continued and expanded production.
- Increase labor productivity.
- Access to investment capital.
- Access to worldwide sale and distribution networks.
- Transfer of technology and know-how.
- Improved competitiveness.
- Increased R&D.

Local and regional economy

- Saving of existing jobs and creation of new jobs.
 - Increased wages.
 - Growth of real income.
 - Increased tax base.
 - Increased exports.
 - Labor training.
 - Provision of social services to local communities.
 - Spillovers to local and regional economy.
 - Increased opportunities for local companies to supply foreign-owned companies.
-

At the local and regional level, FDI should ideally contribute to the overall economic growth because of increased exports, tax base, access to capital etc. Furthermore by increasing competition, transferring and diffusing new forms of production organization, FDI should contribute to the regional economic restructuring. These changes then should lead to productivity improvements across the local and regional economy (Florida, 1996).

According to Hardy (1998), the immediate positive effects of FDI may be considerable at the enterprise and local and regional level, but the long-term economic effects of FDI in the host countries are less clear. After a FDI is made the local or regional economies may benefit from continued and often expanded production that saves jobs or creates new jobs (in the case of Greenfield investments).

The most important mechanism through which the transfer of technology takes place, new jobs are created and new local companies are formed, are the linkages of foreign-owned companies with domestic companies (UNCTAD, 2003). The degree of integration of these foreign affiliates in the local and regional economies of the host counties varies because there are large differences between sectors and in strategies pursued by a MNE within a particular sector as well. The foreign affiliates which are highly integrated can play an important role in the regional economic transformation, by encouraging and triggering restructuring of suppliers networks (Pavlínek, 1998).

The effect of FDI on local and regional employment is often regarded as being the most important possible effect. FDI does not only create jobs directly within a foreign company but besides this it creates jobs indirectly as well, through forward and backward linkages and multiplier effects in the local and regional economy. On the contrary foreign companies can crowd out domestic companies, which will be clarified later on. Therefore the net creation of jobs by foreign companies is measured by the number of jobs created directly and indirectly minus the number of jobs lost by domestic companies. Labor training is also a possible positive effect of FDI on a local or regional economy. Often training in a foreign-owned company is closely related to the transfer of technology and the introduction of computer aided technologies (Dicken, 1986).

There are several ways in which foreign-owned companies affect the wages in a host country. The first is that foreign companies can offer higher wages than are paid by domestic companies. This differential can be explained to some extent by the composition of FDI, the FDI can be done in sectors with relatively high wages. But the differences are also found within sectors in most countries. If foreign companies pay higher wages, for whatever reason, the impact can still vary. If foreign companies hire away high-wage workers from local companies, or acquired local companies with skilled labor forces, the foreign ownership is associated with higher wages in the foreign-owned companies and lower wages in domestic companies, but no difference in average sector wage levels. If foreign companies pay more, but do not hire away the best workers from local companies, a larger presence of foreign ownership associated with higher wages in the sector, but not in locally-owned companies in the sector, can be found. The second way in which foreign-owned companies affect the wages in a host country is by the so called wage spillovers. The presence of foreign companies can affect the level of wages in domestic companies, whether these foreign companies pay relatively higher wages or not. These effects are the so-called wage spillover effects to domestic companies. The final way in which foreign-owned companies affect the wages

in a host country, is that a higher degree of foreign ownership can affect the average level of wages in a country or sector. This is independent of the case whether or not wages are higher in foreign companies than in domestic companies, and whether or not, where there are higher wages, they spill over to domestic companies. It can affect the wages in a host country either by raising the demand for labor or through the higher wages paid by the foreign companies themselves (Lipse, 1994).

According to the OLI framework by Dunning (1981) in order for FDI to occur, the decision of a company to invest in a foreign country is determined by ownership, location and internalization advantages. Based on the OLI framework we can conclude that an investment in a foreign country can improve the productivity of the MNE headquarter or the overall productivity of the MNE in all its locations as these three different types of advantages are combined (Vahter and Masso, 2005). The presence of a multinational enterprise can lead to technology transfer (spillover effects of inward FDI to local companies) to domestic companies. If a company introduces a new product or a new process in its affiliates in a host country, the domestic companies as well as other foreign owned companies may benefit from a faster diffusion of new technology. This faster diffusion occurs through demonstration effects, mobility of workers between foreign owned and domestic companies and through increased incentives to adopt the contemporary technology in domestic companies because of increased competition in the product market. Spillover effects take place as a MNE cannot reap all benefits of their activities in a foreign location, this because of the public good characteristic of the ownership specific advantages of a company. There can exist reverse knowledge spillover effect as well, these are spillovers from domestic companies in the host economy to the affiliate of a MNE. This reverse technology transfer can lead to upgrading of knowledge or technology in the MNE affiliate in the host country (Vahter and Masso, 2005).

The positive spillovers to the rest of economy are also referred to as the beneficial effects. These beneficial effects may also, to some extent, result from the fact that MNE may simply be better firms than the rest, and this is because of the selection effect. The selection effect is a model of exporting and FDI by Helpman, et al. (2004). This model that assumes heterogeneous firms, predicts the following points:

- The least productive firms sell only to the domestic market.
- The relatively more productive firms export.
- The most productive firms engage in FDI.

One of the reasons why firms that engage in outward FDI have higher productivity is the need to be able to cover sunk costs related to FDI, only relatively good firms are able to do that. It is important to mention that this model calls for a cautious interpretation of the results because by doing a simple productivity comparison, the causal effect, of a higher productivity of the home company of a MNE than a purely national company, can act in both ways. A company that goes multinational can cause a rise to the productivity at home. But companies with high productivity can self-select themselves in investing in a foreign country.

The increased R&D in a host economy is often applied research while the basic research as a strategic function tends to be localized close to the company headquarters. Thus the most important R&D centers are located in the home country where the leading-edge R&D on multinationals core technologies is conducted. In the host country often the R&D operations are at a smaller scale and involve applied and development activities. Therefore the most expenditures of R&D by multinationals are done in the home countries. There are two types of R&D investments in foreign countries. The first one is demand-driven, this means that a MNE wants to customize and develop the products for foreign markets and wants to support their manufacturing, sales, or service activities in host countries in order to gain and maintain market power. The second type of R&D investment is supply-oriented, this means that a MNE wants to use pools of foreign R&D labor and expertise and wants to develop new product that could be sold at a global level. These new products are based on ideas and innovations which are generated in foreign subsidiaries. A R&D investment in a foreign country leads to upgrading of R&D in the host country, this through the location of home-base laboratories in the host country regions to exploit specialized local expertise (Howard, 1990).

Besides the effects on an enterprise and local and regional level one of the most important possible positive direct economic effects of FDI on the national scale is the growth in real income resulting from imports of capital, technology and skills. Also domestic suppliers of foreign affiliates that survive the rigorous selection process may become more competitive internationally. However, direct economic benefits such as in capital formation, employment, trade and the balance of payment may only be short term (e.g. Pavlínek, 2003).

6.6 Possible negative effects of FDI in a host country

There is a general shift of attitudes of countries in favor of FDI, but significant concerns remain about the possible negative effects of the FDI. These concerns are less intensive than before, but they remain strong enough so that many governments feel the need to control the inward flowing FDI and the operations of the foreign affiliates. As the possible positive effects, the negative effects are divided in possible negative effects at an enterprise level and at a local and regional level. These are summarized in figure 6.3.

As mentioned in the section about the possible positive effects at the local and regional level, the local or regional economies may benefit from continued and often expanded production that saves jobs or creates new jobs, after a FDI is made. But at the same time, foreign takeovers are often associated with labor shedding, disinvestment and downsizing of production (Hardy, 1998).

Figure 6.3: Possible negative effects of FDI in a host country. (Source: Pavlínek, 2004).

Enterprise level

- Labor shedding.
- Disinvestments and downsizing of production.
- Transfer of R&D abroad.

Local and regional economy

- The transfers of polluting activities or technologies.
- Anticompetitive practices by foreign affiliates.
- Tax avoidance and abusive transfer pricing by foreign affiliates.
- Concessions to MNEs allowing them to avoid labor and environmental regulations. This is especially the case in export processing zones.
- Volatile flows of investment and related payments deleterious for the balance of payments, which can lead to local dependency on foreign capital.
- External control of local economies.
- Attracting skilled and semi-skilled workers from local companies.
- Crowding out local companies and suppressing domestic entrepreneurial development.
- Crowding out local products, technologies, networks and business practices with harmful socio-cultural effects.
- Regional specialization in low-skilled, labor-intensive production.
- Uneven development and regional polarization.
- Branch plant syndrome.
- Instability of investment.

It is also mentioned before that FDI can lead to productivity improvements across the regional economy (Florida, 1996). But effects of FDI have been very uneven distributed both geographically and throughout the various sectors. In most of the cases FDI is typically attracted to existing economic clusters, this way they can benefit of external economies of scale like existing pools of qualified labor, factors of production, institutions and innovative capabilities, suppliers, infrastructure etc. This explains why FDI contributes to uneven development and regional polarization. For example some type of FDI like investments in banking, finance and services concentrated in the capital cities increased there primacy (UNCTAD, 2003).

The long-term costs for local communities, invisible at a short-term, may be substantial in terms of the creation of new forms of local dependency on foreign capital and external control of local economies. Furthermore FDI may have a negative effect on local companies by attracting their skilled and semi-skilled workers to the foreign affiliates, especially if the workers have been trained by these local companies. Also the local companies can be crowded out and domestic entrepreneurial development can be suppressed, this is often the consequence of the fact that the local companies are unable to compete with multinational companies. This is because the multinational companies

are supported by generous governmental investment incentives and benefiting from transfer pricing. Furthermore foreign companies can crowd domestic companies out of the market through their more efficient production methods, access to cheaper sourcing and because they can hold out longer due to better access to capital (Dicken, 2003). Besides this the foreign companies are often more efficient than domestic companies because the foreign investors have taken over the local companies which are relatively efficient, leaving the less efficient companies to domestic owners. Also by taking over markets from local companies, foreign companies might force the domestic companies into less efficient scales of production (Lipsey, 1994).

The section about the possible positive effects of FDI showed that the degree of integration of foreign affiliates in the local and regional economy is of importance for some possible positive effects to occur. However, not all FDI is likely to result in the development of supplier linkages with local companies. Particularly the export-oriented, cross-border investments are likely to be isolated from local economies. Companies may not develop or develop only few linkages with local companies because they find it difficult to secure supplies of components from domestic companies at the desired level of sophistication, quality and timing of deliveries. Within Western Europe this occurs mainly in the peripheral regions and it can lead to long-term disadvantage, this because the potential development of suppliers linkages within the domestic economy are restricted. Additionally the stability of investments depends on the degree of local integration. This because if a foreign-owned company has no or very weak linkages with the local companies, it can relatively easy shut down and relocate the foreign affiliate if for example the wages were to go up or the investor face difficulties at home (Pavlínek, 1998).

Thus there are a number of possible negative effects which may concern the host county of FDI. According to the goals, values and ideologies of a host country related to FDI, it has to make the following considerations in order to minimize the negative effects (Johnson, 2005):

- *Equity considerations*: reflected in the effects of FDI on the distribution of wealth and income. This is the case between capital and labor, and between different labor groups as well.
- *Cultural considerations*: this is reflected in the type and quality of goods and services which are produced by the foreign companies. Furthermore the way of life, like how they run business practices, how do they deal with labor, marketing and advertisement, and the environment.
- *Participatory considerations*: reflected in the desire of a country's citizens to participate in the making of decisions which effect their own welfare.
- *Political consideration*: reflected in the attempt by a company to interfere with the politics of a host country.
- *Ethical considerations*: reflected in the policies of a company regarding to safety standards like product content and labeling, labor practices, advertising and selling techniques etc.
- *Environmental considerations*: reflected in the effect of the company regarding to pollution.

H7. Spain

7.1 Introduction

Spain is a constitutional monarchy in the south of Europe and is divided in seventeen autonomous regions, *comunidades autónomas*. These *comunidades autónomas* also include the Balearic Islands in the Mediterranean Sea, the Canary Islands in the Atlantic Ocean and furthermore there are the two enclaves Ceuta and Melilla in North-Africa. Spain borders with Portugal in the west and in the north with France and Andorra. The head of the state is King Juan Carlos de Bourbon and the capital of Spain is Madrid. Furthermore there are four different languages that are spoken in Spain, the majority (about 72%) has Castilian as native language and the other three languages are Catalan, Galician and Basque (EVD, 2005). Spain is the world's 51st largest country by size and the 30th by population, in 2004 Spain had a population of 43.2 million and between 2003 and 2004 the population growth was 1.2 percent. The population growth is mainly the consequence of the liberal immigration policy. The National Bureau of Statistics of Spain (INE) predicts that the population of Spain will be more than 50 million in the year 2025 (INE, 2005). Spain is about 12.2 times the size of the Netherlands and has a surface of 504.880 km² and the five biggest cities, according to the size of the population, are the following (EVD, 2005):

- Madrid: 3.100.000
- Barcelona: 1.600.000
- Valencia: 785.000
- Sevilla: 704.000
- Zaragoza: 661.000

Figure 7.1: Map of Spain (Source: EVD, 2005).



7.2 Economic development and indicators

The economy of Spain is the 11th biggest and the 8th among OECD countries. In the year 2004 the GNP (market price) was 798.7 billion euro and the GNP per head was 19.456 euro (Chislett, 2002). The real growth of the Spanish GNP in the year 2004 was about 3 percent. From 1995 until 1998 there was an increase in the percentage of real growth of GNP in Spain but after this period it decreased until the year 2002. After 2002 the percentage real growth of GNP increased again but after a peak in the year 2005 with a real growth GNP of 3.3 percent, the growth is expected to decrease until the year 2008 (INE, 2005).

