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Workshop on International Investment Statistics

DRAFT (first revision) –
OECD BENCHMARK DEFINITION OF FOREIGN DIRECT INVESTMENT – 4TH EDITION

Note by the Benchmark Advisory Group (BAG)

26-28 March 2007

This second revision of the Draft OECD Benchmark Definition of Foreign Direct Investment (4th edition) is circulated by the Benchmark Advisory Group (BAG) for consideration under agenda item 4.3. It incorporates the results of the October 2006 discussions and comments of the Workshop on International Investment Statistics and of the Benchmark Advisory Group.

Delegates are invited to review the document taking into account the discussion document circulated by the BAG [DAF/INV/STAT(2007)3] and the Presentation of PECD FDI statistics which incorporates the work of the project groups on Special Purpose Entities, Mergers and Acqusitions and Ultimate investing/host country.

Note to the reader: The document contains a number of brackets to indicate that these concepts are still under review/development either by OECD project groups, SNA groups or the IMF Committee. Additional comments are also included as a reminder for future review.

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– DRAFT –

OECD BENCHMARK DEFINITION OF FOREIGN DIRECT INVESTMENT

4TH EDITION[1]

March 2007

1. Foreword, preface and acknowledgements will be drafted at the time of publication.

TABLE OF CONTENTS

Boxes

ACRONYMS

AMNE	Activities of Multinational Enterprises
Benchmark Definition	OECD Benchmark Definition of Foreign Direct Investment
BPM	IMF Balance of Payments Manual
COPC	Current Operating Performance Concept
DP	Directional Principle
EUM	European Method
FDIR	Framework of direct investment relationships
FDI	Foreign Direct Investment
Globalisation Handbook	OECD Handbook on Economic Globalisation Indicators
IIC	Immediate Investing Country
IIH	Immediate Host Country
ISIC	International Standard Industry Classification
M&A	Mergers and Acquisitions
MFSM	Monetary and Financial Statistics Manual
MNE	Multinational Enterprise
MSITS	Manual on Statistics of International Trade in Services
RE	Reinvested Earnings
SIMSDI	Survey of Implementation of Methodological Standards for Direct Investment
SME	Small and Medium-size Enterprise
SNA	System of National Accounts
SPE	Special Purpose Entity
UIC	Ultimate Investing Country
UIH	Ultimate Host Country
USM	United States Method
ECB	European Central Bank
EUROSTAT	Statistical Office of the European Communities
IMF	International Monetary Fund
OECD	Organisation for Economic Co-operation and Development
UNCTAD	United Nations Conference on Trade and Development

Disclaimer:

(i) There are numerous references to SNA, BPM. When concepts are directly referenced to these or other manuals, subsequent versions, if any, should supersede the version referenced at the time of drafting.

(ii) The term "country" is used as a substitute to "economy" which is the statistical unit concept (as some economies are not sovereign countries); it does not relate to the legal definition of country.

[TO COMPLETE]

CHAPTER 1.
INTRODUCTION

1.1 Summary

1. Financial markets have evolved into a more globally integrated framework as a result of increasing liberalisation of exchange controls and market access. This integration, accelerated by increasing competition amongst market participants, has led to the introduction of new financial instruments with broad market access and lower transaction costs, attracting investors of multiple nationalities and residences. The expansion of cross-border financial flows has been further accelerated by technological innovations in communications and data processing.

2. Foreign direct investment (FDI) is a key element in this rapidly evolving international economic integration, also referred to as globalisation. FDI provides a means for creating direct, stable and long-lasting links between economies. Under the right policy environment, it can serve as an important vehicle for local enterprise development, and it may also help improve the competitive position of both the recipient ("host") and investing economy. In particular, FDI encourages the transfer of technology and know-how between economies, and it provides an opportunity for the host economy to promote its products more widely in international markets. FDI, in addition to its positive effect on the development of international trade, is an important source of capital for a range of host and home economies.

3. The significant growth of FDI in recent decades and its international pervasiveness reflect an increase in the size and in the number of individual transactions as well as the growing geographical diversification across economies and across industrial sectors. Large multinational enterprises (MNEs) are traditionally the dominant players in such cross-border capital transactions. This development coincided with an increased propensity for MNEs to participate in foreign trade. In recent years, it is believed that small and medium-size enterprises (SMEs) have also become increasingly involved in foreign direct investment.

4. Internationally harmonised, timely and reliable statistics are essential to assess trends and developments of the FDI activity to assist policy makers in dealing with the challenges of global markets. The usefulness of direct investment statistics depends on their compliance with several quality parameters: (a) alignment with international standards; (b) avoiding inconsistencies between countries and reducing global discrepancies; (c) achieving consistent statistical series over time; and (d) allowing a meaningful exchange of data between partner countries.[2]

1.2 Purpose of the Benchmark Definition

5. The *Benchmark Definition of Foreign Direct Investment* (*Benchmark Definition*)[3] sets the world standard for direct investment statistics as it is fully compatible with the underlying concepts and definitions of the *IMF Balance of Payments Manual (BPM)*. It also follows the general economic concepts set out by the *System of National Accounts (SNA)*. Within this overall framework, it is important to stress

2. See also IMF Data Quality Assessment Framework [WEB link]

3. *OECD Benchmark Definition of Foreign Direct Investment* was first issued in 1983.

that the main focus of the *Benchmark Definition* is FDI statistics encompassing direct investment positions and related direct investment financial and income flows. The *Benchmark Definition* also provides a brief overview of the methodology of closely related statistics on the Activities of Multinational Enterprises (AMNE).[4] Moreover, the *Benchmark Definition,* in terms of detail and breakdowns, goes beyond the aggregate statistics of the functional category "direct investment" of the balance of payments financial account and of the international investment position. To support these recommendations, the *Benchmark Definition* provides guidance on how to compile comprehensive breakdowns by partner country[5] and by industrial activity as well as on new breakdowns such as {mergers and acquisitions (M&As)}, {Special Purpose Entities (SPEs)}, {identification of partner country for direct investment positions by ultimate investing/host country}. By setting the global standard for FDI measurement, the *Benchmark Definition* complements the *OECD Handbook on Economic Globalisation Indicators* (*Globalisation Handbook*).

6. The *Benchmark Definition* serves several objectives. It provides:

(i) a single point of reference for foreign direct investment statistics;

(ii) clear guidance for individual countries as they develop or change their statistical systems for recording direct investment;

(iii) international standards for FDI taking into account the effects of globalisation;

(iv) the basis for economic analysis of direct investment, especially in international comparisons, to the extent that progress is made in reducing national deviations from the standard;

(v) practical guidance to users of direct investment statistics including the relations of FDI to other measures of globalisation and

(vi) an objective basis for measuring methodological differences that may exist between national statistics that need to be taken into account both for cross-country and industry analysis of FDI.

7. Since publication of the first edition of the *Benchmark Definition*, compiling countries have made important progress in revising FDI measurement systems towards greater compliance with its requirements and definitions. To measure the extent to which statistical systems have implemented the recommendations on direct investment statistics, IMF and OECD have, since 1997, conduct the Survey of Implementation of Methodological Standards for Direct Investment (SIMSDI) which also provides standardised information on data sources and collection methods, and reporting practices for national direct investment statistics. SIMSDI serves as the metadata for statistics published in the OECD *International Direct Investment Statistics Yearbook*. Moreover, it facilitates the exchange of information between reporting economies for bilateral data comparisons.[6]

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4. For a more detailed description see *Handbook on Economic Globalisation Indicators*, OECD 2005.

5. In this *Benchmark Definition* the term "country" is used as a substitute to "economy" which is the statistical concept (as some economies are not sovereign countries); it does not relate to the legal definition of country.

6. SIMSDI results are analysed in *Foreign Direct Investment Statistics: How countries measure FDI*, IMF and OECD, 2003. Results of subsequent revisions of SIMSDI are posted on IMF and OECD web sites. http://www.imf.org/bop and http://www.oecd.org/daf/simsdi

1.3 Revision of the *Benchmark Definition*

8. The removal of legal and regulatory restrictions on cross-border operations in many countries has complicated the task of statistical systems that historically depended largely on reports from national financial institutions. As economic activities become more global, investors have more and more recourse to overseas financing and may establish complex structures to obtain optimal benefits from their investments and for efficient management of the funds and related activities. These developments have had an adverse impact on the capability of traditional statistics to respond to user needs for adequate analytical information on direct investment. They have also reinforced the need for adopting a harmonised analytical framework for constructing meaningful, comprehensive and internationally comparable statistics on cross-border investments. This latest edition of the *Benchmark Definition* sets out the methodology to address those concerns.

9. Main features of the *Benchmark Definition, 4th edition* can be summarised as follows:

(i) Full consistency with the BPM concepts and definitions relating to cross-border investment positions and corresponding international financial and income flows. Consistency with broad definitions and accounting framework of the SNA;

(ii) Clarification of certain recommendations of the *Benchmark Definition 3rd edition* with a view to eliminating possible misinterpretations by national compilers which may lead to deviations from standards;

(iii) Preserving a reasonable degree of continuity in national statistical systems by making relatively few changes to fundamental recommendations of the *Benchmark Definition, 3rd edition* (see Annex 1 for more details);

(iv) Introduction of new concepts and breakdowns driven by user requirements to analyse direct investment in the context of globalisation;

(v) Providing new sections devoted to uses of FDI statistics and to FDI globalisation indicators;

(vi) Introduction of an FDI glossary; and

(vii) Transparent revision process and close co-operation with national and international experts and the establishment of a future research agenda for developmental work to advance methodological issues which remain unresolved at the time of publication (see Annex 13 for more details).

