International trade and foreign direct investment (FDI) are the main defining features and key drivers of global value chains (GVCs). However, despite their strong complementarities, the two flows are typically presented and treated separately in the statistical information system. Drawing on new and improved measures of trade and investment, this country note provides relevant statistical information from OECD databases on trade, investment, the activities of multinational enterprises (MNEs) and global value chains (TiVA). It sheds new light on the trade-investment nexus by highlighting the interrelationships between trade and FDI, their economic impact in the context of GVCs, and the role of MNEs as the main directors of these flows. The data are as of 1 May 2017. More information and country notes are available at www.oecd.org/investment/trade-investment-gvc.htm.

According to 2014 TiVA data, over 40% of economic activity (GDP) in Iceland depends on foreign markets, relatively high for OECD countries and around the same as in Estonia and Slovenia; the importance of exports of value added to the Icelandic economy has increased since the crisis. On the investment side, Iceland is integrated in global FDI markets; its shares in OECD inward and outward direct investment are higher than its share in OECD GDP.

Gross bilateral trade figures can disguise the true nature of trade interdependencies, particularly between final consumers in one country and producers at upstream parts of the value chain. For example, gross data indicate that Germany is the main destination by far for Icelandic exports in 2014, while in fact value added data show that the United States and the United Kingdom are both more important. On the import side, Denmark moves below Germany as a supplier of the Icelandic market once value added data are used.

The top manufacturing exporting industries in Iceland are food and beverage products (FOD) and basic metals (MET), together accounting for 88% of exports in 2014. The food and beverages industry exports 85% of its value added and has a relatively low import content of exports, while the basic metals exports almost all value added and has a high import content of exports at 55%, illustrating how exports and imports can go hand in hand. The services content in Icelandic exports is 61%, above the OECD median and correlated with a relatively high share of its inward investment going to the services sector.
Trade and investment in Iceland

Growth in trade has recovered since the global and domestic crises

Like many OECD economies, Icelandic trade contracted significantly at the height of the global crisis, with imports suffering an exceptional drop. Icelandic imports had grown faster than OECD rates pre-crisis, while exports had followed OECD rates more closely. Since 2010, trade growth has recovered and in 2015 import growth was 14% and export growth 9%, among the highest rates in the OECD.

![Figure 1. Growth rates of trade and GDP for the OECD and Iceland, 2001-2016](image_url)

Source: OECD SNA

Gross exports amounted to USD 9 billion in 2016, (62 per cent of GDP), and gross imports to USD 7 billion, (54 per cent of GDP). Gross trade figures, however, overstate the ‘real’ contribution of trade to the economy. In value-added terms, exports contributed 42% per cent of total GDP in 2014, similar to recent years and significantly above the OECD median (grey diamond). The contribution of direct and indirect imports to domestic final demand measured 33% in 2014.

![Figure 2. Trade in value added terms, imports and exports, 2001-2014](image_url)

Source: OECD-WTO Trade in Value Added Data

Investment is more inward than outward

Icelandic direct investment has fluctuated since 2008, at times more inward orientated while at other points outward investment was more substantial. In 2016, the inward stock was equivalent to almost 50% of GDP while outward direct investment was equivalent to 30% (Figure 3). In 2015, Iceland’s share of the OECD total inward FDI stock (0.05%) and its share in the outward stock (0.04%) were both above its share of GDP (0.03%) (Figure 4).
...and are more export intensive than domestically owned firms

On average, foreign-owned firms in the OECD are more export intensive (share of exports in turnover) than domestically owned firms. The import intensity of foreign-owned firms (share of imports in purchases) is also typically higher for foreign-owned than domestic firms.

Domestic MNEs provide important channels to penetrate foreign markets via affiliates...

In 2015, Iceland received USD 284 million in income from its outward investment, equivalent to approximately 2% of GDP. Iceland’s rate of return at 3% (green bar) on its outward FDI is below the OECD median, but above recent values (see chart insert). On the other hand, the return to foreign investors in Iceland was 0.1% in 2015, the lowest of OECD countries.
Looking across a selection of European economies, MNEs play a significant role in GVC integration. In some countries it is through the activity of MNE parents, while for other it is foreign-owned firms. In each country with available data, at least half of all goods exports are conducted by MNEs.

Iceland’s export orientation is high relative to many OECD countries

Exports (in value added terms) contribute around 42% of Icelandic GDP; this is relatively high compared to other OECD countries but comparable with other smaller economies and may, in part, reflect high levels of inward investment supporting their GVC integration as measured by the import content of exports. Export orientation has increased strongly since the crisis (see chart insert).

Not all of the domestic value added content of exports sticks in the economy…

Gross export figures overstate the real economic impacts of trade to the exporting economy, but TiVA estimates can also overstate these impacts as the profits earned by foreign-owned firms through exports are repatriated if they are not reinvested. Figure 9 illustrates the importance of these flows across countries by showing the value added in exports of domestically-owned firms (blue bar), wages paid by foreign-owned firms (green bar), and profits of foreign-owned firms (grey bar), which in practice can be repatriated. The split cannot be calculated for Iceland due to data availability.
Taking a broader view by including the income of foreign affiliates can provide a more complete picture of the international orientation of the domestic economy

Firms serve foreign markets by exporting or by selling through their foreign affiliates. Figure 10 takes a broader view of an economy’s international orientation by taking account of both trade and investment. The chart begins with the domestic value added in exports that remains in the economy – exports of value added by domestic firms (blue bar) and wages paid by foreign-owned firms associated with exporting (grey bar) – and adds to it the profits that domestic MNEs receive from the activities of their foreign affiliates as measured by FDI income receipts (light blue bar). The income payments made to foreign parents are presented for information purposes (green bar). This broader measure cannot be calculated for Iceland due to data availability.