Table 7.1: (Expected) real growth of GNP (%) 1995-2008 (Source: INE, 2005).

	1995	1996	1997	1998	1999	2000	2001
Real GNP (%)	2,8	2,4	4,0	4,3	4,1	4,1	2,8
	2002	2003	2004	2005	2006	2007	2008
Real GNP (%)	2,1	2,4	3,0	3,3	2,9	2,5	2,2

With 66.5 percent of the GNP in 2002 the service sector dominates the Spanish economy, like most countries in Europe. The growth in the service sector over the years is at the expense of the sectors agriculture, forestry and fishery (3.1 percent of the GNP in 2002), but also the share of the sector industry in the Spanish economy has declined (20.8 percent of GNP in 2002). The most important producing industry is that of transportation (5 percent of GNP in 2002), more than 80 percent of this production is exported. Since 1997 there is an increase in the construction activities and this explains the historical high share of the construction sector (10 percent in 2002). Because Spain is one of the most popular tourist destinations in the world, the tourist sector is of major importance for Spain (INE, 2005).

The main trade partners of Spain in the area of import are France, Germany, Italy and the Netherlands, from the Netherlands Spain imported 4.9 billion euro of the total imports of 207.1 billion euro in 2004. The national demand of Spain is exuberant, for this reason the imports have increased which contributes to a negative trade balance. The main trade partners in the area of exports are France, Germany, Portugal, Italy, United Kingdom and the Netherlands, Spain exported 10.1 billion euro of the total exports of 146.5 billion euro to the Netherlands 2004 (INE, 2005). Thus the members of the European Union are important trade partners of Spain of which France is the most important partner. Furthermore the trade with Latin-America has been growing and is still growing strongly. As you can see in table 7.2 both the import and the export of Spain have increased over the period 1998-2002. Until the year 2000 the balance was getting more negative, because import grew relatively faster. But in the years 2001 and 2002 this negative balance was decreasing, because the export grew relatively faster (EVD, 2005). The motor vehicle industry is the most important export sector followed by the ceramic industry and the food industry.

The biggest shortage is caused by the energy products because Spain is dependant on oil and gas imports. In the year 2002 the shortage of energy products was 15.7 billion euro which equals 2.3 percent of the GNP (EVD, 2005).

Table 7.2: Foreign trade of Spain in billions of euros 1998-2002 (Source: EVD, 2005).

Year	Import	Export	Balance
1998	122,9	99,8	-23,1
1999	139,1	104,8	-34,3
2000	169,5	124,2	-45,3
2001	173,2	129,8	-43,4
2002	172,8	130,8	-42,0

Spain wants to develop towards a service economy. The growth based on productivity and the improvement in new technology and the higher developed industries are the main objectives of the current government policy. But Spain lags behind the most other countries of the EU-15 and the Spanish economy is relatively closed. Companies with big foreign interests are scarce and mainly focused on Latin-America, one of the reasons for this is the lack of knowledge of the English language. The centre-left party PSOE (Partido Socialista Obrero Español) of Zapatero is striving for a budgetary balance and seems to succeed in this. The interpretation of the Stability- and Growth-treaty of Spain is very precise (Ministerie van Buitenlandse Zaken, 2005).

7.3 Characteristics of the market

In the approach of the Spanish market it is reasonable to take in account the big differences in population density and wealth in the regions. Madrid and Catalonia have the highest population density with more than fifty inhabitants per km². Only in four regions the GNP is at the level of the European average, these regions are Madrid, Catalonia, Canary Islands and the Balearic Islands. The wealthiest regions of Spain are located around the city of Madrid, in the east (Catalonia, Valencia and the Balearic Islands) and in the north-east (Basque Provinces, La Rioja, Navarra and Aragon). Catalonia and the Basque Provinces have the biggest industrial tradition (EVD, 2005).

The behavior of the consumers has changed strongly over the last few years. The consumer is more open for foreign products than before. The increasing number of female employees, the smaller families and the melting of different cultures are the drives behind these change. Also since the nineties the amount of employees that work outside the normal working hours has increased. The consumption climate in Spain is favorable because of the low consumption price inflation. Furthermore the domestic demand is great and for this reason the import has increased. Also the interest rate in Spain is relatively low compared to the other countries that have the euro as currency. However there is a regional inequality in purchasing power in Spain which is bigger than in most of the other EU members. The purchasing power is the highest in the Basque Provinces, Catalonia, Madrid, Balearic Islands and Navarra (EVD, 2005).

7.4 Education and labor force

In Spain the primary school takes six years and the following secondary school takes four years. For further education the so-called *Bachillerato* of two years can be taken as a preparation for the university. In the year 2002/2003 there were 1.5 million students, furthermore about 20 percent of the population between 25 and 65 year had an academic degree. In 2002 the government started a reform design for the secondary school system and in addition the government is now investing in the improvement of the higher and academically education (INE, 2005).

For many years there was a low percentage of growth of jobs and this was accompanied with a high rate of unemployment. But in the period 1993-2001 Spain reduced its stated unemployment rate from 22.5% to 10.5%; this was much faster than the other OECD countries. The reason for this is that the unemployment rate in 1993 was the highest among these OECD countries and is still the highest among the developed countries. Thus the last few years the conditions of the labor force have been improved, mainly because of 1997 reforms in legislation which have led to a higher flexibility in the labor market and uplifting economic activity. There is a strong growth in the demand for labor, only in 2003 480.000 new jobs were created. According to the INE the demand for labor will increase in the next few years and the percentage of unemployment will decrease further, this is displayed in the table 7.3 (EVD/INE, 2005).

Table 7.3: (Expected) employment development and unemployment, 2001-2008 (Source; INE, 2005).

	2001	2002	2003	2004	2005	2006	2007	2008
Employment (Million)	15,9	16,3	16,7	17,1	17,4	17,7	18,0	18,3
Unemployment (%)	10,5	11,4	11,3	9,9	8,9	8,4	8,0	6,8

The employment structure of Spain is similar to that of the EU-15 with the exception of a larger proportion of people working in agriculture and construction. In Spain there are very wide disparities in unemployment by region. Of the seventeen *comunidades autónomas* five have unemployment levels below or in line with the EU average, these are Aragon, the Balearic Islands, Catalonia, Navarra and La Rioja, furthermore two *comunidades autónomas* have rates of more than 20%, these are Andalusia and Extremadura. While unemployment remains high, there is the paradox of unskilled and skilled labor shortages in certain sectors like construction and agriculture and also increasingly in the ICT sector. Also the Spanish employment rate is still one of the lowest among the countries in the European Union. Less than 10% of the total employees are part-timers; this rate is much lower than the average of the countries in the EU.

The hiring of part-time employees has been made easier and subsidies were paid to employers' social-security costs to encourage more hiring of women. The part-time jobs are particularly essential in Spain to reduce the high unemployment rates of women and the elderly who are capable of working. Furthermore part-time employees contribute to tax and social security revenues. The stringency of Spain's employment protection legislation for core workers is among the highest in the OECD countries. The proportion of temporary workers has declined little since the 1997 reforms. Almost 30% of all workers in Spain are still on a short-term contract, which is three times higher than the average of the European Union (Chislett, 2002).

The minimum wage is determined every year and in 2004 this was 6.447 euro per year for employees older than eighteen years, this inclusive a thirteenth month and vacation bonus. The minimum wage is being recorded differently for every category in the collective labor agreement. It has to be mentioned that different salaries are being paid in the different provinces. In cities like Barcelona and Madrid the highest salaries are being paid. The irregular working hours and the overtime of employees are normally being recorded in the collective labor agreements or individual working contracts. Spain has a 40-hour workweek (EVD, 2005).

Subjects of the European Union do not need a work permit but a residence permit is still required if a person's stay is longer than three months. Non subjects of the European Union who wants to work in Spain need a special work visa and a work and residence permit depending of the type of work and the durance of the work (EVD, 2005).

7.5 Subsidies

There are subsidies made by the government in the area of education and employment for specific industry sectors. These are the so-called *incentives a la formación* and *Incentivos al empleo*, their purpose is to improve employment by offering education, improve quality of employees and reduces unemployment. There are also a few subsidies available through official institutes that fall under EU-programs that are financed by the structural funds of the European Union. The subsidies for specific branches are 20 till 50 percents of the amount of the investment and are given in the form of support credits and tax subsidies. The sectors to which these subsidies are available are the food sector, energy, technological development, R&D and mining. The application for these subsidies is done at the *Comunidad Autonoma* where the investment is made. Furthermore foreign investors can apply for subsidies through the European Agrarian Funds (EVD, 2005).

7.6 Tax legislation

Spain has three levels of taxation these are at the level of the central government, *Comunidad Autonoma* and the local governments. The Basque Provinces and Navarra have an autonomous tax system because they are aiming to be a more autonomous region. The Canary Islands have a specific economic and fiscal system with favorable fiscal measures to attract foreign investors and to improve the development of the islands. The overall tariff of the corporation tax or *Impuesto sobre Sociedades* is 35 percent.

This corporation tax is applied to Spanish and foreign companies. In comparison to the Netherlands this percentage is almost the same. Furthermore for the middle and small companies there is a reduced tariff of 30 percent over the first 90.000 euro taxable income. Also there are certain organizations which submit to adjusted tax tariffs, for example the collective investment funds, certain corporations and organizations which are active in the field of oil and gas research. Tax reductions are available for investments in the ICT, training of employees, research and development and certain specific investments like ecological investments. The top marginal income tax and the standard VAT is relatively low in Spain. Spain has an agreement with the Netherlands to avoid double taxing which can be applied to the income and the wealth tax (EVD, 2005).

Table 7.4: Tax rates in the EU (%), 2002 (Source: Chislett, 2002).

	Top Marginal Income Tax	Corporate Tax	Standard VAT
Austria	43.7	34	20
Belgium	65.2	40.17	21
Denmark	63.5	30	25
Finland	58.6	29	22
France	51.4	34.3	19.6
Germany	49.8	38.35	16
Greece	40	25/35	18
Ireland	42	16	21
Italy	51.4	40.25	20
Luxembourg	38	30.38	15
Netherlands	52	29/34.5	17.5
Portugal	40	33	19
Spain	48	35	16
Sweden	55.6	28	25
UK	40	30	17.5

On the mainland and on the islands as well there are numerous free trade zones where manufacturing, processing, sorting, packaging, exhibiting, sampling and other commercial operations may be undertaken free of any Spanish duties or taxes. Most of the free trade zones are located at Spanish airports and seaports and the largest free trade zones are in Barcelona, Cadiz and Vigo (EVD, 2005).

7.7 Development zones

The Spanish government is concerned with the amount of FDI that has located around the major cities of Madrid and Barcelona. The government is striving to spread investments more evenly across the country and therefore has created incentives in the form of development zones to attract investment to areas that are vastly in need of economic

development. Spain has two types of development zones. The first type are the so-called Zonas de Promoción Económica (ZPE), these are areas with a big development potential. These ZPE can be found in Andalusia, Asturias, Canary Islands, Cantabria, Castilla-La Mancha, Castilla-León, Cueta, Extremadura, Galicia, Melilla, Murcia and Valencia. The second type of development zones are the so-called Zonas Especiales (ZE), these are areas which are assigned by the government in special occasions. These ZE can be found in Aragon: Huesca, Teruel and certain areas in Zaragoza. The applications for these regional supports are done at the qualified instances of the Comunidad Autonoma where the investment is made. The ZPE and ZE have certain joint-characteristics, like promotional sectors, investment subsidies, project subsidies, stimulating projects, evaluation of the project, competition of varying compensations, applying procedure, project execution, license granting, payment procedures and payment systems. The Comunidad Autonoma assign these subsidies to the investors in there area (EVD, 2005).

7.8 Other incentives

The Spanish government offers foreign investors a broad range of incentives at the central, regional and municipal levels. The types of incentives available include financial subsidies, exemption form certain taxes, preferential access to official credit, customs exemptions, real state grants, credit guarantees, infrastructure facilities and professional training and qualification. Besides these the government provides economic agents with a well-known, predictable short-term framework in which to operate. In Spain there is a growing culture of internationalization of its companies and the Ministry of Economy is ready to offer assistance to companies that are interested in investing in the country. Furthermore there are regional incentives that follow the demands of the European Union and the purpose of these incentives is to develop certain areas. These incentives are aimed at the promotion of new companies, expansion of existing firms, or modernizing an area where there is a high unemployment rate (EVD, 2005).

7.9 Infrastructure

The ports of Bilbao and Barcelona are the fastest growing ports in Spain. Barcelona is the largest port for cruise ships in the Mediterranean. Both the ports of Bilbao and Barcelona are carrying out ambitious expansion and modernization projects which are particularly focused on container transfer (EVD, 2005). Furthermore the Llobregat River is being redirected, bringing its delta 2.5km down the coast and increasing the land adjacent to the port by some 700ha, more than doubling the current 558ha. The aim of this redirection is to be able to handle three million containers and double the amount of goods coming through the port annually by 2015. Also a new railway station is built at the port to take advantage of the European gauge. This will allow goods unloaded at the port to reach European destinations faster and more competitively. Spain's largest port is Algeciras, which has historically benefited from trade in oil and other industrial cargoes. The port of Tarragona is the third biggest port in Spain and the second of Catalonia, this port is the main terminal for oil and chemicals another major port is that of Valencia (Chislett, 2002).

The airports in Spain, particularly Madrid's Barajas, are among the most congested in Europe. Also the airports do not have such a good record of punctuality. In 2001 Spain topped the US as the world's second-most visited country, 49.5 million visitors which is 7.2% of the global market share. The tourism industry needs bigger airports to cope with the constantly growing volume of traffic. In several cities and regions in Spain new airports are being constructed or existing airports are expanded. The Barajas airport in Madrid will be expanded to handle an estimated 70 million passengers in 2020 (EVD, 2005).