1.4 An overview of direct investment concepts

10. Direct investment is a category of cross-border investment made by a resident in one economy (the *direct investor*) with the objective of establishing a lasting interest in an enterprise resident in an economy other than that of the investor (the *direct investment enterprise*). The motivation of the direct investor is a strategic long-term relationship between the direct investment and the enterprise which allows a significant degree of influence by the direct investor in the management of the direct investment enterprise. The "lasting interest" is evidenced when the direct investor owns at least 10 per cent of the voting power of the direct investment enterprise. Direct investment may also allow the direct investor to gain access to the economy of the direct investment enterprise which it might otherwise be unable to do. The objectives of direct investment are hence different from those of portfolio investment as portfolio investors do not expect to influence the management of the enterprise. [LAST SENTENCE TO BE REVIEWED]

11. Direct investment enterprises may be either controlled or non-controlled affiliates (subsidiaries, associates or quasi-corporations-including branches) of direct investors. The relationship the direct investor and its direct investment enterprises may be complex and bear little or no relationship to management structures. Direct investment relationships are identified according to the criteria of the Framework of Direct Investment Relationships (FDIR)[7] including both direct and indirect relationships.

12. Direct investment statistics cover all cross-border transactions between enterprises which are a part of the same international group as defined in the FDIR. According to the standard presentation, FDI statistics include direct investment positions (equity and debt), direct investment income (distributed earnings, reinvested earnings, interest income) and direct investment financial flows (equity and debt) and other changes (price changes, changes arising from movements in foreign currency and changes in volumes). Market value is the preferred conceptual basis to measure both direct investment positions and flows.

13. Direct investment statistics are presented with a geographical breakdown, the allocation being by partner country using the *debtor/creditor* principle. It is recommended that the geographic allocation be on the basis of immediate counterpart (host or investing) country for both direct investment flows and positions. Nevertheless, it is also recommended that direct investment positions be also presented {on a supplemental basis} for ultimate host/investing country.

14. Direct investment statistics are disaggregated by major industrial activity based on International Standard Industrial Classification, 4th revision (ISIC4), in priority according to the activity of the direct investment enterprise (in the home economy for inward investments and in the host economy for outward investments).

15. Cross-border positions/transactions involving pass-through capital (also referred to as "capital in transit") via structures put in place to facilitate the financing of investment for multinational enterprises are included in direct investment as they are integral parts of the direct investment relationship identified according to the FDIR. {{Nevertheless, since these transactions, mostly transited through SPEs, may distort the analysis of gross direct investment positions/transactions, countries should also compile {on a supplemental basis} direct investment statistics {excluding SPEs}.}} These statistics should be broken down geographically, by country of counterpart, and by industry classification to facilitate the economic analysis of direct investment. {{Acknowledging that there is no single definition of SPEs, the *Benchmark Definition* recommends that these supplemental data be developed based on national definitions of SPEs.}}

16. {{Moreover, considering user needs for information on the type of FDI which provide an interesting dimension for economic analysis, {supplemental} additional breakdowns should be provided for mergers and acquisitions (M&A) as a sub-category of direct investment transactions classified by partner economy and industry. }}

1.5 Organisation of the *Benchmark Definition*

17. In providing guidance to national compilers and users of FDI statistics, the *Benchmark Definition* recommends harmonised standards to measure direct investment and proposes practical solutions to compilation problems. Where appropriate, concrete examples are provided in annexes to demonstrate or supplement the recommendations described in various sections of the main text. The section devoted to the use of statistics on direct investment supplements FDI statistics published regularly by the OECD in the *International Direct Investment Statistics Yearbook*, *International Investment Perspectives* and quarterly statistical releases on the OECD web site. The FDI glossary, introduced for the first time in this edition of

7. Referred to as the "Fully Consolidated System (FCS)" in earlier editions of the *Benchmark Definition.*

the *Benchmark Definition* is intended to assist both the compilers and users of direct investment statistics. The topics addressed in the remaining chapters are:

Chapter 2: Uses of FDI statistics

Chapter 3: Main concepts and definitions

Chapter 4: Scope of FDI

Chapter 5: Measuring FDI

Chapter 6: Special entities

Chapter 7: Country attribution and industry classification

Chapter 8: FDI and Globalisation

Further details are provided in the Annexes, Bibliography, Glossary, and Index.

CHAPTER 2.
USES OF FDI STATISTICS

[THIS CHAPTER WILL BE FURTHER AMENDED AND EXPANDED IN THE LIGHT OF NEW CONCEPTUAL WORK BY PROJECT GROUPS ON SPEs, M&AS, UIC/UHC AND THE CONCLUSIONS OF WIIS]

2.1 Summary

18. This edition of the *Benchmark Definition* includes for the first time a chapter devoted to the uses of FDI statistics to assist users in their analysis of FDI statistics. As economies become more and more global, methodologies need to be adapted to new realities, hence maintaining the analytical quality of the statistics. Keeping in mind that this *Benchmark Definition* attaches high priority to user needs, a chapter on the uses of FDI statistics should prove very valuable for a wide range of users. The concepts described are rather from the point of view of users than of compilers and the terminology is more analytical than technical.

19. In summary, this chapter reviews the underlying reasons for measuring FDI and its importance in the global economy. This section is followed by a brief description of the main features of FDI statistics and their interpretation. A list of frequently asked user questions is also provided in Text-box 1.

2.2 Why measure FDI?

20. Deregulation of markets, technological innovations and cheaper communication has allowed investors to diversify further their participation in overseas competitive markets. In consequence, a significant increase in cross-border capital movements including direct investment has become a key factor in international economic integration, more generally referred to as globalisation.

21. By the very nature of its motivation, FDI promotes stable and long-lasting economic links between countries through direct access to production units of the host country. It assists host countries in developing local enterprises, promotes international trade through access to markets and promotes the transfer of technology and know-how. In addition to its direct effects, FDI has an impact on the development of labour and financial markets, and influences indirectly other aspect of economic performance through spillovers. The measurement of FDI however has to rely on clear and unambiguous rules. In the context of more complex structures of enterprise groups, these results may not always allow the identification of the investment bearing these features from other types of inter-company investments not having these effects (see section 2.4. Interpreting FDI data series).

22. The analysis of direct investment trends and developments is an integral part of most macro-economic and cross-border financial analysis. As explained in Chapter 8: FDI and globalisation, a number of indicators based on direct investment statistics facilitate the measurement of the extent and the impact of globalisation. Nevertheless, there is a need to go one step further and to complete the analysis by using other economic indicators to complement direct investment financial and income flows and positions. These are mostly the statistics on the activities of multinational enterprises discussed in Chapter 8 and elaborated in the OECD *Handbook on Economic Globalisation Indicators*.

23. In response to such analytical needs, the preparation of the 4^{th} *edition of the Benchmark Definition* was strongly influenced by two concerns:

(i) maintaining consistency with the broad concepts and definitions of balance of payments statistics and international investment position; and

(ii) developing new statistical methodologies to bring direct investment statistics into line with financial and economic developments as well as with new statistical frameworks such as the statistics on the Activities of MNEs.

24. {{The complexity of operational and managerial structures of MNEs, are such that the some of the new data breakdowns (point ii) could not be completed before the publication of the current edition of the *Benchmark Definition*. As a consequence, it was agreed to publish the remaining results as a supplement in the near future (as described in Annex 13: Research agenda). The present edition provides the elements of underlying concepts to:

- identifying direct investment transactions in the form of mergers and acquisitions;
- distinguishing direct investment excluding SPEs; and
- classifying FDI positions in respect of ultimate investing/host country.}}

2.3 Understanding main features of FDI

25. It is useful to first describe the role of direct investment within overall economic accounts of a country, then within the balance of payments and international investment positions framework and, finally, with that of the statistics on the activities of multinational enterprises.

(i) *National financial accounts and flows of funds accounts* (in the SNA) record the overall stocks of financing and the corresponding flows between the economic units of a country and with the rest of the world, i.e. with non-resident units which enter into transactions with resident units or have economic links with them. Foreign direct investment relates to one of the categories of cross-border financing of enterprises (see SNA for more details).

(ii) Direct investment is one of the five functional categories of the *financial account* of the balance of payments and the corresponding international investment statements. Direct investment income is a sub-item of investment income of the current account. Data for balance of payments and international investment positions are presented as broad aggregates for main sub-components of these accounts. (see IMF BPM for more details)

(iii) Conceptually, the population of enterprises covered by the statistics on the activities of MNES is a sub-category of the enterprises covered by FDI statistics: the former relates to control, while the latter is based on ownership and influence (i.e. a larger population of enterprises). Further breakdowns of FDI are necessary to achieve a sound analysis when using the two data sets (see also Chapter 8: FDI and Globalisation).

26. Direct investment is defined as "a category of cross-border investment made by a resident entity in one economy (the *direct investor*) with the objective of establishing a lasting interest[8] in an enterprise resident in an economy other than that of the investor (the *direct investment enterprise*)" (see Chapter 3). The main motivation of the direct investor is to establish influence over the management of its direct investment enterprise(s) without necessarily exercising a controlling interest. However, in many, if not most cases, the influence will be strong enough that the direct investor will control the direct investment enterprise. This motivation is the underlying factor that differentiates direct investment from cross-border portfolio investments where the investor's focus is mostly on income resulting from the acquisition and sales of shares and other securities without expecting to influence the management of the assets underlying these investments. Direct investment relationships lead to long-term and steady financing and technological transfers with the objective of maximising production and the earnings of the multinational enterprise over time.