Source: OECD-WTO Trade in Value Added Data and OECD AMNE statistics

Taking a broader view by including the income of foreign affiliates can provide a more complete picture of the international orientation of the domestic economy

Firms serve foreign markets by exporting or by selling through their foreign affiliates. Figure 10 takes a broader view of an economy’s international orientation by taking account of both trade and investment. The chart begins with the domestic value added in exports that remains in the economy – exports of value added by domestic firms (blue bar) and wages paid by foreign-owned firms associated with exporting (grey bar) – and adds to it the profits that domestic MNEs receive from the activities of their foreign affiliates as measured by FDI income receipts (light blue bar). The income payments made to foreign parents are presented for information purposes (green bar). This broader measure cannot be calculated for Iceland due to data availability.

Source: OECD-WTO Trade in Value Added Data and OECD AMNE statistics

Source: OECD-WTO Trade in Value Added Data, OECD AMNE and OECD FDI (BMD4) statistics
This broader perspective can also shed light on how foreign firms serve the domestic market

Foreign producers supply products and services for final consumption through trade (foreign value added in domestic final demand) blue bar, and sales by foreign affiliates sold domestically (green and grey bar) (Figure 11). Foreign production can be split between labour costs and profits, the profit component of value added by foreign-owned firms can be repatriated to the parents. Due to limited data availability, the following chart cannot be reproduced for Iceland, but it is likely that foreign firms serve the Icelandic market more through trade than through investment as in other economies.

Trade and investment by partner country

Trade measured from a value added perspective better reflects the bilateral relationships

Gross bilateral trade figures can disguise the true nature of trade interdependencies, particularly between final consumers in one country and producers at upstream parts of the value chain. For example, gross data indicate that Germany is the main destination by far for Icelandic exports, while in fact, value added data show that the United States and the United Kingdom are both more important. On the import side, Denmark falls behind Germany as a supplier of the Icelandic market, and the Netherlands falls behind China, Brazil and Spain once value added data are used.

Source: OECD-WTO Trade in Value Added Data, OECD AMNE and OECD TEC statistics

Source: OECD-WTO TiVA Data
Trade and investment by industry

Together accounting for almost 90% of the exports from Iceland; food and beverage products (FOD) and basic metals (MET) are the top manufacturing industries. The import content of exports varies across these industries—illustrating the role that importing plays in supporting exports and indicating the degree of GVC integration in these industries.

Exports and imports go hand in hand…

Across industries in many OECD countries there is a strong positive correlation between higher import content of exports and a higher share of their domestic value-added being exported (export orientation) illustrating the strong complementarity of exports and imports. Although this is not as strong in Iceland, there remains a positive relationship; those industries that export more of their value added also had a higher import content of exports (Figure 16). Figure 17, foreign ownership and export orientation, and Figure 18, goods trade by ownership and industry, cannot be produced for Iceland due to data limitations.

Service industries play an important role in the export orientation of an economy…

Typically, services account for a large share of the value added in the economy but conventional gross trade statistics understate this as they cannot reveal the contribution that the upstream services industry plays in the production of goods exports. Accounting for this contribution, the services content of Iceland’s total exports of goods and services was 61% in 2014 (Figure 19), above the OECD median of 57%. Considering the services content of manufactured goods alone, over one third of manufacturing exports reflects services value added, the same as the OECD average of 36%.
…and so inward FDI in the services sector can be an important channel for export success

Greater foreign investment in the services sector is associated with higher services content in exports. For Iceland, the share of investment in services is at the higher end for OECD economies which could contribute to its relatively high services content in exports.

Figure 20. Share of services industries in foreign-owned firms’ value added and domestic services value added share of gross exports, OECD countries, 2014

Source: OECD-WTO TiVA Data and OECD AMNE statistics
*For Iceland, the share of inward FDI in services of total inward FDI is used as value added data are not available.
Annex: Further data requirements

To make this note as informative as those of other OECD countries, more detailed data about Icelandic trade and investment are needed.

Primarily, more complete data on foreign-owned firms or inward AMNE statistics at the aggregate, industry and partner country level. Data on the value added by foreign-owned firms, their labour and personnel costs and gross operating surplus would greatly enhance the extent of the analysis that could be completed in (Figures 8, 9, 10, 11, 13, 16, 17).

Secondly, data on trade by enterprise characteristics (TEC) would benefit the analysis to create the trade intensity of domestic and foreign-owned firms. Information on the domestic enterprises; whether they are domestic MNEs or domestic non-MNEs would be welcomed. These data would enable the production of Figures 5, 7, 11, 14 and 18.
### Table of industry codes

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