The Spanish trains have a good record of punctuality because 98% arrive less than five minutes late. But the Spanish railway system does not meet the European standard norm on all the sections. The reason for this is the mountainous route, the great distances and the deviation of the width of the rails. Only the high-speed railway meets the European standard norm. The government of Spain gives a high priority to the expansion of the railway system. Furthermore by 2010, Spain plans to have added 5,000km to its current rail network of 8,000km (Chislett, 2002). The expansion of the rail way is divided in three parts: the expansion of the high-speed railway, expansion and connection of the commuter-trains and modernizing of conventional rail way system. Of the total 41 billion euro invested in the rail infrastructure 28.2 billion will be spend on the high-speed railway. The planning is to reduce the traveling time from every province capital to Madrid to less than four hours. Furthermore Spain is planning to improve the connections with the ports and construct a high-speed railway between Madrid and Lisbon together with the Portuguese government (EVD, 2005).

Spain has a good and modern road system. This road system is of great importance because 81.7 percent of the freight traffic and 89 percent of the passenger traffic uses the road system. The highways connect the most important cities and these cities have a ring road. The roads are the property of the state and the Ministry of Development is responsible for the construction of the roads (EVD, 2005).

The telecommunication has been modernized and liberated in the last few years. The established telecommunication market of Spain is the responsibility of the Secretaría General de Telecomunicaciones (SGT) which is a part of the Ministry of Science and Technology. The liberalization of the telecommunication market in the year 2001 has generated a lot of investments in the infrastructure and telecommunication services, the number of providers and the use of communication devices went up and the prices went down. An important result of these last few years is the supply of broadband accompanied with low tariffs of internet access. The e-commerce business in Spain is a fast growing business this accounts the business-to-business (B2B) as well as the business-to-consumer (B2C). Companies appreciate especially the short delivery time and the ease of the internet (EVD, 2005).

7. 10 Research & Development

The spending of Spain on the R&D is relatively low, the amount spent on R&D is only half the EU-15 average and one-third of leading countries such as Finland. Spain has a relatively high rate of technology dependence, as measured by the technology balance of payments, and a low rate of inventiveness. Spain is advanced in some areas despite the generally low R&D effort. Spain has a state-owned aircraft company (CASA) which was one of the three companies that created the European Aeronautic Defense and Space Company (EADS). EADS is vested in Andalusia and is part of the third biggest cluster, after Toulouse and Hamburg for the airport industry in Europe (Chislett, 2002).

7.11 Energy

The Spanish energy sector takes account for 1.6 percent of the GNP and employs 200.000 persons. Within the EU Spain is the fifth market of energy consumption. Spain is highly dependent on import for the supply of energy. Spain imports 99 percent of the consumed oil and natural gas and 50 percent of the coal and charcoal. The Spanish coal production is not profitable and is highly subsidized. Because there has not been found any oil or natural gas the government of Spain has decided to conclude long-term contracts with foreign suppliers. Almost 60 percent of the natural gas comes from Algeria and is transported by pipeline or ship. Besides natural oil, charcoal and coal, atomic energy is a frequently used source of energy but the policy of the government wants to reduce the usage of atomic power. Spain stimulates the increase of usage of alternative energy through support of the EU to the Kyoto protocol. The last few years there has been a big development of sustainable energy in Spain and the country is the third biggest producer of wind energy in Europe. It is expected that the capacity of wind energy will be increased and the costs will fall. Besides wind energy there is also a lot of interest in solar-energy, biomass and wave power energy. In 2003 the Spanish market of gas and electricity has been liberated in order to increase competition and decrease the prices but in reality it did not cause much change (EVD, 2005).

7.12 Water

In Spain 80 till 85 percent of the water is used by the agricultural sector, the rest is used for domestic and industrial use. For years there was not any stimulation of reducing water usage because the price of water was much lower in contrast to Northern Europe. Nowadays a price mechanism is frequently being applied to stimulate reduced use of water. The last few years Spain has to cope with large water shortages, the country has an increasing problem of desertification. Not only the shortage is a problem but also the bad quality of the drink and irrigation water as well as the treatment and dumping of effluent water and the expansion of the water pipes and maintenance of the sewer system. To solve these problems the Spanish government has made a National Hydrologic Plan (NHP), the NHP is probably the most important infrastructure project of the future, it was approved in 2001 and its objectives are the improvement of the infrastructure and water management (EVD, 2005).

7.13 Agreements

Since 1971 Spain has an agreement with the Netherlands in order to avoid double taxing, which are applied to income taxing and wealth taxing. Furthermore Spain has, as a member of the European Union, bilateral and multilateral agreements which are associated with the European Union. Besides these agreements Spain is a member of the following international organizations (Ministerie van Buitenlandse Zaken, 2005):

- United Nations (UN)
- World Bank
- International Monetary Fund (IMF)
- Organization for Economic Co-operation and Development (OECD)
- Organization for Security and Co-operation in Europe (OSCE)
- North Atlantic Treaty Organization (NATO)
- Organization for the Prohibition of Chemical Weapons (OPCW)

7.14 Spain and FDI

The role of Spain as a foreign direct investor is getting more important but Spain plays an important role as host country for FDI as well. Spain continues to appeal to foreign investors, offering numerous advantages. As a member of the EU and the euro-zone, Spain offers an attractive market to foreign companies, both in terms of the wider EU and its own domestic market. Besides the easy access to the EU-market there is an easy access to the Latin-American-market as well. The country has a broad industrial and technological base and a strongly developed service sector. Spain is the second-biggest tourism market in the world, besides this Spain is also a major motor vehicle manufacturer and chemicals producer. Furthermore it is the eighth-largest economy in the Organization for Economic Co-operation and Development. Also Spain has excellent infrastructure, modern transport and telecommunications networks. Generally, labor costs are below the EU average, translating into lower production costs and the Spanish government attracts foreign by means of incentives. However the inward FDI of Spain experience high competition of Asian countries and Central and Eastern European countries which are members of the European Union since May 2004 (EVD, 2005).

Table 7.5: Inward and outward flows of FDI in Spain 1991-2004, millions US dollars (Source: OECD fact book, 2006).

	1991	1992	1993	1994	1995	1996	1997
Outflow FDI	4 424	2 171	3 174	4 111	4 158	5 590	12 547
Inflow FDI	12 445	13 351	9 572	9 276	6 285	6 821	6 388
Balance	- 8 021	- 11 180	- 6 398	- 5 165	- 2 127	- 1 231	6 159
	1998	1999	2000	2001	2002	2003	2004
Outflow FDI	18 938	42 085	54 685	33 100	31 540	23 395	42 000
Inflow FDI	11 798	15 759	37 530	28 010	35 940	25 649	9 850
Balance	7 140	26 326	17 155	5 090	- 4 400	- 2 254	32 150

Spain has been one of the main recipients of FDI in Europe over the last decade and as you can see in the figure above Spain had a bigger inward flow of FDI than the outward flow from 1991 until the year 1997 and thus a negative balance. In the period 1997 until the year 2002 this balance was positive with a peak in 1999. But as you can see above in the years 2002 and 2003 the balance of Spain turned over to a negative balance again. In the year 2004 the balance was positive and peaked higher than before (OECD fact book, 2006).

Table 7.6: Gross FDI in Spain 2004 in million euros by countries of ultimate origin (Source: FDI magazine, 2005).

Countries	Amount	%
O.E.C.D.	8,482	76.21
European Union	6,221	55.9
Belgium	108	0.97
Germany	364	3.27
France	1,243	11.17
United Kingdom	2,013	18.09
Italy	259	2.33
Netherlands	854	7.67
Portugal	1,054	9.48
Sweden	100	0.9
Non EU European	157	1.41
Switzerland	149	1.34
Non European OECD	2,104	18.9
Canada	145	1.3
United States	1,896	17.04
Tax Havens	181	1.63
Latin America	2,019	18.14
Mexico	1,758	17.73
Rest	83	0.74
Total	11,129	100

Breakdown of inward flows of FDI by country of ultimate beneficial owner is more meaningful than by immediate country of origin, as it reflects, where possible, the country where decision-making headquarters are located. As shown in the above figure the OECD countries were the main countries of ultimate origin of FDI in Spain, together they accounted for 76.21% of investments in the year 2004. Within this area of OECD countries, the European Union accounted for 55.90% of total investments. The main individual countries of ultimate origin in 2004 were United Kingdom (18.90%), Mexico (17.73%), United States (17.04%), France (11.17%), Portugal (9.48%) and the sixth position was taken by the Netherlands (7.67%), (FDI magazine, 2005).

Table 7.7 shows that in the period 1992-2003 the Netherlands has always been one of the nine most investing countries. In the years 1993, 1996 and 1997 the country was even the biggest foreign direct investor in Spain (Banco de España, 2004).

Table 7.7: FDI flows in Spain by geographical origin 1992-2003 (Source: Banco de España, 2004).

	1992	1993	1994	1995	1996	1997
1	France	Netherlands	Germany	Germany	Netherlands	Netherlands
2	UK	France	France	Bel/Lux	USA	Germany
3	Germany	UK	USA	Italy	France	UK
4	Belg/Lux	Germany	Italy	USA	Germany	France
5	USA	Bel/Lux	Switzerland	France	Italy	USA
6	Switzerland	Switzerland	Bel/Lux	Switzerland	UK	Italy
7	Netherlands	Italy	UK	UK	Switzerland	Portugal
8	Portugal	Portugal	Netherlands	Netherlands	Portugal	Mexico
9	Italy	USA	Portugal	Portugal	Mexico	Switzerland
	1998	1999	2000	2001	2002	2003
1	France	USA	UK	Portugal	USA	UK
2	Bel/Lux	UK	USA	Bel/Lux	Bel/Lux	USA
3	Germany	Bel/Lux	Netherlands	Netherlands	Netherlands	Netherlands
4	Netherlands	Germany	Germany	France	UK	France
5	UK	Netherlands	Bel/Lux	UK	Germany	Bel/Lux
6	USA	Italy	France	USA	France	Switzerland
7	Italy	Portugal	Switzerland	Switzerland	Chile	Portugal
8	Portugal	France	Italy	Germany	Italy	Mexico
9	Mexico	Mexico	Portugal	Italy	Brazil	Italy

As you can see in table 7.8 the ranking position of an industry in gross inward FDI is quite unstable this is because an investment accounts often a large sum of money and is a well considered decision therefore most of the time investors do not invest annually. But the table below does show that there are certain industries, like the cement industry or real estate services industry, which are relatively high ranked in two following years. Thus the figure is an indication of industries which are popular among foreign investors (FDI magazine, 2005).

Table 7.8: Gross FDI in Spain top 15 industries 2003-2004 (Source: FDI Magazine, 2005).

Host Industries	Amount '03	Ranking Position '03	Amount '04	Ranking Position '04
Cement	151	5	2,106	1
Food Retail	82	7	1,305	2
Non Life Insurance	68	9	886	3
Electricity	48	10	624	4
Real Estate Services	582	3	596	5
Life Insurance	455	4	400	6
Raw Plastic Materials	824	2	301	7
Aluminium	0	15	220	8
Telecommunications	2,106	1	193	9
Textiles	0	13	183	10
Meat Foods	0	14	180	11
Trade in Fuel and Minerals	3	11	154	12
Synthetic and Man-made Fibres	71	8	136	13
Trade in Real Estate	109	6	135	14
Non Perishable Foods	1	12	133	15

Most of the FDI can be made freely and only needs an ex-post notification. But some FDI in Spain needs verification at the *Registro de Inversiones* of the Spanish Economic Department before they are made. These include FDI from tax havens and those that involve national security. For the industries of air transport, radio and television, telecommunication, private security, pharmaceuticals, mining and gambling account industry specific restrictions. There has been a liberalization of restrictions on acquisitions of local companies and investors can now make a formal take-over bid to acquire more than 50 percent in a Spanish company. Furthermore the public and private companies are in general given an equal treatment with respect to the local access to markets, licenses, credit and supplies (EVD, 2005).

7.15 Types of establishments

A Dutch entrepreneur can open an establishment in Spain in several ways. The first one is the *sociedad de responsabilidad limitada* (SRL) this is a partnership with restricted responsibility. The minimum amount of capital to establish a SRL is 3.005 euro and needs to be paid completely during the establishing process and the shares can only be transferred through a notarial deed. The second type is the *sociedad anónima* (SA), this is a limited liability company and the minimum amount of capital to establish an SA is 60.102 euro and 25 percent needs to be paid during the establishing process furthermore there is a free transfer of shares. These first two types require a minimum of two partners. It is possible that a single person establishes a SRL or SA this is the so-called one-person-partnership or *sociedad unipersonal*. To establish a *sociedad unipersonal* the demands

are stricter than in the case of a SRL or SA with more than one partner. The third type *Sociedad Limitada Nueva Empresa* (SLNE) is a simple form of a limited company which can be established within 48 hours and after a few years transfers in a normal limited company. This type of establishment offers a great flexibility in the legal regime because of the relaxation of the establishment conditions. The advantages of establishing an SLNE are lowering of the establishment costs, establishment according to the Spanish profile of small- and medium-sized companies, and simplification of the establishment forms. The fourth type is the *sucursal* this is a branch office; this *sucursal* carries the name of its parent company with the addition of the name of the *sucursal*. There is no requirement for a minimum capital and does not have a legal body, the parent company is responsible for all its debts. The fifth type is *sociedad regular colectiva* (SRC or SC) this is a general partnership. A SRC exists of two or more persons and the partners are responsible for the obligations concerning the company. The sixth is public limited company or *sociedad en comandita* (S en Com. or SCom) here one or several partners are only responsible for the invested capital in the company. Also there exists a *sociedad en comandita por acciones* this is a public limited company with shares. In this type at least one partner is responsible for the obligations concerning the company. Foreign investors seldom choose for the establishment in the form of a commendatory partnership. The seventh type is the joint ventures there are different forms of collaborations which can account partners as *persona física* and *persona jurídica* as well. One of these is *Unión Temporal de Empresas* (UTE), a temporarily collaboration, with a period of maximum ten years. In the case of UTE the company's results are divided between the participating companies and all the members are responsible. The final type is the *Comerciante individual* or one-man business this type of establishment can be established by everybody who is older than eighteen years and who has commodities at his disposal (EVD, 2005).