27. It has been argued that in practice there are several factors which impact influence a direct investor has over the direct investment enterprise. However, for the sake of consistency and for comparability, a strict application of a numerical guideline is recommended to identify direct investment. Accordingly, direct investment is considered evident when the direct investor owns at least 10 per cent of the voting power of the direct investment enterprise. In other words, the 10 per cent threshold is the criterion to determine whether (or not) a direct investor has influence over the management of an enterprise, and, therefore, whether direct investment exists or not.

28. Multinational enterprises often have complex group structures including a number of direct investors and direct investment enterprises. For example, a direct investor could be the ultimate parent or the intermediate parent. This implies that a direct investment enterprise may itself be a direct investor. Direct investment enterprises can take many different legal forms but are all corporations (incorporated enterprises) or quasi-corporations (unincorporated enterprises operating separately from their owners and have, or can readily construct, a separate set of financial accounts). An incorporated enterprise is either a *subsidiary* (if it is more than 50 per cent owned by its immediate direct investor) or an *associate* (if it is between 10 to 50 per cent owned by its immediate direct investor).

29. A direct investment enterprise may become an investor in its direct investor. Such investment may consist of equity or debt but the extent of any equity investment dictates the appropriate recording basis for the investment. Where there is no equity investment in the direct investor or where the equity investment amounts to less than 10 per cent of the direct investor's voting equity, all the investment made is referred to as *reverse investment* and is recorded as such appropriate under *equity* or *debt* (see also Chapter 4). Where a direct investment enterprise holds 10 per cent or more of the voting equity of its direct investor, such investment and any associated or additional debt investment into the direct investor is regarded as separate direct investment in its own right and is recorded as appropriate under *equity* or *debt*.

30. Direct investment also covers investment positions, financial transactions and associated income flows between enterprises which, although related through a direct investment relationship (see *Framework*

8. There may be instances where non-resident investor, or investors acting in concert, acquire a resident enterprise (in whole or in part), with a view to asset stripping, or restructuring and then reselling the entity. The relationship between the investor(s) and the enterprise may not be "long lasting" but the direct investor's(s') influence will have a lasting effect. Indeed, in some instances, such purchasers could have no intention of retaining their equity holding for a year but they could have a profound impact on the entity. Private equity buy out funds and companies specialize in this type of short-term ownership (though they may, in many cases, hold their investments for longer than one year), but such investment is not necessarily restricted to these types of investors.

of Direct Investment Relationship in Section 3.7), are not linked through a direct investor/direct investment enterprise relationship. Any investment between such enterprises is recorded as appropriate under *equity* or *debt* as described in Chapter 4.

31. Direct investment statistics embody three distinct statistical accounts:

(i) *Direct investment positions* [stocks of investment]; provide for a given reference date information on the total stock of investment made by an investing country abroad or investment received at a given point in time. Yearly data are usually reported at the end of the calendar year which, in most countries, is the same as the fiscal year. These data allow a structural analysis of investments. Due to the accumulation of earlier investments over time, in general stock data allow the dissemination of more detailed estimates as they are less likely to identify individual positions subject to confidentiality;

(ii) *Direct investment financial transactions* show the net inward and outward investments with assets (acquisitions less disposals/redemptions) and liabilities (incurrence less discharges) presented separately by instrument in any given reference period, e.g. a calendar year or a quarter;

(iii) *Direct investment income* provides information on the earnings of direct investors and of the direct investment enterprises. Direct investment earnings arise from (a) equity, i.e. essentially the profits generated by the enterprise and consisting of distributed earnings (dividends) from equity invested in an enterprise and reinvestment of earnings in that enterprise; and (b) from debt, i.e. interest from inter-company loans, trade credits and other forms of debt). The concept of income is closely related to direct investment positions as it is the size of the overall investment that produces the income, not just the most recent transactions. Income relates to recent performance and allows short-term analysis of investment activity

32. Direct investment financial flows and positions comprise mainly three types of financing: (i) acquisition or disposal of equity capital; (ii) reinvestment of earnings which are not distributed as dividends; and (iii) inter-company debt (payables and receivables, loans, debt securities). Changes in FDI positions other than those due to transactions, such as changes due to exchange rate changes as well as other price changes resulting from holding gains or losses and other changes in volume are not included in financial flows. On the other hand reclassification from portfolio investment are reflected in both FDI flows and positions (e.g. when a direct investor acquires additional equity bringing the overall investment to more than 10 per cent of equity stocks, investment is reclassified from portfolio investment to direct investment as described in Chapter 4: FDI components, accounts and scope).

33. FDI aggregates as a part of macro-economic statistics are based on asset/liability principle. They are consistent with balance of payments statistics and international investment positions as well as national accounts statistics. However, these data do not provide the most appropriate basis for partner country and by industry analysis.

34. FDI statistics compiled according to the directional principle, outward investments and inward investments, include investments by direct investors as well as reverse investments and investment between affiliated enterprises identified according to the Framework of Direct Investment Relationship (see Chapter 3). More specifically, from the point of view of a reporting country (RC)

Outward investment = Investments by direct investors of the RC in direct investment enterprises abroad

-

Reverse investment(s) by direct investment enterprise(s) in the RC in their direct investor(s) abroad

+

Investments by direct investment enterprises in the RC in other affiliated enterprises abroad

Similarly, FDI liabilities (inward investments) include obligations by direct investment enterprises to their direct investors as well as reverse investments and investment in related affiliated enterprises identified according to the Framework of Direct Investment Relationship (see Section 3.5). From the point of view of a reporting country (RC), these liabilities are as follows.

Inward investment = Investment by direct investor(s) from abroad in direct investment enterprises in the RC

-

Reverse investment(s) by direct investment enterprise abroad in their direct investors in the RC

+

Investments by affiliated abroad in affiliated enterprises in the RC

35. Direct investment assets and liabilities should be measured according to market value. Where direct investment enterprises are not listed on a stock exchange, their value is, in principle, estimated as a proxy to market value. There are various methods for such estimates. In practice, methods of valuation to estimate market value still remain an area for improvement for international consistency of FDI statistics.

2.4 Interpreting FDI data series[9]

36. Direct investment statistics described in this *Benchmark Definition* apply the same basic criteria as the BPM. However, they offer different analytical products. The *Benchmark Definition* recommends two breakdowns for the core accounts along with additional {supplemental} breakdowns in response to user needs. It must be acknowledged that, in addressing the extended detail requested, compilers may face data confidentiality problems and may have to report the data at an appropriate higher level of aggregation (e.g. for the region rather than for the country).

37. The first main breakdown specified by the *Benchmark Definition* requires that direct investment statistics be classified geographically for both outward and inward investments including the associated income data. Such classifications should be according to the immediate partner (see the allocation methods described in Chapter 7). These series provide the geographical distribution of investment and would be useful in any comparative analysis on the attractiveness of a country or a group of countries.

38. However, this methodology is being questioned to a greater extent due to the increasing use of complex organisations of multinational enterprises and the intermediary entities they use to finance or

9. Detailed direct investment statistics are published annually in the *OECD International Investment Statistics Yearbook* and an analysis of recent trends and developments is included in the annual *OECD International Investment Perspectives*.

manage their investments. A direct investor in country A may wish to invest in country C but may do so through its holding company in country B. This simple example demonstrates how sources and destination of investment based on such FDI series may be influenced through indirect routing and, in consequence, distort the relevant economic analysis. Massive investment flows into and out of a country may not be of primary interest to analysts of direct investment if they reflect merely a pass-through of funds. Therefore, users seeking to analyse the economic impact of FDI currently often have to focus on net investment flows. They might preferably wish to analyse {investment flows excluding SPEs}.

39. The second core classification of the *Benchmark Definition* is the *industry classification (based on ISIC4)* which provides a very useful analytical tool. Statistics should be based on the predominant local industrial activity of the direct investment enterprise. In other words, for outward investment, data should be according to the industry of the direct investment enterprise abroad and for inward investment they should reflect the industry of the direct investment enterprise in the reporting country. Deviations from this principle will distort international comparison of industries that are recipients of direct investment. As a {supplemental} series, it is also recommended that the data according to the industry of the direct investor be provided to show as to which sectors of industry are engaged in direct investment. { It is also recommended that users focus on direct investment excluding SPEs for analysing some transactions and positions related to FDI.}

40. A breakdown which is of utmost interest, particularly for structural analysis, is the cross-classification of the data breakdowns by partner country and industry. Recognising the possible confidentiality issues involved, the *Benchmark Definition* recommends the use of more aggregate Top-top classification based on ISIC4 for these data.

41. {{Reference was made in previous paragraphs to direct investment excluding SPEs. Despite their supplemental nature, these data are considered by most analysts to more closely approximate[10] "genuine FDI". While they shed valuable light on direct investment for directly productive purposes, they do not provide information on the transactions involved in routing of the funds. }}

42. {Optional} series on mergers and acquisitions as a sub-category may be of substantial interest for analysts. Generally speaking M&As relate to existing company structures taken over fully or partially by other entities. In the context of public debate, a sharp distinction is often drawn between "greenfield" investment, providing fresh capital and additional jobs, and M&As that are perceived to include only a change of ownership in an existing corporate entity. The distinction is problematic while the acquisition of existing enterprises can provide important economic benefits. The separate treatment of M&A is part of a political reality to which investment analysts have to respond – and in light of the present debate about "strategic sectors", "national champions", etc. the need is likely to grow.