7.16 Short summary

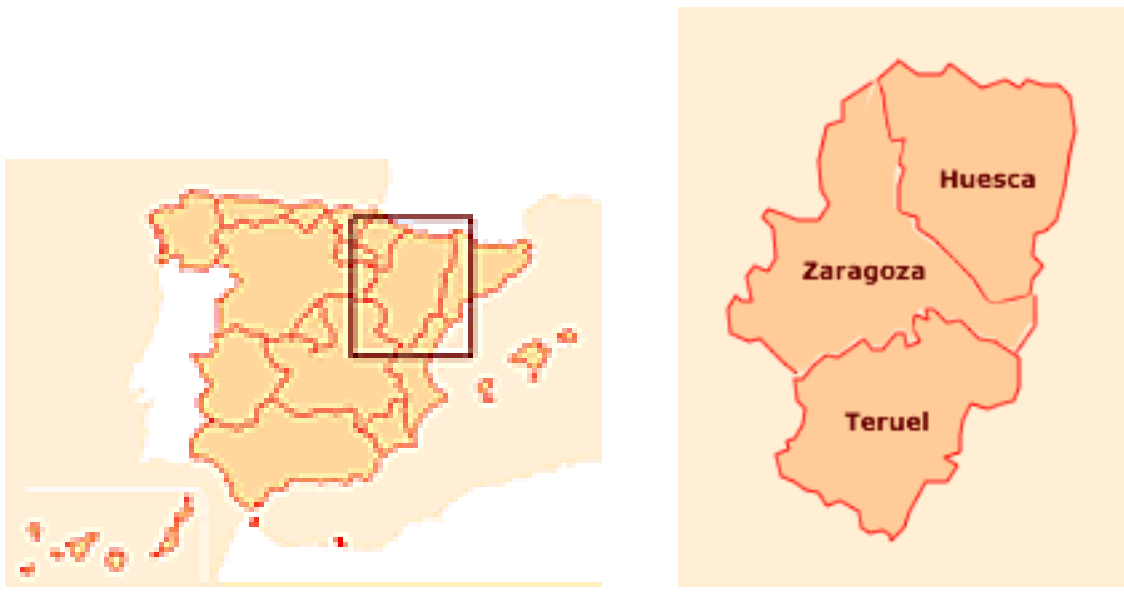
Spain has been one of the main recipients of FDI in Europe over the last decade and thus the inwards FDI are of great importance for the Spanish economy. In short the most important foreign investors for Spain are OECD countries and of these countries the members of the European Union take most of the investments for their account. As mentioned before the Netherlands has always been one of the nine main investing countries during the period 1992-2003. The FDI relevant location factors of Spain which are important to attract foreign investors are various. Spain is a member of the EU and the euro-zone; it has easy access to the EU-market and to the Latin-American-market; it is the eighth-largest economy in the OECD with a big domestic market; the country has a broad industrial and technological base and a strongly developed services sector; it is the second-biggest tourism market in the world; it has excellent infrastructure, modern transport and telecommunications networks; labor costs are below the EU average; and there are incentives at the central, regional and municipal levels to attract foreign investors.

H8. Aragon & Zaragoza

8.1 Introduction

Aragon, one of Spain's 17 Autonomous Community, is located in northeastern Spain and encompasses 47,699 km² of land. The region is divided in three provinces; Zaragoza, Huesca and Teruel. Zaragoza, which is located on the Ebro River, is the capital and political and administrative centre of Aragon and it is the fifth most populated city in Spain with a population of roughly 661.000 inhabitants (72% of population of Aragon). Over the last century the population of the province of Zaragoza has increased, which is in contrast with the declining population of the provinces of Huesca and Teruel. The increase of the province of Zaragoza is large enough to raise the overall population of Autonomous Community Aragon. Aragon has a total surface of 47.650 square kilometers and takes 9.44% of the national territory. The municipal area of Zaragoza has a total surface of 1.060 square kilometers, making it one of the largest in Spain. Zaragoza is situated in the centre of an area which holds 60% of the population of Spain and 80% of its GDP within a radius of 350 kilometers. The city lies in the valley of the Ebro River and into it flow the Rivers Gállego and Huerva and the Imperial Canal of Aragon. The city of Zaragoza lies in the geographical centre of a hexagon of important cities. This hexagon is formed by Madrid, Valencia, Barcelona, Toulouse, Bordeaux and Bilbao. Zaragoza has leveraged this central location through public and private initiatives to become a major logistics hub to both local and international companies (PLAZA, 2005).

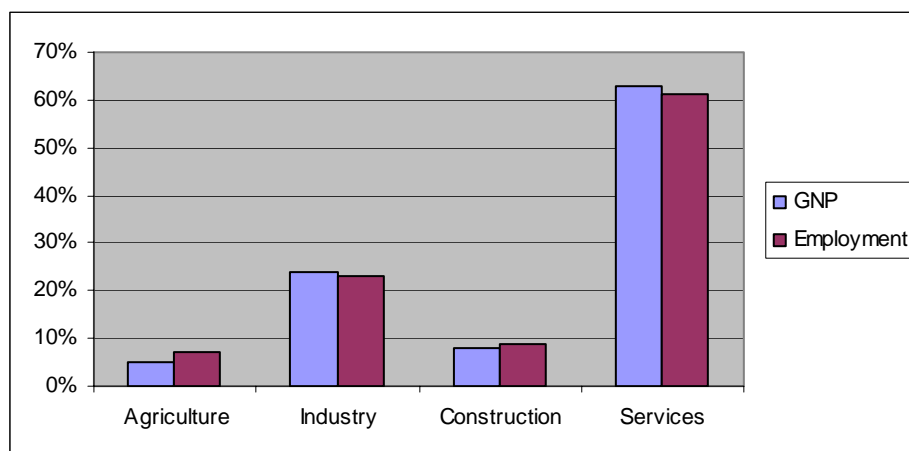
Figure 8.1: Comunidad autónoma Aragón and municipal Zaragoza (Source: EVD, 2005).



8.2 Economic development and indicators

Aragon is in a healthy condition from an economic, social and political point of view. The political environment is relaxed and confident and the economy is developing favorably. The regional economy of Aragon has to deal with an excessive concentration of activity around the capital city of Zaragoza. For this reason there are major economic imbalances in Aragon. Overall productivity of Aragon in recent years has fluctuated around the Spanish average, with the agricultural sector showing the best results (Strategis, 2003). Aragon has a strong industrial tradition and the industry accounts for 24% of the regional GNP while this is 21% of the GNP for Spain as a whole. Furthermore it accounts for 23% of the employment in the Autonomous Community while this is 18% for Spain as a whole. Industries that account for the mayor part of the GDP are energy, metal, automotive manufacturing, machinery and electrical material. The industrial sector is led by transport equipment manufacturing and this sub-sector industry accounts for 17% of the industrial employment in Aragon (AREX, 2004). There is a concentration of manufacturing industry in the area of Zaragoza and in the south of Teruel there is a concentration of iron and lignite mining. Furthermore large companies and multinational companies like car manufactures, railway equipment manufactures and generators of electricity exist alongside small family-run businesses. These small companies with antiquated equipment and little business capacity are active in textiles, footwear, leather and clothing. They are having difficulty in surviving in an increasingly competitive market. The most of the agricultural sector exists of dry-farming, although agriculture under irrigation is far more productive and accounts for the better part of the agricultural output. Furthermore Aragon accounts for about one third of the construction companies of Spain of which the majority is focused on building construction and civil engineer installations (Strategis, 2003). With a share of 63% of the total GNP and 61% of the total employment, the service sector is of major importance for the Autonomous Community. The finance industry is the biggest sub-sector industry and there is a extensive network of national and international banks in Aragon (AREX, 2004).

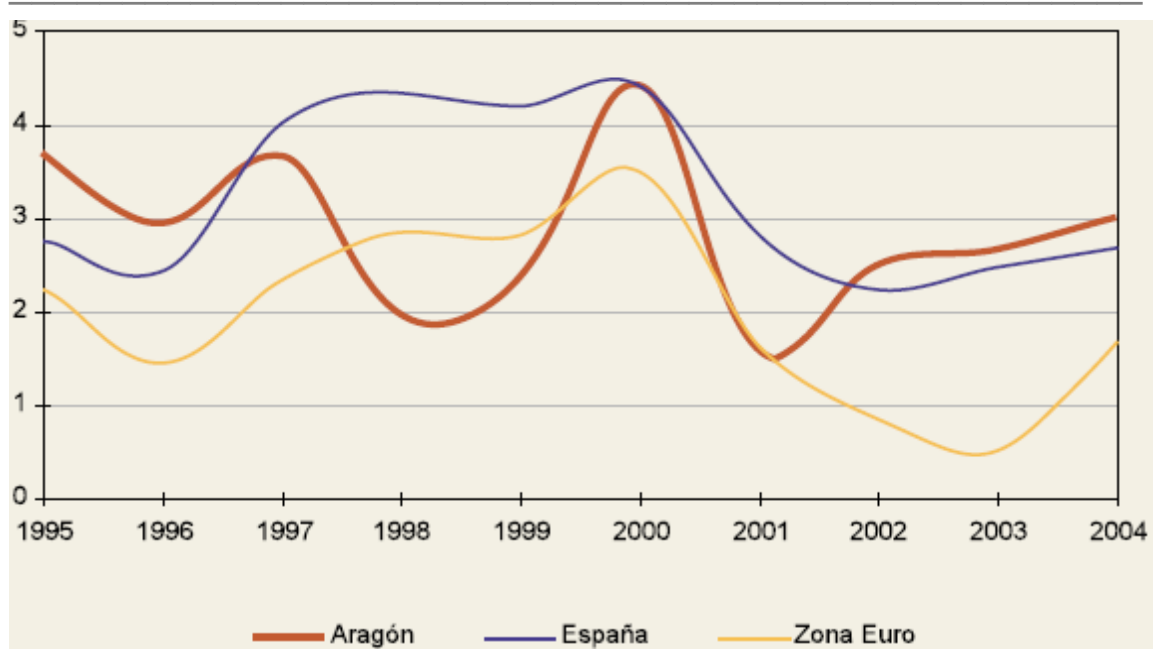
Figure 8.2: Share of GNP and employment in % per sector in Aragon, 2004 (Source: AREX, 2004).



According to the INE the sector construction was the most dynamic in Aragon during the year 2005 with a growth percentage of 6.9%, 2.9% growth in the year 2004. This is followed by the sector services, with a growth of 3.8% in 2005 and 2.9% in 2004. The sector industry, including the energy sector, grew modest in 2005 with a growth percentage of 2.1% which was 2.6% in 2004 (INE, 2006).

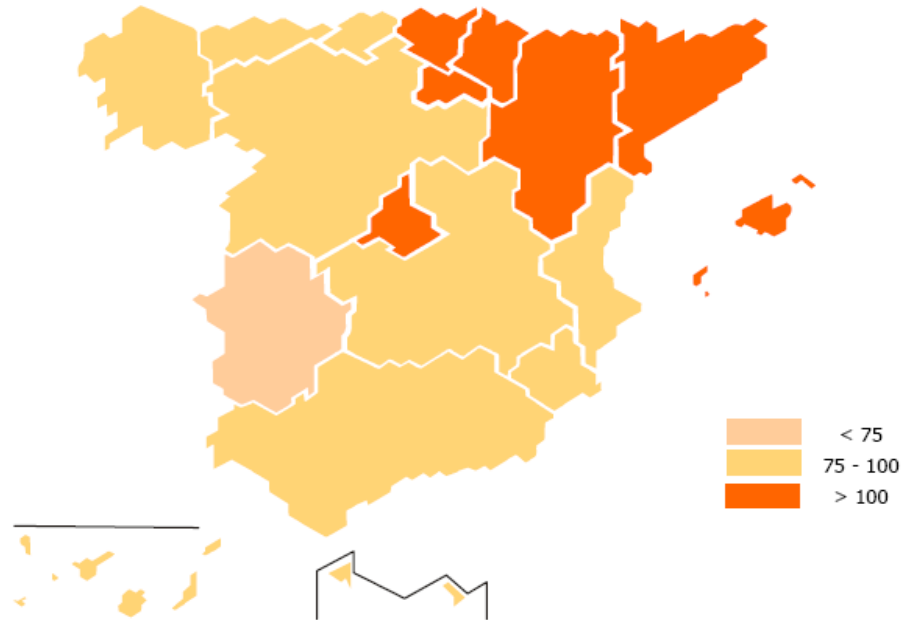
As shown in figure 8.3 the growth of the GNP, in the period of 2002-2004, in Aragon was higher than the Spanish average and higher than the average of the euro-zone as well (AREX, 2005). The growth of GNP between the years 2004 and 2005 of the Autonomous Community Aragon with 3.5% was above the national average of 3.4% and also above the EU-25 average of 1.7%. The highest percentage of growth, 4%, took place in Madrid and Aragon was at the fifth position. Over the years 2000-2005 the average growth of GNP for Aragon was 3.19% which is above the 3.14% average growth of GNP of Spain as a whole (INE, 2006).

Figure 8.3: GNP rate (at constant prices) % annual change (Source: AREX, 2005).