10. SPEs are not the only entities that act as vehicles for "pass through finance". Nonetheless, {{identification of SPEs should assist analysis of "genuine" direct investment.}}

Box 1. Frequently asked user questions

1) What is the relation between FDI transactions, positions (stocks) and income?

FDI financial transactions refer to those cross-border transactions which qualify as direct investments recorded during the reference period (year, quarter, or month). FDI positions represent the value of the stock of direct investments held at the end of the reference period (year, quarter, or month). Direct investment positions are affected not only by financial transactions recorded during the period but also by other changes in price, exchange rates, and volume. FDI income data are linked to the stocks of investments, are used for analysis of the productiveness of the investment, and are also used as part of the calculation of the rate of return on the total funds invested. (see also Chapter 4 and Chapter 8)

2) How to interpret negative values for FDI flows and positions?

Negative values in transactions may indicate disinvestment. In case of equity, the direct investor may sell all or parts of the equity held in the direct investment enterprise to a third party; or the direct investment enterprise may buy back its shares from the direct investor thereby reducing or eliminating its associated liability. If the financial movement is in debt instruments between the direct investor and the direct investment enterprise, it may be due to the advance and redemption of inter-company loans or movements in short term trade credit. Negative reinvested earnings indicate that, for the reference period under review, the dividends paid out by the direct investment enterprise are higher than current income recorded or that the direct investment enterprise is operating at a loss.

The changes in FDI positions are affected by the accumulated flows and hence may also result in negative values, but mainly for other capital (e.g. when the loans from the affiliate to the parent exceed the loans – or even the original capital- given by the parent to the affiliate. This could be the case where conduits or treasury companies are involved).

3) Why are there such large revisions in the FDI data?

The analysis of direct investment trends and developments is an integral part of many macro-economic and cross-border financial analyses. In order to serve users requiring timely data, the compilers of FDI data make initial estimates for some components on preliminary information available at that time. It is especially difficult to have timely and at the same time complete data on the accrued income when the results are first published, as these values are only known once the direct investment enterprise has closed its books and the current operating income and earnings distributions have been determined for the reference period.

Consequently, when more complete data are provided for the reference period, data compilers revise the estimates for the previous periods.

4) What are the criteria for the classification of FDI by economic activity: according to the activity of the resident parent company or that of the non-resident affiliate?

The recommendation is to provide inward and outward FDI data on the basis of the activity of both the resident and the non-resident enterprise. However, if this is not feasible, it is recommended to compile the data in priority according to the activity of the direct investment enterprise, for both inward and outward investments (i.e. economic activity of the resident direct investment enterprise for inward investment and that of the non-resident direct investment enterprise for outward investment).

5) Why are large FDI transactions concentrated in particular countries – i.e. what is the role of capital in transit and/or passing through Special Purpose Entities?

{{For the purposes of the international accounts, a country must record all inward and outward direct investments, including the large amounts of capital in transit, passing through special entities in off –shore centres, e.g. for tax purposes. However, the provision of {supplementary} data excluding the capital in transit passing via these special entities {UIC/UHC, 'of which SPEs'} is recommended (TO BE COMPLETED ONCE THE WORK OF THE PROJECT GROUP IS FINISHED) }}

6) How complementary are FDI statistics and the statistics on the Activities of Multinational Enterprises (AMNE)?

The statistics on direct investments include cross-border investments made with the objective of establishing a lasting interest to exercise an influence in the management of the direct investment enterprise (the target entity)) which is evidenced by the ownership of at least 10 per cent of the voting power by the direct investor. Control by the direct investor of the direct investment enterprise is not obligatory. The Framework for Direct Investment Relationship establishes the relationship between direct investors and their direct investment enterprises. FDI statistics only record the financial value of the investments; the geographical attribution is based on the debtor/creditor principle, the allocation being made on the basis of the immediate first investor of the resident direct investment enterprise or conversely, on the residency of the first foreign affiliate of the resident direct investor. {TO BE REVIEWED}}

The statistics on AMNE (also referred to as FATS) cover affiliates which are *controlled* by an enterprise residing in another economy. *The OECD Handbook on Economic Globalisation Indicators* recommends that AMNE statistics cover the majority owned affiliates. AMNE data cover a sub-set of the entities involved in FDI but include the full value of positions and transactions of the MNE and not just the value of the investment by the direct investor. The AMNE present detailed data on the foreign affiliates, e.g. on the employment, turnover, value added, etc. In addition, the geographical attribution of the units is based on the ultimate investing country (for inward investment) or the ultimate hosting country (for the outwards data). (See Chapter 8 for more details).

In theory FDI and AMNE statistics are very closely related and, therefore, complementary. However, methodologies applied to current statistics represent divergence and render difficult the analysis of financial and income flows and positions along with the economic impact of the AMNEs.

7) Why are there discrepancies (sometimes significant) in the data provided by international organisations?

Several International organisations compile and disseminate FDI data are: the OECD, Eurostat, the ECB, IMF, and UNCTAD. FDI statistics of OECD and Eurostat are essentially based on a common framework for reporting detailed FDI statistics. IMF and ECB compile and disseminate FDI as a functional category of balance of payment, i.e. total aggregates. The data released by the OECD and Eurostat are generally very consistent, as the same data framework is used. Data regarding the Euro-zone is consistent between Eurostat and the ECB. OECD and IMF research demonstrated that the main differences between their FDI statistics are largely due to the timing of revisions. UNCTAD data are in a number of cases different due to adjustments [TO BE VERIFIED MORE CAREFULLY]

CHAPTER 3.
MAIN CONCEPTS AND DEFINITIONS

3.1 Summary

43. This chapter provides an overview of statistical units and the framework for the direct investment relationship (FDIR). Rigorous application of these fundamental aspects is pivotal to the implementation of the FDI concepts and recommendations described in this *Benchmark Definition*. It is also important for the interpretation and the use of FDI statistics. Definitions of statistical units which underpin the concepts and treatment of FDI are in line with the general principles adopted in the SNA and the BPM and, therefore, consistent with the concepts and definitions underlying most macro-economic statistics.

44. The first section which describes statistical units has mainly two purposes. First of all it identifies the economic territory to be covered by the FDI statistics and highlights its main features. Secondly, it describes the economic agents that are involved in direct investment, including a clarification of some special cases representing non-standard features, and stresses the importance of the institutional sectors making up the economy even though this *Benchmark Definition* does not recommend data presentations of FDI statistics according to institutional sector.

45. Thereafter, the FDI universe is described more specifically on the basis of statistical units. The concept of direct investment, direct investor, direct investment enterprise and the relationships between the various units based on the Framework for Direct Investment Relationship are described in detail.

3.2 Statistical units

3.2.1 Economic territory and the concept of residence[11]

46. The concept of residence is a fundamental factor for direct investment statistics which measure cross-border investments between residents of two or more economic territories. Foreign direct investment involves transactions/positions between a resident and a non-resident institutional unit but excludes all transactions/positions between two units that are residents of the same economy, unless they are a part of the same enterprise group and therefore covered by the FDIR. [SEE DISCUSSION IN DOCUMENT DAF/INV/STAT(2007)7]

47. The concept of residence in the *Benchmark Definition* is identical to that adopted by the SNA and the BPM. The residence of an economic entity (or an institutional unit) is determined on the basis of the *economic territory* with which it has the strongest connection determined by its *predominant centre of economic interest*. Each institutional unit is a resident of a single economic territory. While some units may have connections with more than one economy, for statistical consistency, there is a need to attribute a single economic territory based on objective and comprehensive criteria.

48. An *economy* consists of all the institutional units that are resident in its territory. Even though there is close correspondence, the statistical definition of the *economic territory* (or the economy) is not

11. For a more detailed discussion of these broad statistical concepts, see IMF BPM.

identical to the concept of a country or to any other legal definition (such as nationality). In many cases, but not always, a country indeed constitutes the economic territory. The relationship between an institutional unit and the economic territory is determined by aspects such as physical presence and being subject to the jurisdiction of the government of the territory. In this *Benchmark Definition*, the term "country" is used as a substitute to "economic territory" but not according to any legal framework.

49. Economic territory has the dimensions of physical location as well as legal jurisdiction. In other words, the definition relates to the geographic area over which the government has jurisdiction including some legal entities that have little or no physical dimension but which are under its legal jurisdiction. With regard to its composition, an economic territory or economy consists of all the institutional units that are resident in that territory. The concepts of economic territory and residence are designed to ensure that each institutional unit is a resident of one and only one economic territory.

Box 2. The *economic territory*[12]

The *economic territory* includes the following:

(i) Land area, airspace, territorial waters, and any continental shelf lying in international waters including jurisdiction over fishing rights and rights to fuel or minerals. In a maritime territory the economic territory includes islands that belong to the territory (BPM 4.6)

(ii) Clearly demarcated territorial enclaves that are located in the rest of the world and are established with the formal political agreement of governments of the territories where the land areas are physically located. Such enclaves are used by governments that own or rent them for diplomatic military, scientific or other purposes;

(iii) Territorial enclaves used by foreign governments and physically located within a territory's geographical boundaries are not included in that economic territory but included in the territory of the governments that use them.

(iv) When a government has a separate physical or legal zone that is under its control, but to which, to some degree, separate laws are applied (e.g. off-shore financial centres), these special zones should not be omitted from the economic statistics of the territory.

(v) In cases of disputed zones, effective economic control may be unclear. In such cases, compilers make a decision on the inclusion or exclusion of the zone based on circumstances and preferably include a description in the metadata.

(vi) In addition to economic territories under the effective control of a single government, the economic territory of a currency or economic union is also considered as a type of economic territory.

Source BPM: chapter 4 [TO BE VERIFIED FOR CONSISTENCY]

12. The importance of economic territories described under (iii) and (iv) relates to the fact that they reflect the usual scope of macroeconomic policymaking.

3.2.1.1 Predominant centre of economic interest

50. An institutional unit is considered to have a *predominant centre of economic interest* in an economic territory:

(i) when there exists, within the economic territory, some location, dwelling, place of production, or other premises in which or from which the unit engages and intends to continue engaging, either indefinitely or over a finite but long period of time, in economic activities and transactions on a significant scale;

(ii) if the location is not fixed but remains within the economic territory;

(iii) if the unit has already engaged in economic activities and transactions on a significant scale in the territory for one year or more, or if the unit intends to do so. The choice of one year as a specific period is somewhat arbitrary, but is applied to avoid uncertainty and to facilitate international statistical consistency;

(iv) While actual or intended physical presence for a year or more is the main criterion, other criteria apply in some special cases such as corporations with little or no physical presence or individuals that move so that they do not stay in any territory for more than a year.

51. There are cases where the institutional unit has little or no physical presence in a territory. This arises with some categories of special purpose entities (SPEs) and similar units. Some cases of restructuring or outsourcing could also result in residual units with little or no physical presence. Moreover, these units might not undertake significant production. In such cases, the jurisdiction where the unit has its legal domicile and/or which regulates its activities is considered to be that unit's predominant centre of economic interest while location and production criteria may not be meaningful.

Box 3. SNA: Classification of Institutional Units[13]

The definition of Institutional units covered in this *Benchmark Definition* is fully in line with the concept of the SNA (1993 and subsequent updates) whereby an institutional unit *is an economic entity that is capable, in its own right, of owning assets, incurring liabilities and engaging in economic activities and in transactions with other entities*. [SNA: Para 4.2] Accordingly, an institutional unit has four main attributes:

(i) It is entitled to own goods or assets in its own right and exchange their ownership with other institutional units;

(ii) It has the ability to take economic decisions and engage in economic activities for which it is itself held to be directly responsible and accountable at law;

(iii) It is able to incur liabilities on its own behalf, to take on other obligations or future commitments and to enter into contracts; and

(iv) It either has a complete set of accounts, including a balance sheet of assets and liabilities, or it would be possible and meaningful, both from an economic and legal point of view, to compile a complete set of accounts if they were to be required.

As classified by the SNA, there are basically two types of institutional units:

(a) ***Households*** are defined in the *SNA* as a small group of persons who share the same living accommodation, who pool some, or all, of their income and wealth and who consume certain types of goods and services collectively, mainly housing and food. …... (*SNA93* §4.132-134) A person who pools income with the household in one economic territory, but is resident of another economic territory, is not classified as a member of that household. Households can be direct investors but not direct investment enterprises.

(b) ***Legal and social entities*** are recognised by law or society independently of the persons or other entities that may own or control them. (*SNA*93 §4.3) Such entities include *corporations*, *non-profit institutions* and *government* [a] units. Some unincorporated enterprises belonging to households or government units may behave in much the same way as corporations, and such corporations are treated as quasi-corporations when they have complete sets of accounts, or such a set of accounts can be constructed. (*SNA93*. §4.5). Only business enterprises can be both direct investors and direct investment enterprises; governments and nonprofit enterprises can be direct investors but not direct investment enterprises.

[TO VERIFY WITH THE FINAL TEXT OF SNA]

a. See also glossary.

13. Only a summary of SNA and BPM concepts are included in this section. For a more detailed discussion of the items therein, the reader should refer to SNA and BPM.

3.2.2 Institutional units

52. An institutional unit is an economic entity that is capable, in its own right, of owning assets, incurring liabilities and engaging in economic activities and in transactions with other entities. (SNA93 § 4.2)

53. Institutional units of an economy are classified by the SNA under two main categories: (i) households (formed by persons or group of persons); (ii) legal and social entities (including enterprises) (see also Box 1). While the *Benchmark Definition* follows the general principles of the SNA to identify institutional units, the treatment of some specific issues raised by cross-border direct investment transactions/positions also need to be addressed.

54. Institutional units are defined by the SNA to reflect the point of view of a single economy and to identify the residents of that economy. However, a legal entity may have to be split into separate institutional units, resident in different economies, to address the statistical treatment of entities which have strong links with more than one economy. As a result, some arrangements that are not legal entities in their own right may be recognised as being institutional units. Examples are: *branches, multi-territory enterprises,* and *land ownership.*

55. Likewise, legal entities are not combined across territories. In some cases, business entities that may normally be combined with their owners, namely ancillary companies and some trusts, are treated as separate institutional units if they are resident in a different economy than that of their owners.

56. The requirement for having (or potentially having) a set of accounts is essential in the definition of institutional units because it provides a recognised indication of the existence of an economic decision-making unit. The definitions do not require that the unit be autonomous. Therefore, wholly-owned subsidiaries have legal personality and are separate institutional units from their parent units, even when all decisions are effectively made by another unit.

3.2.2.1 Enterprises

57. An ***enterprise*** is a sub-group of the broad SNA category *legal and social entities*. It is defined as an institutional unit engaged in production. An enterprise may be *a corporation* (including *quasi-corporations)*, *a non-profit institution*, or an *unincorporated enterprise*. Incorporated enterprises and non-profit institutions are complete institutional units. An unincorporated enterprise, however, refers to an institutional unit – a household or government unit - only in its capacity as a producer of goods and services. It covers only those activities of the unit which are directed towards the production of goods or services. (*SNA93* §5.1)

58. Institutional units that have the sole function of holding financial assets on behalf of their owners provide a service to its owners, so they are enterprises, even though there may be no explicit service charges. For example, some mutual funds, holding companies, trusts, and special purpose entities may not receive payment from their owners for the services they provide. However, in these cases, a service is recognised as being provided to the owner, payable out of the property income or assets.

3.2.2.2 Unincorporated enterprises

59. An unincorporated enterprise is a producer unit which is not a legal entity separate from the owner (household, government or foreign resident); the fixed and other assets used in unincorporated enterprises do not belong to the enterprises but to their owners, the enterprises as such cannot engage in

transactions with other economic units nor can they enter into contractual relationships with other units nor incur liabilities on their own behalf; in addition, their owners are personally liable, often without limit,[14] for any debts or obligations incurred in the course of production. (SNA93 §4.140, 4.141)

Box 4. Structures related to enterprises

[EU REGULATION ON UNITS AND ENTERPRISES WILL HAVE TO BE REFERENCED AS APPROPRIATE ; THERE MAY BE A NEED TO ADD PARTNERSHIPS]

{{An **enterprise group** consists of all the enterprises under the control of the same owner. When a group of owners has control of more than one enterprise, the enterprises may act in a concerted way and the transactions between them may not be driven by the same concerns as "arm's length" transactions. The Framework for Direct Investment Relationship can be used to determine which enterprises are under control or influence of the same owner. There are two concepts of enterprise groups:

- A multinational enterprise group consists of all the enterprises under the control or influence of the same owner
- An economy-specific enterprise group consists of all the enterprises under the control or the influence of the same owner and that are resident in the reporting economic territory.

A **joint venture** is a contractual agreement between two or more parties for the purpose of executing a business undertaking In which the parties agree to share in the profits and losses of the enterprise as well as the capital formation and contribution of operating inputs or costs. It is similar to a partnership (see Glossary), but typically differs in that there is generally no intention of a continuing relationship beyond the original purpose. A joint venture does not involve the creation of a new legal entity. Whether a quasi-corporation is identified for the joint venture depends on the arrangements of the parties and legal requirements. The joint venture is a quasi-corporation if it meets the requirements for an institutional unit, particularly by having its own records. Otherwise, if each of the operations is effectively undertaken by the partners individually, then the joint venture is not an institutional unit and the operations would be seen as being undertaken by the individual partners to the joint venture. Because of the ambiguous status of joint ventures, there is a risk that they could be omitted or double-counted, so particular attention needs to be paid to them.

60. A ***quasi-corporation*** is an unincorporated business that operates as if it was an entity separate from its owners. Examples are *branches*, *land ownership*, *partnerships (both limited and unlimited liability,) trusts*, and resident portions of *multi-territory enterprises.* These quasi-corporations are treated as if they were corporations, i.e. as separate institutional units from the units to which they legally belong. For example, quasi-corporations owned by households or government units are grouped with corporations in the non-financial or financial corporate sectors. The purpose of this treatment is to separate from their owners those unincorporated enterprises which are sufficiently self-contained and independent that they behave in the same way as corporations. (*SNA93* § 4.49-51)

14. However, some unincorporated enterprises may have limited liability such as a limited liability partnership.

61. Even though a ***branch*** is not a separate legal entity, it is statistically identified as a quasi-corporation when the branch has operations over a significant period in an economic territory.[15]

62. To avoid the multiplication of artificial units, the definition of branches requires several indicators of substantial economic activity and separate accounts. All or most of the following features should be present for a branch to be recognised:

(i) undertaking or intending to undertake production on a significant scale based in the territory for one year or more. If the production requires physical presence, then the operations should be physically located in that territory.

(ii) If the production does not require physical presence, such as some cases of insurance or other finance, the operations should be recognised as being in the territory by virtue of registration or legal domicile of those operations in that territory;

(a) having substantial operations in the entity's own right (i.e. rather than as an agent on behalf of another entity);

(b) recognition of the operations as being subject to the income tax system of the economy of location; and

(c) existence of separate set of accounts (income statement and statement of assets and liabilities) or the ability to construct them.