In the map below the GNP per head of the Autonomous Community in the year 2005 is displayed in relation to the GNP per head of Spain as a whole. As you can see, with the exception of Madrid and the Balearics, the GNP per head above the national average (which is considered 100) is concentrated around the so-called Ebro Spill. The GNP per head in the year 2005 was the highest in Madrid with 27.279 euros the Autonomous Community Aragon was at the seventh position with 22.403 euros. The GNP of Aragon was slightly above the national average of Spain which was 20.838 euros. For indication the average of the EU-25 in that year was 23.400 euros (INE, 2006).

Figure 8.4: GNP per head, Spanish Autonomous Communities 2005 (Source: INE, 2006).



As you can see in table 8.1 most of the main trading partners of Aragon are countries within Europe. In the year 2004 the Netherlands were seventh biggest export partner with an amount of 220 million euros and the ninth biggest import partner with an amount of 128 million euros (INE, 2005). The main products that are imported into Aragon are motor vehicles, industrial machinery, iron and steel, plastics and textiles. European Union countries are the dominant suppliers. In the year 2003 the EU countries provided 77.5% of the total imports (Strategis, 2003).

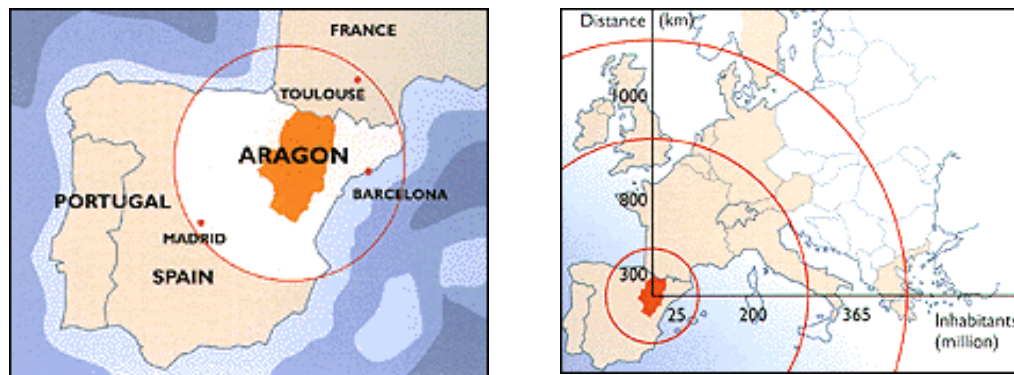
Table 8.1: Export/import in thousand of euros of main trading partners of Aragon, 2004 (Source: INE, 2005).

Position	Countries	Export	Countries	Import
1	France	1,162,885	Germany	1,827,000
2	UK	1,153,306	Italy	602,835
3	Germany	1,134,460	France	577,797
4	Italy	961,280	UK	560,894
5	Portugal	665,308	Poland	552,218
6	Turkey	233,293	Portugal	296,723
7	The Netherlands	220,261	Belgium	315,118
8	Belgium	220,186	Austria	274,162
9	Greece	131,839	The Netherlands	128,219
10	USA	80,747	Suize	123,944
	Total	7,166,828		6,594,559

8.3 Characteristics of the market

Within a 300 kilometer radius from Zaragoza there is a volume of more than 25 million consumers and a potential market of more than 240 million within an 800 kilometer radius. Within these 300 kilometers the most important cities of Spain are located, like Madrid, Barcelona, Valencia and Bilbao, and also the main cities of south France can be found within this distance, like Toulouse, Montpellier and Perpignan. Furthermore almost 370 million consumers can be supplied quickly in the European Union, thus with reduced costs and free trade. Thus Aragon is a large gateway to the domestic and other European markets because of its strategic location between the development corridors of the Valley of the Ebro, the Mediterranean and the Atlantic (Investing in Europe, 2002).

Figure 8.5: Market range of the Autonomous Community of Aragón (Source: Investing in Europe, 2002).



8.4 Education and labor force

As shown in table 8.2 many students in Aragon are studying engineering as a reflection of the industrial environment. This gives companies in the region of Aragon a large pool from which they can hire educated and qualified workers (Strategis, 2003).

Table 8.2: Distribution of students in secondary education, 2002-2003 (Source: Strategis, 2003).

Engineering Studies	12,522
Business Studies	7,632
Law Studies	4,901
Science Studies	4,296
Other Studies	16,240
Vocational Training	18,200
Total Students	63,791

The labor market in the Autonomous Community of Aragon is stable and there is an excellent social climate. There are a large number of qualified people in the region and ten percent less industrial dispute than the national mean and a reduced level of industrial accidents. Furthermore the production ratios per employee in Aragon are among the best of Europe and the production level per employee is greater than the national average (Investing in Europe, 2002).

In order to make all human and material resources of the University of Zaragoza available for the companies situated in Aragon, the institutions in the technology sector in Aragon have as objective the creation of a coordination link between private companies and the university. Therefore an Enterprise-University Foundation (FEUZ) was created. Besides this a centre was created as well in order to increase the relationship between the companies and the university and make the relationship more efficient. In this centre the research enquiries of the companies are channeled and distributed to the proper faculties or colleges (Investing in Europe, 2002).

The economic strength of Aragon is reflected in the statistics of employment. These show that the unemployment rate in the Autonomous Community with 5% in 2005 was half of the Spanish average which was 10% in that year. Aragon is alongside La Rioja and Navarra one of the Autonomous Communities with the lowest unemployment rates (INVEXTA, 2006). In 2005 Aragon had an employment rate of 56.2% which was slightly under the national rate of 57.7%. The unemployment rate was 5.65% in that year which was below the national rate of 8.7%. In the years of the period of 1996-2003, both the employment rate and the unemployment rate were under the national rate. From 1996 until 2001 the unemployment rate declined until 4.8% but in the following years the rate increased again. In the period of 1996-2001 the unemployment rate of women declined 12.3% which is bigger than the decline of the unemployment rate of men which was 4.9% in that same period (ICO, 2004).

Table 8.3: Employment rate and unemployment rate Spain and Aragon, 1996-2003 (Source: ICO, 2004).

	Employment rate		Unemployment rate	
	Aragon	Spain	Aragon	Spain
1996	49.3%	51.3%	15.3%	22.2%
1997	49.7%	51.6%	14.1%	20.8%
1998	49.9%	52%	11.4%	18.7%
1999	49.8%	52.5%	9%	15.7%
2000	50.7%	53.6%	7.2%	13.9%
2001	49.7%	52.9%	4.8%	10.5%
2002	50.4%	54%	5.5%	11.4%
2003	52.2%	55%	6.3%	11.3%

8.5 Incentives

There are regional economic incentives available for FDI in the Autonomous Community of Aragon. The amount is a percentage of the subsidy over the investment which will be established depending on the evaluation of the investment project. In this evaluation of the investment project the following will be evaluated: The number of jobs created, the use of productive factors in the area, the added value tax, the productivity increase, the addition of technology to the investment project and its dynamism for the economy of the area. Investment projects, which create or enlarge establishment with an approved investment more than 6.010.121 euro, are considered for the subsidy. Besides this other requirements are technical, economic and financial feasibility of the investment project. The investment must be done after requesting the regional economic incentives and the self-financing must be at least 30% (Investing in Europe, 2002). Furthermore there are regional incentives that follow the demands of the European Union and the purpose of these incentives is to develop certain areas (EVD, 2005). These regional incentives in Aragon can cover between 20% and 25% of the project costs. However in the city of Zaragoza this regional incentive is not available because the region is not considered by the EU as an area in need of special promotion (AREX, 2004).

There are also sector specific incentives like the support for improvement of commercialization and transformation of agricultural and service products. Also there is a life annuity for design and set up of industrial quality systems as well as for the costs originated by official approval and certification of the products. Furthermore there is quite a large variety of incentives for FDI in R&D, innovation and technology. First there is the co-financing in pre-competitive research projects with the collaboration of two or three companies from different countries. Second there are grants for the launching of projects of new products, processes or services within the cooperation of these two or three companies from different countries. Third there are subsidies for R&D, industrial and technology development projects. Fourth there are very low interest loans for industrial development and innovation which are compatible with other incentives. And finally there is aid for the presentation of investment projects within the EU-programs and aid to obtain foreign patent (Investing in Europe, 2002). Furthermore there are a few types of employment incentives available in the Autonomous Community of Aragon these include grants for hiring people with indefinite contracts, support to the employment in the cooperatives and the promotion of self-employment. There are also incentives for staff training like subsidies for company training projects, projects for inter-sector training and individual permits for training (Investing in Europe, 2002).

Besides these incentives that are mentioned, there are also incentives for improvement of the environment which are subsidies for innovating projects for rational use of energy and projects for demonstration and diffusion of renewable energy sources (Investing in Europe, 2002).

8.6 Infrastructure

The city of Zaragoza has a highly national and international strategic value because of its geographical location. As shown in the figure below Zaragoza is located on several important national and international corridors. Furthermore the city of Zaragoza has an inter-urban transport infrastructure, which connects the city directly with the surrounding economic centers and the transportation corridors of its surroundings (PLAZA, 2005).

Figure 8.6: National and international corridors of Zaragoza. (Source: PLAZA, 2005).

National corridors:

- Ebro axis: from Cantabria to Vizcaya, Guipúzcoa, Álava, Navarra, La Rioja, Zaragoza, Lérida, Tarragona and Barcelona.
- Axis Madrid - Zaragoza - Barcelona.
- Axis Basque Country - Navarra - Zaragoza – Valencia.
- Pyrenean axis.

International corridors:

- Mediterranean axis entering from the border of la Junquera Atlantic.
 - Axis on the Irún – Bohemia border.
 - North-South axis from Bordeaux to Valencia.
 - N-II, N-232 and the Ebro motorway
-

The Autonomous Community of Aragon has a great number of logistic companies in its region and in combination with the fact that Aragon is a strategic location, this leads to lower transport costs than the other regions in the north-east of Spain. The distance from Zaragoza to the most important cities in Spain and the south of France is about the same and the city is seen as the best connection between the principal Spanish cities.

Furthermore because Zaragoza has an international logistic route the average costs of international transport are also lower in the city of Zaragoza. In the north-east of Spain, Aragon is the centre of the network of highways and toll free highways (Investing in Europe, 2002).

- Highway: Zaragoza- Pamplona- San Sebastian, Zaragoza- Logroño- Vitoria- Bilbao and Zaragoza-Lérida-Barcelona-Perpignan.
- Toll free highway: Zaragoza- Guadalajara- Madrid, Zaragoza- Huesca, Zaragoza- Huesca- Pau (under construction) and Zaragoza- Teruel- Valencia (under construction).

The Autonomous Community of Aragon is also the centre of the railway network in the north-east of Spain and this network is accessible to the route of passengers and freight trains. Furthermore Aragon is integrated in the project of the High Speed Railway which will improve the communications between Aragon and other European regions. If the project is completed it will only take an hour and a half to get to Madrid or Barcelona from Zaragoza (Investing in Europe, 2002).

Zaragoza has an airport which communicates with the main European capital, like Paris, Lyon, Milan, Rome, and Frankfurt. The international Airport is situated about nine kilometers from the central city of Zaragoza and is in the immediate surrounding of the Logistic Platform of Zaragoza. The airport is accessible through several highways and toll free highways. The transport of goods is very high through the International Airport of Zaragoza and this is of great importance for the companies that are located at the Logistic Platform of Zaragoza. The airport is considered as one of the most important strategic locations for both internal and external distribution. Furthermore there are 8 national and international airports within a radius of 300 kilometers (Investing in Europe, 2002).

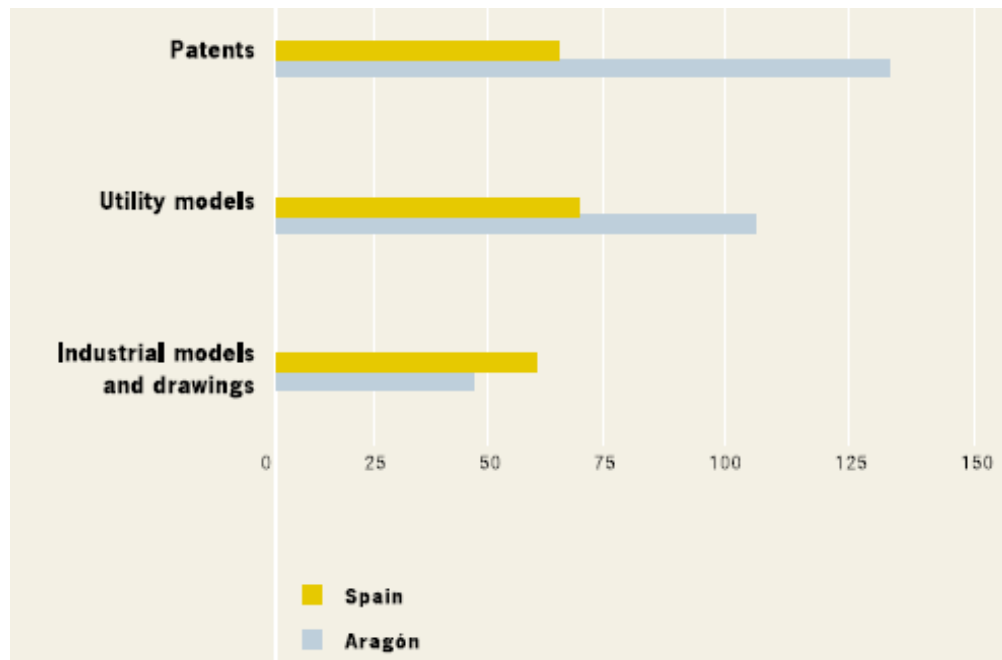
Aragon has the strategic objective of making it a worldwide centre for logistics. This is possible because of an excellent communication infrastructure and the geo-strategic location (INVEXTA, 2006). The government has created the Logistics Platform of Zaragoza (PLAZA); with 12.826.898 m² it is the largest logistics premises on the European continent. It is located near the airport of Zaragoza. The characteristic of the PLAZA is based on an inter-modal transport centre of railways, roads, and air routes, with connections to the most relevant European production and consumer centers. The PLAZA is completely open to businesses which participate in activities related to logistics, at the platform there are collective installations and common services which multiply the profitability of its location (PLAZA, 2005). Furthermore the government of Aragon is creating the Industrial-Logistics Platform of Teruel (PLATEA). The objective of this project is the integration and positioning of Teruel within the transport, distribution and logistics axis. Besides this the government will also make industrial and logistics land available for the economic and social development of Teruel. These platforms combined with the excellent geo-strategic location of the Autonomous Community in Spain, will increase importance of logistics as a competitive factor for the companies already based in the region, and will be of great importance for the setting up of new companies in Aragon (AREX, 2004).