63. The identification of branches has implications for the statistical reporting of both the branch and legal entity from which the branch has been created. The operations of the branch should be excluded from the institutional unit of its head office in its home territory and should be reported consistently in both of the affected economies. Each branch is a direct investment enterprise.

64. Construction of major specific projects (bridges, dams, power stations, etc.) may take several years to complete and be carried out and managed by non-resident enterprises through site offices in the territory of location. In most instances, the operations managed from the site office satisfy the criteria to be a branch.

65. Some production processes may involve mobile equipment that operates in more than one economic territory, such as ships, aircraft, drilling rigs and platforms, and railway rolling stock. Some of these operations may take place outside any territory, such as ships on the high seas. Moreover, services such as consulting, maintenance, training, technical assistance and healthcare can also be delivered on-site with sufficient presence to amount to a branch. The criteria for recognition of a branch apply in these cases. In many instances, the activity can be seen as having been undertaken from a base of operations, so that the operations are attributed to that unit, and the recognition of an additional unit for non-resident operations is not appropriate. However, in some cases, the operations in a territory outside the home base could be substantial enough to meet the definition of a branch. For example, the existence of a branch would be recognised if a shipping company has a secondary base for servicing its fleet that is substantial, permanent, and has its own accounts.

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15. The common usage of the term branch is broader, where a "branch" may also mean establishments, incorporated subsidiaries, or industrial classification group.

66. If operations in a territory do not meet the criteria to be identified as a separate institutional unit resident in that economy, the goods or services sold by the operation to customers in the territory where the operations occur are shown as imports of that territory.

67. Prior to its incorporation a resident enterprise is imputed when preliminary expenses such as those associated with mining rights, license fees, local office expenses and legal costs are first incurred as steps prior to establishing a legal entity. Those preparatory expenses are recorded in the economy of the future operations as being resident-to-resident transactions that are funded by a direct investment inflow, rather than as sale of non-produced assets to non-residents, exports of legal services, etc. Many of these operations would qualify as a branch. Because of the limited scale of these activities, the assembly of the data for these enterprises is feasible prior to incorporation.

68. A resident ***notional unit*** is identified for statistical purposes for direct non-resident ownership of immobile non-financial assets such as land and buildings. Land and buildings can only be used for production in the territory in which they are located. Therefore, the land and buildings and other structures owned by a non-resident are always treated as being owned by a resident notional institutional unit that is in turn owned by non-resident unit(s) holding the legal title.

69. Consistent with this treatment, a notional unit is imputed for the ownership of mineral rights, bodies of water, and leases and licences that amount to assets. In fact, many such cases would qualify as branches, by virtue of having substantial operations, accounts, etc. The notional unit is nearly always a direct investment enterprise.[16] [WORDING ON LEASES AND LICENCES TO BE VERIFIED WITH SNA EDITOR]

70. ***Multi-territory enterprise***s operate as a seamless operation over more than one economic territory. Such an enterprise has substantial activity in more than one economic territory, but it cannot be separated into a parent and branch(es) because it is run as a seamless operation and cannot supply separate accounts for each territory. They are typically involved in cross-border activities and include shipping lines, airlines, hydroelectric schemes on border rivers, pipelines, bridges, tunnels, and undersea cables.[17] Some non-profit institutions serving households may also operate in this way.

71. In the case of a multi-territory enterprise, it is preferable that a parent and branch(es) be identified separately. If possible, enterprises should be identified in each territory according to the principles for identification of branches. If that is not feasible because the operation is so seamless that separate accounts could not be developed, it is necessary to prorate the total operations of the enterprise into the individual economic territories. The factor used for prorating should be based on available information that reflects the contributions to actual operations. The prorating of the enterprise implies that every transaction needs to be split into each component economic territory, a process which may be difficult to implement by compilers. Hence, for the country of residence, each apparently/ostensibly domestic transaction would be split into resident and non-resident components. Equally, non-resident entities of those economies outside the territories of the multi-territory enterprises that have transactions and positions with such entities need to make the same split, so as to capture the counterparty claims in a consistent manner. Bilateral agreements between compilers will help to minimise possible asymmetries. This treatment has implications for other macroeconomic statistics and its implementation should always be co-ordinated with other

16. Instances may occur when land and buildings are owned (wholly or in part) by unrelated non-residents, wherein some (or all) of the non-resident owners hold less than 10 per cent of the equity in the (notional) unit. In those cases, the 10 per cent threshold is still applicable so that some (or all) of the owners may not be direct investors.

17. Similar issues may arise for a *societas europaea*, that is, a company created under European Union law that is able to operate in any member state.

statistical interests for consistency. Compilers in each of the territories involved are encouraged to co-operate in order to develop consistent data, avoid gaps, and minimize respondent and compilation burden.

3.2.2.3 Special corporate structure

72. {{***Holding companies*** or ***holding corporations*** are defined as enterprises whose principal function is to control and direct subsidiaries. (*SNA* §4.37) These corporations are institutional units, separate from the subsidiaries (with the exception of those controlled by the government), have no significant production and are incorporated in the same economy, in which case they are combined with their owners like a resident ancillary activity unit. They are direct investors when they are resident in one territory and they have subsidiaries in another territory. Some may only have holding company functions either as a primary or secondary activity. Many parent companies undertake holding company functions as a secondary activity. Some holding companies also have other secondary activities. For determining the predominant function of an enterprise, value added contributions of each function undertaken within the enterprise are preferable as a criterion, but if not available, other indicators such as employment could be used. Some holding companies may have no employees and little or no physical presence, but are still considered holding companies, and actual decision-making and autonomy is not a requirement for being an institutional unit. In complex legal structures, there may be multiple holding companies and, therefore, some holding companies are also subsidiaries}}. [TO BE CONFIRMED: THERE IS CURRENTLY A DISCUSSION WITH SNA]

73. An ***ancillary activity enterprise*** is a subsidiary corporation or a branch, wholly owned by a parent corporation, whose productive activities are ancillary in nature: that is, are strictly confined to providing services to the parent corporation, or other related corporations owned by the same parent corporation. (*SNA93* § 4.40) For example ancillary activities may include transport, purchasing, sales and marketing, various kinds of financial or business services, computing and communications, security, maintenance and cleaning. An ancillary activity enterprise is treated as a separate institutional unit if it is located in a different territory from that of the parent enterprise. [TO BE CONFIRMED: THERE IS CURRENTLY A DISCUSSION WITH SNA]

74. ***Corporate structures with little or no physical presence:*** Special purpose entities/vehicles, international business companies, shell companies, shelf companies, and brass plate companies are all labels that are applied to legal entities facilitated under legislation of various jurisdictions. They are commonly incorporated in separate territories from that of at least one of their owners and have few or no owners. Some purposes that these structures are used for are holding and managing wealth for individuals or families, holding assets for securitisation, and issuing debt securities on behalf of related enterprises. They may also be used as holding companies, securitisation vehicles, ancillary companies, and other financial functions. Such enterprises are treated as separate institutional units if resident in a territory different than their owners.

75. ***A nominee*** is a legal device for holding assets for confidentiality or convenience reasons. Assets held by a nominee are treated as being owned by the beneficial owner, rather than by the nominee or by a quasi-corporation. However, for issuers of securities, it may be difficult to identify whether nominees hold claims in their own right or as nominees, and if the latter, it may be difficult to identify the beneficial owner.

76. ***Estates, other trusts, and partnerships*** are treated as separate institutional units if they are constituted in a different territory from that of their owners or beneficiaries.

3.2.3 Institutional sectors

[DEFINE ALSO FINANCIAL INTERMEDIARY AND FINANCIAL INTERMEDIATION]

77. The *Benchmark Definition* does not recommend as standard data components a classification of direct investment statistics by institutional sectors, while the focus is rather given to industry classification.[18] However, identifying the institutional sector of the resident party and the non-resident counterparty is important information for the compiler in determining whether or not a transaction/position be included in direct investment statistics. Classification principles for resident and non-resident institutional sectors are based on the enterprise's primary activity, which is determined by its principal product or group of products produced or distributed, or services rendered.

78. These sectors are: non-financial corporation sector, financial corporation sector, general government sector, non-profit institutions serving household sector (NPISH), household sector. Any of the five sectors identified by the SNA to cover all the activities of an economic territory may include enterprises that are direct investors, because any resident unit may own or control a non-resident unit that qualifies as a direct investment enterprise. On the other hand, all direct investment enterprises are classified either in the non-financial corporations sector or the financial corporations sector. This is because governments and households cannot be owned by non-residents units. Also, although NPISHs can be established or owned by non-residents, financial transactions/positions involving NPISHs are generally not driven by investment considerations and, therefore, they are generally not regarded as direct investment enterprises. [TO BE CONFIRMED]

3.3. Foreign Direct Investment

79. *Foreign direct investment* reflects the objective of establishing a lasting interest by a resident enterprise in one economy (*direct investor*) in an enterprise resident in an economy other than that of the investor (*direct investment enterprise*). The lasting interest implies the existence of a long-term relationship between the direct investor and the direct investment enterprise and a significant degree of influence on the management of the enterprise. The ownership of 10 per cent or more of the voting power[19] of a resident enterprise by a non-resident investor in a resident enterprise is the evidence of such a relationship. Some compilers may argue that in some cases the ownership of 10 per cent of the voting power may not lead to the exercise of any significant influence while on the other hand, a direct investor may own less than 10 per cent but have an effective voice in the management. Nevertheless, the recommended methodology does not allow any qualification of the 10 per cent threshold and recommends its strict application to ensure statistical consistency across countries.