8.7 Research & Development

In Aragon the activities in R&D receive high priority. There are various R&D centers and institutes in the Autonomous Community that focus on issues like energy, new materials, computer science, logistics, health sciences and agro-food industry. Furthermore there is a Foundation for Development of Hydrogen Energy Technology to promote R&D and innovation in the hydrogen industry and renewable energy sources. Also there is a Technological Institute (ITA) to promote innovation among firms and there is a Institute for Economic Development (IAF) through which the government provides financial support for R&D. Besides this all the government of Aragon is involved in research and innovation programs. One of these programs is the Program for Logistic Innovation in Aragon (PILOT) which provides companies with technical assistance and training in logistics. Another is the European Centre for Business Innovation (CEEI) which is a part of the European Business Network (EBN) and this centre promotes innovation among small and medium-sized companies (AREX, 2004).

The presence of these institutes and the availability of these research programs are successful which can be shown by the number of applications made by the Autonomous Community for the registration of patent. In figure 8.7 you can see that the patent application per million inhabitants in Aragon is more than twice as much as for Spain as a whole, also the application for utility models in Aragon is greater than Spain as a whole (Ministry of Science and Technology, 2005).

Figure 8.7: Patent applications per million inhabitants (Source: Ministry of Science and Technology, 2004).



8.8 Energy

A large part of the energy of Aragon is derived from renewable energy sources. As shown in table 8.4 the biggest part is derived from hydroelectric energy which is generated by the Ebro River damn Huesca. About 10 percent of the renewable energy of Spain is produced in Aragon (Strategis, 2003).

Table 8.4: Produced electric power by source and province, 2001 (megawatts) (Source: Strategis, 2003).

	Huesca	Teruel	Zaragoza	Aragon
Hydroelectric	1,148	28	406	1,582
Conventional (Coal, gas & oil)	0	1,210	80	1,290
Co generation	124	40	291	455
Wind	94	19	334	447
Total	1,366	1,297	1,111	3,774

8.9 Aragon & Zaragoza and FDI

In this part of the chapter Aragon & Zaragoza the number and characteristics of the FDI in Aragon will be displayed. The numbers and figures are based on a research named *Inversión Extranjera en Aragón (INVEXTA)* that was done in the year 2001 by an institute of the government of Aragon named AREX (*Aragón Exterior*). AREX is an institution specialized in assisting foreign investors to find their way in the Autonomous Community and the institute has responsibility for the external promotion of the companies and for attracting foreign investment. The aim of AREX is to provide support for companies that want to invest in Aragon. The research of the AREX was based on six different databases. There was ascertained that there were 154 companies which have invested capital with an origin other than Spain; of these, 108 were used for the research. The institute recognizes that more foreign-owned companies could exist but for various reasons they did not take part of the research. Some of these reasons are for example that the company was created during the research, foreign-owned companies transform into Spanish companies or visa-versa. Some of the numbers of the research of AREX are updated until the year 2005 based on an interview with Roberto Antón. Roberto Antón works at Union of Promotion and Incentives which is a part of the Instituto Aragones de Fomento (IAF) which in turn is a part of AREX. This interview was done on the nineteenth of May 2006.

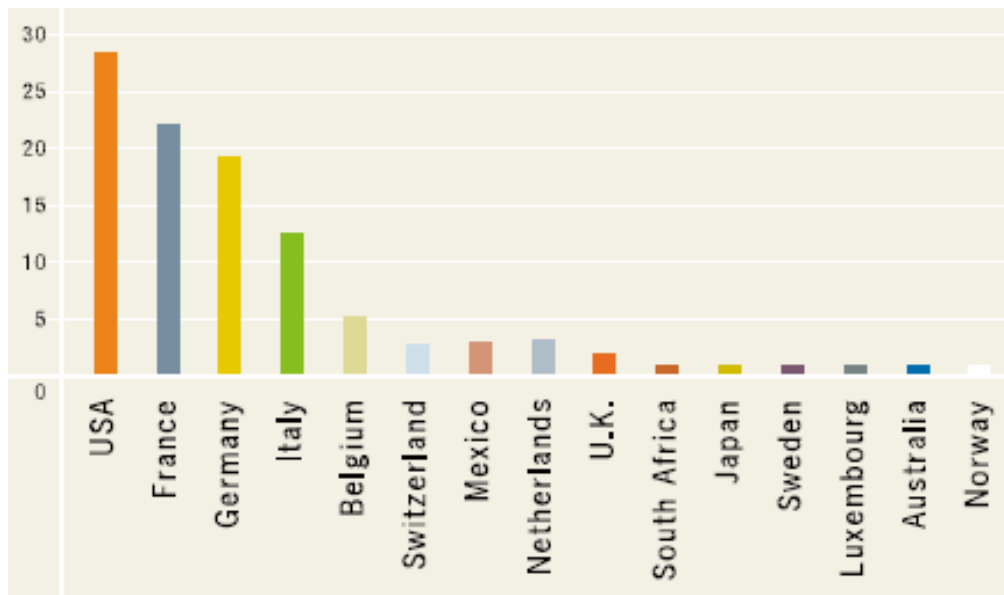
Seven of the ten companies that were the first to establish in Aragon are foreign-owned or have participation of foreign capital. This also accounts for twenty-two of the fifty companies that were first established in the Autonomous Community (AREX, 2001). The foreign invested capital in Aragon has increased rapidly in the 80's and 90's. But the contribution of foreign invested capital in the economy of Aragon knows a downward trend in the last few years. Reasons for this downwards trend is increasing competition of countries in Central and East Europe which are new members of the EU since May 2004 and the new industrializing countries in Asia, especially China. Thus this competition does not only affect Aragon but Spain as a whole as well (IAF, 2006). Despite this fall back the foreign companies are of great importance for the enterprise identity of Aragon. For example alongside the foreign-owned companies in the textile industry many local suppliers have been established. With these foreign-owned companies and local companies many jobs were created and the local economy has been significantly strengthened. According to the INVEXTA research 7.15% of all the companies, in Aragon, with twenty workers or more are foreign-owned (AREX, 2001). Furthermore in the year 2001 6.27% of the total population and 8.36% of the working population occupied jobs at foreign-owned companies (IAE, 2001). The total turnover of the foreign-owned companies in the year 2000 was more than 11 million euros. Almost 50% of this total turnover, 5.4 million euros, came from exports and 85.25% of the foreign-owned companies exported products (AREX, 2001).

According to the IVEXTA research the invested capital came from fifteen different countries and six different continents. As shown in table 8.5 most of the investments were done by countries from the EU. Of the individual countries the USA was the biggest investor in Aragon followed by France and Germany. The Netherlands shared the sixth position with Mexico and Switzerland; these countries are the origin of three investments each in the Autonomous Community (AREX, 2001).

Figure 8.5: Companies by geographic origin of invested capital in Aragon, 2001 (Source: AREX, 2001).

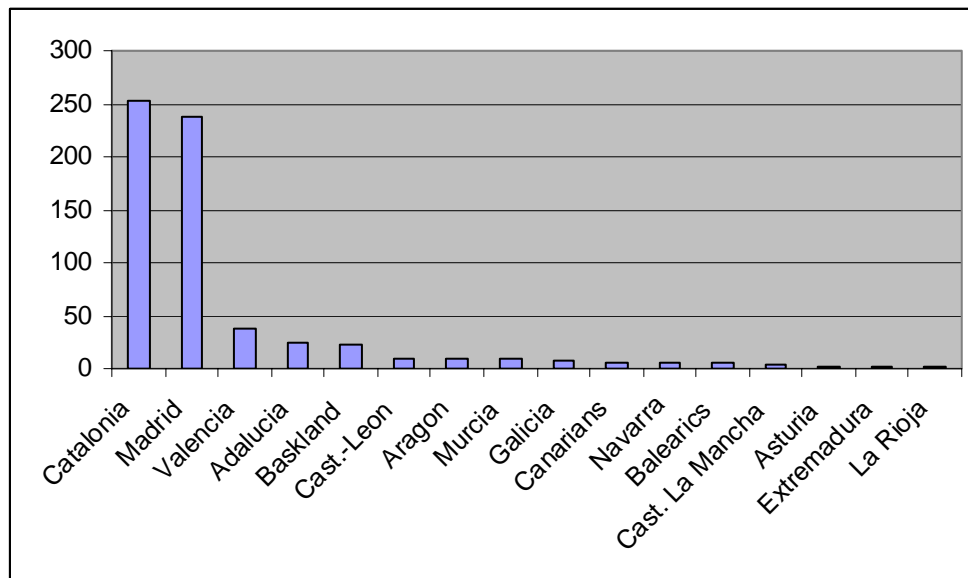
Origin	Investments	Percentage
EU	69	63.90%
USA	30	27.80%
Rest of Europe	3	2.80%
Latin America	3	2.80%
Africa	1	0.90%
Asia	1	0.90%
Oceania	1	0.90%

Figure 8.8: Multinationals in Aragon, share by country (Source: AREX, 2001).



In figure 8.9 the amount of Dutch companies per Autonomous Community in the year 2003 is displayed, based on a data-base of the Dutch Embassy in Spain. The most Dutch companies were situated in Catalonia and Madrid. The difference between these two Autonomous Communities and the rest of the Autonomous Communities of Spain are enormous. With 253 companies in Catalonia and 238 in Madrid they account for 77.69% of all the Dutch companies in Spain. Aragon is at seventh position and with 10 companies and thus accounts for 1.41% of all the Dutch companies in Spain. It is striking that the Dutch Embassy has published that there are ten Dutch companies in Aragon and according to the INVEXTA research of AREX there are only three. This last issue will be discussed in more detail in Part IV (Dutch Embassy in Spain, 2004).

Figure 8.9: Dutch companies in Spain per Autonomous Community, 2003 (Source: Dutch Embassy in Spain, Madrid, 2004).



As shown in table 8.6 the biggest amount of total turnover, more than five million was in the automotive industry and this was in the year 2000 almost half of the total turnover by foreign-owned companies. Striking is the fact that the finance industry is the second biggest industry with regards to total turnover but the percentage of companies located in Aragon is one of the lowest. Also it is remarkable that the metal and mechanic construction industry has the highest contribution of foreign-owned companies but the percentage of the total turnover is only 5.45%. The automotive, finance, food, and pharmacy and cosmetic industries account for almost 80% of the total turnover by foreign-owned companies in the Autonomous Community. Furthermore most of the established foreign-owned companies are in the metal and mechanic construction industry (21.8%) and the automotive industry (19.5%), together these two industries account for more than 40% of the foreign-owned established companies (AREX, 2001).

It has to be noticed that in the last few years there have been a lot of investments in the paper industry and that recently there has been done a big investment by an Italian company in this sector. Thus the paper industry and the contribution of foreign capital, which was relatively not important in the year 2001, has grown of relatively importance in the last five years for the economy of Aragon (IAF, 2006).

Table 8.6: Contribution of FDI per sector in Aragon, 2001 (Source: AREX, 2001).

Industry	Turnover (€ million)	% of total turnover	% of total companies
Automotive	5.269	46.96%	19.50%
Finance	1.652	14.73%	1.10%
Food	1.129	10.07%	8.00%
Pharmacy/cosmetic	0.817	7.28%	6.90%
Metal/Mechanic contr.	0.611	5.45%	21.80%
Chemical	0.374	3.34%	6.90%
Service	0.247	2.20%	4.60%
Informatics	0.241	2.14%	2.30%
Sports	0.236	2.11%	2.30%
Communications	0.174	1.55%	3.40%
Energy	0.143	1.28%	2.20%
Plastics	0.133	1.19%	5.70%
Medicine	0.108	0.96%	2.30%
Agriculture	0.071	0.63%	4.60%
Retail	0.008	0.08%	1.10%
Wood	0.003	0.03%	1.10%
Glass	Not available	Not available	1.10%
Transport	Not available	Not available	2.30%
Cement	Not available	Not available	1.10%

As you can see in figure 8.7 the USA was the biggest job supplier in Aragon among the foreign investors with 13737 workers in the year 2001. In 2001 the USA together with Germany and France supplied more than 85% of the total jobs created by foreign investors. The Netherlands were at the tenth position with 115 workers which accounted for 0.46% of the total jobs supply by foreign investors (AREX, 2001).

Table 8.7: Number of worker per origin of foreign investors, Aragon, 2001 (Source: AREX, 2001).