80. Direct investment involves both the initial equity transaction that meets the 10 per cent threshold and all subsequent financial transactions between the direct investor and the direct investment enterprise and among affiliated enterprises, both incorporated and unincorporated. Direct investment is not solely limited to equity investment but also relates to reinvested earnings and inter-company debt. [See for more details Chapter 4: FDI components, accounts and scope]

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18. In contrast, the *Balance of Payments Manual* uses sector classification, rather than industry breakdowns, as the primary disaggregating of an economy's structure for all its functional categories

19. In general ordinary shares are the same as voting power. However, there may be instances that the voting power is not represented by ordinary shares. In such cases, compilers must determine the voting power.

81. Direct investment includes inward and outward financial transactions/positions between directly and indirectly owned incorporated and unincorporated enterprises.[20] The extent of the direct investment relationship is determined according to the Framework of Direct Investment Relationships (see Section 3.6 Direct investment relationship and the FDIR.).

82. Some relationships may exist between enterprises which may exhibit the characteristics of direct investment even though there are no links which qualify as direct investment. Such borderline cases should not be treated as direct investment (see Annex 3. Borderline cases and list of exclusions)

3.4 Foreign Direct Investor

83. A *foreign direct investor* is an entity that has a direct investment enterprise (see also section 2.4 Direct investment enterprise) – i.e., a subsidiary, or an associate or an unincorporated enterprise (including branches) resident in an economy other than the economy of residence of the foreign direct investor. A direct investor could be:

(a) an individual;

(b) a group of related individuals;

(c) an incorporated or unincorporated enterprise;

(d) a public or private enterprise;

(e) a group of related enterprises;

(f) a government; or

(g) estates, trusts and other organisations that own a direct investment enterprise; or

(h) any combination of the above..

3.5 Foreign Direct Investment Enterprise

84. A direct investment enterprise is as an incorporated enterprise – a subsidiary or associate company – or unincorporated enterprise (including a branch) in which a non-resident investor owns 10 per cent or more of the voting power of an incorporated enterprise or the equivalent of an unincorporated enterprise.

85. The numerical threshold of ownership of 10 per cent of the voting power determines the existence of a direct investment relationship between the direct investor and the direct investment enterprise. An effective voice in the management, as evidenced by an ownership of at least 10 per cent of the voting power, implies that the non-resident direct investor is able to influence or participate in the management of the resident enterprise; it does not require control by the investor (i.e. more than 50 per cent owned by the investor and/or its related enterprises). Direct investors may have direct investment enterprises in just one economy or in several economies.

86. To facilitate international comparison and to achieve global consistency of FDI statistics, the *Benchmark Definition* recommends a strict application of the 10 per cent rule. Therefore, compilers should not qualify the 10 per cent threshold further by applying other criteria. The *Benchmark Definition* does not

20. Direct investment enterprises are also referred to as "foreign affiliates" (subsidiaries, associates, unincorporated business) that are either directly or indirectly owned by the direct investor or their non-resident branches. See glossary for a definition of affiliates.

recommend the use of other considerations such as representation on the board of directors; participation in policy-making processes; material inter-company transactions; interchange of managerial personnel; provision of technical information; and provision of long-term loans at lower than existing market rates.

87. Joint ventures and syndicates may be either incorporated or unincorporated, and may or may not qualify as direct investment enterprises, depending upon whether the relevant investment arrangements fulfil the generally accepted criteria to qualify as direct investment.

88. In general, non-resident operations or activities of a direct investor are considered to be in a direct investment enterprise if they are legally or functionally separable from the domestic operation or activities of the direct investor. In most cases, it is clear whether non-resident operations or activities constitute a direct investment enterprise. If an operation or activity is incorporated abroad and is expected to last for at least a year – as defined by predominant centre of economic interest – it is usually considered a direct investment enterprise. The situation is not always so clear with unincorporated non-resident operations or activities. Most are legally or functionally separable from those of the direct investor, but some are not clearly separable, and the determination of whether they constitute a direct investment enterprise is made on a case-by-case basis.

89. The following characteristics which follow from the criteria specified for the existence of an institutional unit are taken to indicate that the unincorporated operation or activity is a direct investment enterprise:

(i) subject to the income tax system of the country of location;.

(ii) It has a substantial physical presence in its economy of location, as evidenced by plant and equipment or by employees that are permanently located in a foreign economy;

(iii) It has separable financial records that would allow the preparation of financial statements, including a balance sheet and income statement. (A mere record of disbursements to, or receipts from, the foreign operation or activity does not constitute a "financial statement" for this purpose);

(iv) It takes title to the goods it sells and receives revenues from the sale, or it receives funds from customers for its own account for services it performs;

(v) Not all these characteristics are required for the recognition of a unit as a branch. For example, some financial institutions may set up a branch abroad that has little or no physical presence but the entity would still be recognized as a separate institutional unit if it maintains its own records, including a statement of assets and liabilities.

90. The following characteristics would indicate that the unincorporated operation or activity is *not* a direct investment enterprise:

(i) It conducts business in its economy of location only for its owner's account, not for its own account (for example, it engages only in sales promotion or public relations activities on behalf of its owner).

(ii) It has no separate financial records that allow the preparation of financial statements.

(iii) Its expenses are paid by its owner.

(iv) It is not subject to the income tax system of the economy of location.

(v) It has limited physical assets or few employees in its economy of location;

(vi) Not all these characteristics are required for the rejection of a unit as a branch. For example, some financial institutions may set up a branch abroad that has little or no physical presence but the entity would still be recognized as a separate institutional unit if it maintains its own records, including a statement of assets and liabilities.

91. The existence of financial records that would allow the preparation of financial statements is a criterion for determining whether an unincorporated enterprise is a direct investment enterprise, because the existence of such records (including a balance sheet and income statement) greatly facilitates the treatment of the operation as one. The absence of such records will often make it impractical or much more difficult to account for the operation as a separate business.

3.5.1 Subsidiaries, Associates and Unincorporated enterprises (including branches)

92. A direct investment enterprise may be an incorporated enterprise – a *subsidiary* (more than 50 per cent of the voting power is owned by a non-resident investor) or an *associate* (10 to 50 per cent of the voting power is owned by a non-resident investors) – or an unincorporated enterprise (including *branches)*. Direct investors may have direct investment enterprises which in turn have their own subsidiaries, associates and branches in the same economy, in a different economy or in several economies.

3.5.1.1 Subsidiary companies

93. A subsidiary company is a direct investment enterprise that is incorporated in its country of residence and that is directly or indirectly owned by a non-resident direct investor to the extent of more than 50 per cent of its voting power. More specifically:

Company X is a subsidiary of enterprise N if, and only if, X is incorporated in its country of residence, and:

(i) enterprise N owns directly more than half of the voting power of enterprise X; or

(ii) enterprise X is a subsidiary of any other company Y that is a subsidiary of N; or

(iii) enterprise N and all of its subsidiaries combined own more than half of the voting power of enterprise X. [TO BE CONFIRMED]

3.5.1.2 Associate Companies

94. An associate company is a direct investment enterprise that is incorporated in its country of residence and for which between 10 per cent and 50 per cent of its voting power is directly or indirectly owned by a foreign direct investor. More precisely:

- Company R is an associate of enterprise N if N, its subsidiaries and its other associated enterprises own less than 50 per cent of the shareholders' or members' voting power in R and if N and its subsidiaries have a direct investment interest in R. Thus company R is an associate of N if N and its subsidiaries own between 10 and 50 per cent of the shareholders' voting power in R.

3.5.1.3 Unincorporated enterprises, including branches

95. A direct investment branch is an unincorporated direct investment enterprise in the host country fully owned by its direct investor. Thus, this term encompasses branches as commonly defined – i.e.,

formally organised business operations and activities conducted by an investor in its own name – as well as other types of unincorporated operations and activities, such as:

(i) a permanent establishment of a foreign direct investor;

(ii) an unincorporated partnership or joint venture between a foreign direct investor and third parties;

(iii) land, structures (except those structures owned by foreign government entities for use as embassies, consulates, military bases), and immovable equipment and objects, in the host country, that are owned by a foreign resident [through the ownership of the notional resident enterprise which owns the land and structures]. Holiday and second homes owned by non-residents are therefore regarded as part of direct investment;

(iv) an operator of mobile equipment (such as ships, aircraft, gas and oil drilling rigs) that operates within an economy for at least one year if accounted for separately by the operator and is so recognised by the tax authorities as being subject to income tax law. This is considered to be direct investment in a notional enterprise in the host country;

(v) if a company is incorporated in the direct investor's economy but carries out most or all of its operations in another economy, its non-resident operations are treated as a non-resident branch even though the direct investor may consider the operations to be an integral part of its domestic operations and consolidated accounts.

3.5.2 Other related enterprises

96. *Other related enterprises* are incorporated or unincorporated direct investment enterprises, none of which holds directly 10 per cent or more of the voting power in each other, but all of which are ultimately owned or controlled by the same direct investor. Inward and outward direct investment enterprises may have equity or debt assets or liabilities (e.g. loans or balances) *vis-à-vis* fellow subsidiaries, associates and branches – that is, companies and their branches which have the same ultimate parent as the direct investment enterprise. Such direct investment capital is (a) capital provided (either directly or indirectly through other related enterprises) by a direct investor to a direct investment enterprise; or (b) capital similarly received from a direct investment enterprise by a direct investor. These amounts should be included in direct investment, categorised appropriately as equity or debt, and allocated to the country of residence the fellow subsidiary or branch, or to that of the indirectly owned direct investment enterprise, as appropriate.