Countries	Number of workers	Percentage
USA	13737	54.40%
Germany	4290	16.99%
France	3664	14.51%
Italy	830	3.22%
Mexico	814	3.20%
UK	676	2.68%
Belgium	607	2.40%
South Africa	305	1.21%
Switzerland	158	0.63%
The Netherlands	115	0.46%
Japan	29	0.11%
Luxemburg	28	0.11%

8.10 Short summary

In the in the 80's and 90's the FDI in Aragon increased rapidly but the contribution of FDI in the economy of Aragon knows a downward trend in the last few years. Reasons for this is increasing competition of countries in Central and East Europe which are new members of the EU and the new industrializing countries in Asia. Aragon also has high competition of other Autonomous Communities within Spain, especially from Catalonia and Madrid. Most of the FDI in Aragon were done by countries from the EU but the USA is the biggest investor. The Netherlands do not take account for a large part of the FDI in Aragon relatively to other foreign investors. Like Spain, Aragon has various FDI relevant location factors. Among these the most important ones are: its healthy condition from an economic, social and political point of view; the growth of the GNP, in the period of 2002-2005, in Aragon was higher than the Spanish average and higher than the average of the euro-zone as well; its open and dynamic economy; it is a large gateway to the domestic and other European markets because of its strategic location; it has a large labor pool of educated and qualified workers; Aragon has good universities and R&D centers; Aragon has a world-class logistic and business parks; Aragon has a relatively low price of ground; and there are various incentives available.

Part IV

The empirical research

H9. The field study

9.1 M&T

The goal of the research is to find out the reason why the Dutch companies, which are established in Aragon, are located there and how the Autonomous Community can attract more FDI. The research is based on in-depth interviews with Dutch companies located in Aragon.

The names and addresses of these companies were obtained through two sources. The first one is the INVEXTA research of the year 2001 done by AREX, in which is written that there are three Dutch companies located in Aragon. The second source is a list of all the Dutch companies in Spain of the year 2003 composed by the Dutch Embassy in Spain. What is striking is that the list of the Dutch Embassy contains ten Dutch companies in Aragon, thus seven companies more than listed by the AREX. A logical answer for this fact is that the other companies have been established in the period 2001-2003. But what is even more striking is that the three Dutch companies that are mentioned in the INVEXTA research by AREX can not be found in the list of ten Dutch companies of the Dutch Embassy. The explanations for this are based on the interview which was held with Roberto Antón of the IAF. One company is now running under another name of another Dutch company which can be found in the list of the Dutch Embassy. The other company was taken over by an American company. The last company, although the establishment in Madrid is noted, can not be found in the list of the Dutch Embassy as vested in Aragon for unknown reasons but the company does exist in Aragon. Thus in the end in the year 2003 there were eleven Dutch companies vested in Aragon. Most of these companies were established before the INVEXTA research was done but for unknown reasons there were only three Dutch Companies noted by the AREX.

During the first approach of these companies it appeared that one company either does not exist anymore or cannot be found. Also one company claims to be vested with capital from the USA. Furthermore two have moved to another address than that of the list of the Dutch Embassy but the new addresses were found in the end. Also there was one company of which the parent-company has changed its name but this company was found in the end as well. Of the nine companies that were left five were kind enough to take the time for an interview. There were two reasons why the other four companies were not willing to cooperate. The first was that there was nobody who was able to answer the questions and the second one was that nobody had time to be interviewed.

9.2 The in-depth interviews

The in-depth interviews were split-up in two parts. In the first part contains of several kinds of questions. The first questions were general questions to recognize what kind of company was dealt with:

- *What is the core product or service of the company?*
This was asked to determine the sector, sub-sector and type of company.
- *How many employees does this establishment have?*
This was asked to indicate the size of the company.
- *When was this establishment established in Aragon?*
This was asked to determine the age of the company.

These were followed by a question to find out what kind of FDI was made:

- *Is this establishment a merger, acquisition or new facility?*
If the investment was made in the form of a new facility it is a green-field investment. If the assets and operations of companies from different countries were combined to establish a new legal entity it is a merger. Finally if the control of assets and operations is transferred from a local to a foreign company the company is an acquisition.

The following questions were asked to find out the multinational character of companies based on Van den Bulcke (1975):

- *How many establishments which are established by the same parent-company are there in the world and in how many different countries?*
To determine whether the company is multinational (MNC), multinational focused (MNFC), restricted multinational focused (RMNFC) or bi-national (BNC).
- *How many establishments which are established by the same parent-company are there in Spain?*
- *How many of these establishments were established in Spain before your company?*
These two questions were asked to find out if the parent-company had preferred other regions in Spain.

The following question was asked to determine the market considerations based growth strategy (Hakanson, 1979), which was applied by the parent-company:

- *Why is this establishment established?*
 1. *To expand product sales of existing products at existing markets?*
 2. *To expand product sales of improved and different products at existing markets?*
 3. *To expand product sales of existing products at new markets?*
 4. *To expand product sales of new products at new markets?*

Number 1 is being the market penetration strategy; number 2 is being production development strategy; number 3 is being market development strategy; and finally number 4 is being diversification strategy.

The following question was asked to determine the role which Aragón Exterior and Instituto Aragones de Fomento play in helping/assisting the companies with the establishing process and problems that are related to this process.

- *Did the company experience any problems before, during or after the establishing process?*
- *Did the company receive help/support from Aragon Exterior or Instituto Aragones de Fomento before, during or after the establishing process? In what way?*
- *Did the company use any help/support from other institutes before, during or after the establishing process?*

The second part of the in-depth interview exists of a list of location factors. The person who was interviewed was asked to judge if each of the location factors of the list were an important reason for the company to set up this establishment in Aragon. The location factors would be marked unimportant, important or very important. This was done to find out the FDI relevant location factors for the Dutch companies. Furthermore the type of FDI could be determined in this way. FDI could be market-seeking, resource/asset-seeking or efficiency-seeking.

- If the following location factors were of relevant importance it would indicate a market-seeking FDI: Market size of Aragon, per capita income and consumer preference in Aragon. Access to market of Aragon, Spanish market, European market and global market.
- If the following location factors were of relevant importance it would indicate a resource/asset-seeking FDI: The presence of suppliers of raw materials, suppliers of intermediate products, companies of the same industry and other foreign-owned companies. The presence of logistic platform (PLAZA), Walqa Technological Park, other business parks, an exhibition centre, R&D centers and the university. Presence of highways, toll-free highways, train network, a high speed train network, a port, an airport, good telecommunication system. Adequate skilled labor, low level of labor conflict, low level of accidents at the workplace, the image of Aragon, investment-facilitation services, presence of after investments services, planned EXPO 2008 and the quality of life.
- If the following location factors were of relevant importance it would indicate a efficiency-seeking FDI: costs of ground, costs usage of infrastructures, low-costs of labor, investment incentives/subsidies and costs of life.

9.3 Results

The first company which was interviewed is a company which installs and maintains wind mills in a wind-energy park at the north-west of Zaragoza. The generated energy and the related distribution and sales of this energy fall outside the core activity of the company. The office was established in 1994 and nowadays there are 33 people at work. Because it was a new facility the kind of FDI was the so-called green-field. Besides the establishment in Aragon there are no other establishments in Spain by the same parent-company. In France there is an establishment which is very comparing to the one in Spain and was established after the one in Spain. But besides the one in France there are no other foreign-establishments in the world under the same parent-company. Because the parent-company has settlements in only three countries is it a Restricted Multinational Focused Company (RMNFC). The parent-company has applied the market development strategy because the object of the establishment in Spain is to sell a product that already exists in a market that is new. There were no specific problems before, during and after the establishing process except that they had to move because the building they were vested in became too small. The company did not receive help from AREX or IAF. However the area in which they install and maintain wind mills was already marked out for the park by the government of Aragon. Of the location factors only consumer preference in Aragon was very important. The location factors that were important are: investments incentives/subsidies, the image of Aragon, adequate skilled labor. Because the location factors that were important all indicate that the investment made was resource/asset-seeking, it is obvious to say that it is of this type. What is striking is that the only factor which was very important indicates a market-seeking FDI.

The second company which was interviewed is a company which produces pharmaceutical products, surgical products and clinical solutions. The company was established in 1991 and nowadays there are about 360 workers. It was originally vested as a new facility and thus a green-field investment. It has to be noted that the parent-company merged with another company, from the United States, in 1997. But the company still runs under the name of the original parent-company, this company has only one establishment in Spain. Furthermore it has got four settlements in four different countries which make it a Restricted Multinational Focused Company (RMNFC). Because the object of the establishment in Spain is to sell a product that already exists in a market that is new the applied strategy is that of market development. There were no specific problems before, during and after the establishing process. The area where the establishment is vested was assigned to by the government of Aragon but in these years the IAF did not yet exist. The location factors that were very important for establishing in Aragon are access to European and access to global markets, the presence of suppliers of raw materials and intermediate materials, presence of R&D centers and low-cost of labor. The market size of Aragon, access to the Spanish market, cost of ground, presence of companies in the same industry, presence of toll-free highway, presence of an airport and adequate skilled labor, were important location factors. The very important location factors of establishing for this company are relatively various and this also accounts for the location factors which were important. But, with the exception of two location factors, these factors indicate a market-seeking or a resource/asset-seeking FDI.

The third company produces exhaust systems for the company OPEL España, for the models Corsa and Tigra. The company was established in Aragon in the year 1991 and has 106 workers. It was established as a new facility and thus a green-field investment. The parent-company has 31 fabrics and 27 distribution centers in about 25 countries which make it a Multinational Company (MNC) because it has settlements in more than 20 countries. In Spain there are three establishments the first one is a fabric which was established in Valencia in 1986, the second establishment was the fabric in Aragon and the ultimate establishment is a distribution centre in Madrid which opened in 1997. The parent company applied a market penetration strategy because it wanted to expand the sales of existing products in an existing market. It has to be noted that one year after they were established the company signed a contract with OPEL España and from then on has only produced for OPEL España. The company did not have major problems before or during the establishing process. However after the establishing process when the contract with OPEL España was signed it was much more efficient to move close to OPEL España. But the company did not actually move until the year 1995. The government of Aragon helped the company to find a suitable location close to the fabric of OPEL España, but this was not done by the ARES. The location factors that were very important for the establishment are the presence of suppliers of intermediate products, presence of other companies of the same industry, presence of business parks, presence of R&D centers, adequate skilled labor and low costs of labor. The location factors which were important are access to the market of Aragon and the Spanish market, cost of ground, presence of toll-free highway and train network. Of all the location factors which were very important five out of six indicate a resource/asset-seeking FDI. Although this is a bit lower, two out of five, for the important location factors it can be assumed that it is a resource/asset-seeking FDI.

The fourth company which was interviewed sells seeds of sugar beets. The establishment is a sales office and does not have seeds in store. This office was established in Aragon in 1990 and has 7 workers. It was established as a new facility and thus a green-field investment. World wide the parent-company has 12 establishments in 9 different countries and thus it is a Restricted Multinational Focused Company (RMNFC). In Spain this sales office is the only establishment. The parent-company applied market development strategy because the purpose of this establishment is to expand product sales of existing products at a new market. The company has moved from a location in the centre of Zaragoza to a nearby town because the price of the rent was significantly lower. The first location was found with help of ARES but the second and current location was found on own initiative. The location factors that were very important for establishing in Aragon are access to the market of Aragon and to the Spanish and European market also the presence of an exhibition centre. The factors that were important are access to the global market and image of Aragon. Because three of the four very important and one of the two important location factors indicate a market-seeking FDI it can be concluded that it was this type of FDI.

The fifth company which was interviewed is active in the plastic industry and produces plastic articles for domestic use and garden furniture. The establishment was opened in 1989 and nowadays has 76 workers. The establishment is a merger with another Dutch company which was vested there in the early eighties. The parent-company still has establishments in Spain running under the same name but this establishment carries the name of the company with which it had merged. The parent-company which runs under the same name has about 20 establishments in 17 different countries and thus according to Van den Bulcke (1975) it is a Multinational Focused Company (MNFC). In Spain it is the only establishment. The parent-company had applied both market development strategy and the diversification strategy because it wanted to expand product sales of existing and new products at new markets. There were no specific problems before, during and after the establishing process. Furthermore the company did not receive any help from the AREX or IAF. The location factors that were very important for establishing in Aragon are market size of Aragon, access to the market of Aragon, access to the Spanish market, presence of suppliers of intermediate products and companies in the same industry, presence of business parks and an exhibition centre, and presence of toll-free high-ways. The important location factors are cost of the ground, low cost of labor and investment incentives/subsidies. Thus there are three, of the very important location factors, that indicate a market-seeking FDI while five location factors indicate a resource/asset-seeking FDI. Furthermore all three important location factors are indicating an efficiency-seeking FDI. Because five of the eleven mentioned location factors which fall in the category very important indicate a resource/asset seeking FDI it may be concluded that it was this type of FDI.

9.4 Further interpretation

All firms that were interviewed can be found in different kind of industries thus there is no clustering among these companies in certain industries. But of all nine Dutch companies three can be found in the metal industry and six companies can be found in the industry sector taken as a whole. What is striking is that the interviewed companies were established in the early nineties respectively '94,'91,'91,'90 and '89. According to table 7.5 Spain had an inflow of FDI in the early nineties that was neither high (like the period 2000-2003) nor low (like the period 1995-1997). But, according to the INVEXTA research, Aragon had higher inwards FDI rates than ever before in the late eighties and the early nineties. The number of workers varied from 7 until 360 and thus it cannot be concluded that the interviewed companies are all small or all big companies according to the number of workers. Of the five companies four were a green-field investment and one was a merger. This is quite particular because as mentioned in Part I the mergers and acquisitions are the primary kind of FDI according to the UNCTAD (2005). But the fact that the majority of the investments are Greenfield investment is positive because they create new production capacity and have created 506 jobs. Furthermore Greenfield investments can lead to linkages to the global marketplace and transfer technology and know-how.

According to Hakanson (1979) there are four different ways or strategies in which companies can expand product sales. Three of the Dutch companies applied a market development strategy to expand the product sales. These companies expanded the product sales of existing products at new markets. One company applied the market development strategy in combination with diversification, thus also expanded the product sales of new products at new markets. Only one of the Dutch companies applied a market penetration strategy; the expansion of product sales of existing products at existing markets. The application of a particular growth strategy can occur through two different ways of growth, internal and external growth. Four of the interviewed companies grew through internal growth which refers to expansion of existing product or new products in the contemporary market, or of existing product or new products in new market areas which are created within the company. Only one Dutch company grew through external growth which refers to merging or taking over a company. The external growth is often considered to be attractive because in this case the company can benefit from the current market, linkages, labor force etc.

One of the interviewed companies has other establishments in Spain while the others do not. This particular company was also the only Multinational Company (MNC) because it has settlements in more than 20 countries. Three of the five companies and thus the majority are Restricted Multinational Focused Company (RMNFC) which means they have settlements in 3-9 countries. Four out of the five companies had applied the market development strategy this is partly related to the fact that only one company has several establishments in Spain. Because the investments were done in the early nineties the companies could not receive help or support from the IAF, besides this only one company received help or support from the AREX. In the period of establishment of the companies, the late eighties and early nineties, FDI has been increasingly efficiency-seeking investments according to the theory of chapter 3. But in contrast to the theory two of the interviewed companies are resource/asset-seeking FDI; two are either resource/asset seeking FDI or market-seeking FDI and one is a market-seeking FDI. These indicate that the motives are for an initial foreign investment.

There are seventeen location factors which none of the companies that were interviewed mentioned as a (very) important location factor. On the web-site of the AREX they have summed ten reasons why to invest in Aragon. Many of the location factors that are mentioned in these ten reasons are not mentioned during the interviews by the companies. These are the following: The presence of the PLAZA, of the university, high-ways, high-speed train network and good telecommunication system, good accessibility to the ports, low level of labor conflict, low level of accidents at the workplace, investment-facilitation services, planned EXPO 2008, good quality of life and the relatively cheap costs of life. It has to be mentioned that location factors like the high-speed train network, the planned EXPO and the presence of the PLAZA are relatively new and this may be the reason why the companies did not mention them. Location factors that were neither mentioned by AREX nor the interviewed companies are: Per capita income, presence of other foreign-owned companies and Walqa Technological Park, costs usage of infrastructure and presence of after investments services.

The strategic location of Aragon in the south of Europe is one of the major competitive advantages of Aragon. During the interviews the importance of this advantage was clear. The location factors access to the market of Aragon, the Spanish market, the European market and the world market were all mentioned as (very) important and indicate the importance of the geographical position of Aragon. Also the presence of suppliers of intermediate products and companies of the same industry many times was mentioned as (very) important. This together with the importance of business parks, which was mentioned as very important two times, indicates that there is clustering among the various industries.

9.5 Conclusion

Throughout the years Spain is getting more important as an investor in foreign countries but moreover Spain plays an important role as host country for FDI. It is shown in table 7.5 that Spain had a bigger inward flow of FDI than the outward flow from 1991 until the year 1997. In the following period from 1997 until the year 2002 the outward flow was bigger than the inward flow but in the years 2002 and 2003 it turned over again. However in the year 2004 the outward flow was once again bigger than the inward flow. According to the Banco de España the Netherlands has always been one of the nine main investing countries during the period 1992-2003 and thus of significant importance for Spain. Spain is thus an attractive country for foreign investors, especially for members of the EU and the USA. This is because of the attractive location factors that Spain has to offer. The most important attractive location factors are: its big domestic market; the easy access to the EU-market and Latin-American-market; it is the eighth-largest economy in the OECD; the broad industrial and technological base; the strong developed service sector; it is the second-biggest tourism market in the world; the excellent infrastructure; the modern transport and telecommunications networks; the labor costs below the EU average; the available development zones and incentives; the low consumption price inflation; and the relative low interest rate.

During the 80's and 90's the foreign invested capital in Aragon has increased rapidly but this was not the case in the last few years. In these last few years the foreign invested capital in Aragon has shown a downward trend. Thus unlike for Spain as a whole the contribution of foreign invested capital in the economy of Aragon becomes less and less significant. FDI should ideally contribute to the overall economic growth of Aragon due to increased exports, tax base, access to capital etc. Furthermore by increasing competition, transferring and diffusing new forms of production organization, FDI should contribute to the regional economic restructuring of the Autonomous Community. These changes then should lead to productivity improvements across the economy of Aragon. Also FDI creates jobs directly within a foreign company but it creates jobs indirectly as well, through forward and backward linkages and multiplier effects in the regional economy. For these reasons attracting FDI is of great importance and the downward trend in the last few years is concerning. The IAF explains this downward trend by increasing competition of countries in Central and East Europe which are new members of the EU since May 2004 and the new industrializing countries in Asia, especially China.

Furthermore according to the INVEXTA research there were 154 companies, in the year 2001, which have invested capital with an origin other than Spain, compared to Catalonia and Madrid this is not a lot. Also mentioned in chapter 8 is the difference between the numbers of Dutch companies in Aragon and in the Autonomous Communities Madrid and Catalonia is significant. With 253 companies in Catalonia and 238 in Madrid they account for 77.69% of all the Dutch companies in Spain in 2003, while Aragon has 10 companies and thus accounts for 1.41% of all the Dutch companies in Spain. But this difference actually is striking for all Autonomous Communities compared with Madrid and Catalonia and therefore Aragon does not have a major disadvantage compared to other Autonomous Communities. However Madrid and Catalonia have the major advantages of their size, these Autonomous Communities have the highest population density in Spain with more than fifty inhabitants per km². Besides this Madrid and Catalonia are two of the four regions in Spain which have a GNP at the level of the European average. Furthermore they have an image of a world city and therefore are big competitors for Aragon. The Spanish government is concerned with the amount of FDI that has located around the major cities of Madrid and Barcelona. The government is striving to spread investments more evenly across the country and therefore has created incentives in the form of development zones to attract investment to areas that are vastly in need of economic development. In Aragon there can be found the so-called Zonas Especiales (ZE), these are areas which are assigned by the government in special occasions. But despite the development zones Aragon still experiences heavy competition both on a national as well as on a global scale. The heavy competition is not striking but the fact that Aragon is more on the losing side of the competition is. This is striking because Aragon is one of the wealthiest regions in Spain and it has a lot attractive location factors to offer. The most important location factors are: the healthy condition from an economic, social and political point of view; the big consumer reach due to the geographical strategic location (25 million consumers within a radius of 300 kilometers); the location in the center of hexagon of important Spanish and France cities; the large pool of skilled labor force; the relatively low labor costs; an unemployment rate below Spanish average; the regional incentives; the excellent infrastructure; the good universities and R&D centers; the world-class logistic and business parks; and the relatively low price of ground.

Thus Aragon has a lot of attractive location factors to offer and the government is aware of these factors. But because nowadays attracting FDI is highly competitive and in the case of Aragon even on various levels. Having market-friendly policies and being aware of the competitive location factors is not enough to attract FDI. It requires stronger location advantages and besides this promotion is an important element. A positive point is that Aragon acknowledged its strategic geographical location and exploits this with among other things the creation of the Logistics Platform of Zaragoza and the Industrial-Logistics Platform of Teruel. Aragon is now promoting itself in a more selective way by focusing on the logistic activity. But despite this the Dutch and other foreign investors are still more attracted to Catalonia and Madrid. This means that the promotion policies are there but their effects on inwards FDI are still not sufficient. This can be explained by the poor knowledge of the foreign companies about the attractive location factors of Aragon or by the relatively inferior image.

According to McKinsey (1978), there are two groups of factors which influence the decision of investment. The first group is that of the return factors, which have a quantitative character. It is therefore important that the (potential) foreign investors are better informed and have more complete information of the advantageous return factors of Aragon. Often this information is very hard to obtain and expensive and the government of Aragon therefore has to make this information better obtainable and cheaper for potential investors. The second group of factors that influence the investment decision is that of the environmental factors. As mentioned before besides the objective value of the environmental factors a decision to invest depends as well on the perception of a company on the environmental factors. The government has to change this perception which is relatively bad compared to other regions in Spain, Europe and Asia. It is of importance that the relatively inferior image changes in a positive way to influence the perception of foreign investors.

FDI requires substantial fixed costs of identifying an efficient location, acquiring knowledge of the local regulatory environment, and coordination of suppliers. Thus if (potential) foreign investors have better and cheaper access to (more complete) information about the Autonomous Community and the perception of (potential) foreign investors on the environmental factors changes it may make FDI in Aragon more likely to occur. In this case good promotion and marketing can make a difference and therefore the current promotion and marketing policies have to be changed. Furthermore Aragon should create conditions that make investments more viable, instead of simply marketing what they already have. This may be for example creating new skills, infrastructure or support institutes.

Aragon has already created some conditions that make investments more viable. Like the Logistics Platform of Zaragoza, with 12.826.898 m² it is the largest logistics premises on the European continent. The characteristic of the PLAZA is based on an inter-modal transport centre of railways, roads, and air routes, with connections to the most relevant European production and consumer centers. Also there are collective installations and common services at the platform which multiply the profitability of its location (PLAZA, 2005). Besides this Aragon is developing the Industrial-Logistics Platform of Teruel, Walqa Technological Park and the development of infrastructures with strict dead-lines for the EXPO in 2008. Also the upcoming EXPO in 2008 is a great opportunity to create a better image and more people will get to know Zaragoza. It is important that besides the goal to attract more tourists to Zaragoza, the government will use this event to show the foreign business world what Aragon has to offer. It is expected that the EXPO in 2008 will highly stimulate the economy of Zaragoza and Aragon as a whole. But besides using this stimulating event for the promotion Aragon can also promote itself to foreign companies in a more aggressive way than the competition in order to cope with them.

This more aggressive promotion may exist of approaching foreign multinational companies which have activities that are desirable for Aragon like for example R&D activities. Also they can approach foreign multinational companies which need the location factors that Aragon can offer.

This can either be done by a governmental institute that specializes in this activity or by the AREX which already has experience in the promotion of FDI. But if the AREX will be responsible for this task it will have to make some changes. For example its INVEXTA research on foreign investment in Aragon, which dates from 2001, is not representative anymore in the year 2006. In order to present already vested or potential vesting foreign companies the activities around foreign invested capital it is important that this information is up to date. Furthermore the AREX already has a professional website where investors can find reasons why to invest in Aragon, guidelines etc. But it is important that the reasons to invest in Aragon which are put at the website match the reasons foreign companies are looking for. As mentioned before many of the location factors that are mentioned as reason to invest did not play an important role for the establishing of the Dutch companies that were interviewed. It can not be concluded that it does not play an important role for establishments in Aragon in general based on five interviews. But if this is the case, it is important to solve the mismatch between the promotion of the location factors and the demand of location factors by foreign companies. Besides creating a better image and improve information provision the government could also improve the standards of treatment of foreign investors. This can be done by granting them non-discriminatory treatment that is not been given domestic or other foreign investors. An example of this is developing new provision of targeted fiscal incentives. The Netherlands or other source countries can also cooperate and assist the government of Aragon by supplying information for potential investors, which is related to investments opportunities. This can be done for example through cooperation with investment promotion agencies.

It is mentioned before that FDI can lead to productivity improvements across the regional economy of Aragon but it is very important that the effects of FDI are not uneven distributed geographically throughout Aragon. The regional economy of Aragon already has to deal with an excessive concentration of activity around the capital city of Zaragoza and for this reason there are major economic imbalances in Aragon. It is important that the government of Aragon takes account of this uneven distribution and does not over emphasize Zaragoza in their promotion in order to prevent further polarization in the region.

Thus since the government of Aragon is already exploiting and improving its (advantageous) location factors the answer for attracting more Dutch and other Foreign Direct Investments, and therefore being able to cope with the (inter-)national competition, lies in a careful adjustment of the promotion policies. Once more foreign direct investors are attracted into Aragon, FDI policies are crucial for ensuring that FDI brings more benefits in this way the competitive position of Aragon can be further strengthened. Policies can for example induce faster upgrading of technologies and skills, secure more reinvestments of profits, raise local procurement, protect the environment and consumers etc. Furthermore they can help counter the potential dangers of FDI, for example preventing foreign companies from crowding out local companies. The most important mechanism through which the transfer of technology takes place, new jobs are created and new local companies are formed, are the linkages of foreign-owned companies with domestic companies

H10. Reflection of the research

During the research there were several complications of which the lack of information was the most common one. It has to be mentioned that for the general theoretic parts there were many interesting sources but the sources needed to compose the chapter about Aragon & Zaragoza were often incomplete or not up to date. This was especially the case with the information about FDI in Aragon. The most recent research on foreign investments in Aragon was done in 2001; this is the so-called INVEXTA research. This research was done by AREX an institution specialized in assisting foreign investors to find their way in the Autonomous Community and also the institute has responsibility for the external promotion of the companies and for attracting foreign investment. It is very particular the AREX does not keep the in 2001 already gathered information up to date. It is also very particular that the AREX mentions different number Dutch companies in Aragon than the Dutch Embassy. Also both institutes have got only information about Dutch companies which are established until the year 2003. Thus there is not one institution which publishes the recent number and data of the foreign companies in Aragon.

Because the research process was done in a foreign country it was very instructive. For some of the interviews at the Dutch companies it took a bit more effort to arrange an appointment than others. But the interviewed people of the institutions and Dutch companies were very interested and took their time for the interview. In the beginning there were some difficulties with communication. Although I already spoke quite good Spanish it was difficult to anticipate during an interview. For that reason I had postponed the interviews with the Dutch companies until the last month of my stay. The supervision, from the home and host university for executing the research was sufficient. Although a disadvantage of a research in a foreign country is that contact through e-mail about the thesis, although it was quite frequent, it is a bit more difficult than through face-to-face contact.