97. Some subsidiaries raise loans which they on-lend to their direct investor and others make loans to their direct investor from their own resources. Such loans should be treated as direct investment and be included in the direct investment statistics, {except where they involve related financial intermediaries at both ends of the transaction}. [CONCEPTS UNDER DISCUSSION]

3.6 Framework of Direct Investment Relationships (FDIR)

[THE FOLLOWING SECTION IS NOT YET FINAL AND WILL BE REVISED FOLLOWING THE DISCUSSION OF DOCUMENT DAF/INV/STAT(2007)7]

98. Direct investment relationships include not only the immediate relationship between two enterprises, but also extended ownership structures, in which control or a significant degree of influence may arise indirectly or through multiple ownership chains. The Framework for Direct Investment Relationships (FDIR) has been developed to deal with such structures and is the recommended method to identify the extent of a direct investment relationship. Under the FDIR:

(i) for a direct investor to be able to exercise undisputed *control* over an enterprise (i.e., the enterprise is its *subsidiary*[21]) the enterprise and all enterprises above it in the ownership chain must be majority owned by their immediate parents, or have a majority of their voting rights owned by related enterprises acting in concert.

(ii) for a direct investor to be able to *influence* another enterprise (i.e., the enterprise is its *associate*),[22] it must own directly or indirectly between 10 to 50 per cent of its voting power. This can occur through one of the following situations must obtain:

  (a) the immediate direct investment enterprise is a directly held associate of the direct investor (that is, the direct investor has between 10 and 50 per cent of the voting power in the enterprise); or

  (b) the immediate direct investment enterprise is an associate of a subsidiary of the direct investor (that is, an enterprise that the direct investor controls has ownership of between 10 and 50 per cent of the voting power of the associate); and it in turn is an associate of the subsidiary's parent if the latter holds indirectly between 10 to 50 per cent of its voting power; or

  (c) the immediate direct investment enterprise is controlled by an enterprise over which the direct investor has significant influence (that is, it is a subsidiary of an associate of the direct investor, or is controlled by an associate and other related enterprises).

99. In other words, a direct investor, under the FDIR, will have a direct investment relationship with entities that are either its own subsidiaries (or subsidiaries of a related group) or subsidiaries of an associate, but not with associates of associates. Associates of associates of a given direct investor are not included in the FDIR as direct investment enterprises of the investor because the ability of the investor to influence the management of such an enterprise is considered to have become too diluted to be effective.

100. The discussion that follows first presents examples to illustrate the particular types of linkages that may exist between enterprises and then lays out the framework for direct investment relationships that elaborates upon the above guidelines for identifying and categorizing them.

21. In this context, the terms subsidiary and associate refer to both incorporated and unincorporated enterprises. The FDIR makes no distinction on the basis of incorporation.

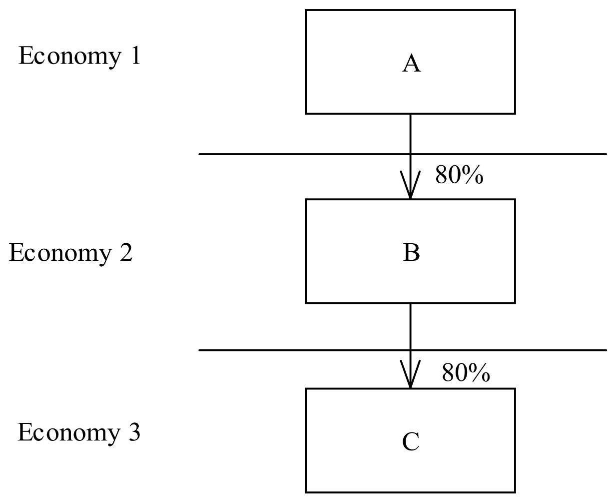
22. Idem.

3.7 Identifying Direct Investment Relationships

101. The discussion of direct investors and direct investment enterprises has focussed on the immediate relationship between two enterprises. In reality, the legal structures of related enterprises can consist of many enterprises linked through complex ownership chains. Within these groups, it is possible that a direct investment enterprise itself owns 10 per cent or more of the voting power of another enterprise, in which case the direct investment enterprise is itself a direct investor in a further direct investment enterprise. The discussion that follows first presents examples to illustrate the kinds of linkages that may exist between enterprises and then lays out a framework for direct investment relationships that provides a generalised methodology for identifying and categorising them.

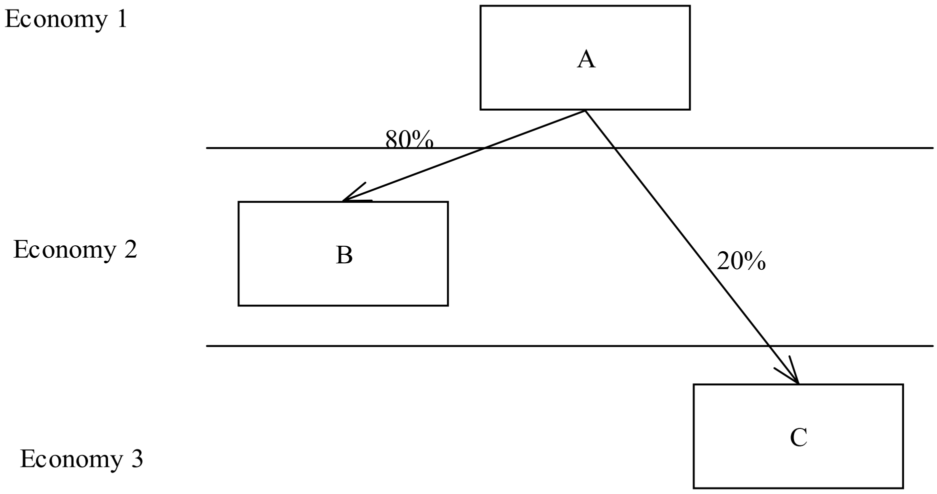
102. In Figure 1, enterprises A, B and C are in different economies. Enterprise A owns an 80 per cent voting interest in enterprise B and is a direct investor in B. Enterprise B, in turn, owns 80 per cent of C and is a direct investor in C. A has control over B, and through its control over B, has control over C. As a result, financial transactions between A and C cannot be considered disinterested, even though A directly holds no equity in C. It is reasonable to consider A and C to be in a direct investment relationship in which A indirectly is a direct investor in C. Financial transactions and positions between A and C should be included in direct investment.

Figure 1. Direct Investment Relationships



103. It is not uncommon for an entity to be a direct investor in more than one direct investment enterprise. In Figure 2, enterprises A, B and C are each in different economies. Enterprise A owns 80 per cent of B and is a direct investor in B and owns 20 per cent of C and is a direct investor in C. A controls B and also has significant influence over C. As a result, financial transactions and positions between B and C cannot be considered disinterested, even though there is no equity participation between them. For example, B may raise capital which it lends to C at a concessional rate due to the control by A. It is reasonable to consider B and C to be in a direct investment relationship – B and C are considered 'other related enterprises' of one another (also referred to as 'fellow enterprises').

Figure 2. Direct Investment Relationships



104. Identifying the extent of the direct investment relationship is of particular importance for national compilers of statistics and for respondents who provide them with information on direct investment transactions and positions.

105. A generalised methodology for identifying and determining the extent of direct investment relationships is provided by the Framework for Direct Investment Relationships (FDIR). Under the FDIR, direct investment enterprises are identified as being either *controlled affiliates* or *non-controlled affiliates* of a direct investor.

(i) A *controlled affiliate* is an enterprise in which an investor owns more than 50 per cent of the voting power. Where the investor and the controlled affiliate reside in different economies and the controlled affiliate is incorporated, the controlled affiliate is termed a *subsidiary* of the investor.

- Where an investor and its controlled affiliates combined own more than 50 per cent of the voting power of an enterprise, the owned enterprise is also regarded as a controlled affiliate of the investor.

(ii) A *non-controlled affiliate* is an enterprise in which an investor owns at least 10 per cent of the voting power and no more than 50 per cent. Where the investor and the non-controlled affiliate are in different economies and the non-controlled affiliate is incorporated, the non-controlled affiliate is termed an *associate* of the investor.

- Where an investor and its controlled affiliates combined own at least 10 per cent of the voting power of an enterprise but no more than 50 per cent, the owned enterprise is regarded as a non-controlled affiliate of the investor.

- Where an investor, its controlled affiliates and its non-controlled affiliates combined own more than 50 per cent of the voting power of an enterprise and the owned enterprise is not otherwise a controlled affiliate, then the owned enterprise is regarded as a non-controlled affiliate of the investor.

106. Note that the residences of the investor and the owned enterprise(s) do not feature within these definitions, however direct investment is recorded only when there is a financial transaction or position between two entities in different economies that are in a direct investment relationship.

107. The FDIR principally identifies all enterprises over which the investor has significant influence. In this determination, three degrees of influence are recognised for each enterprise. They are categorised as *controlled, influenced* and *not influenced*. It is considered that the degree of influence that may be exercised by the investor through controlling links is not diminished by the existence of multiple links. Thus, an enterprise controlled by a controlled affiliate or by a group of controlled affiliates (including the investor) is itself regarded as a controlled affiliate. An enterprise controlled by a non-controlled affiliate or a group of related enterprises including non-controlled affiliates is regarded as an influenced (non-controlled) affiliate. The degree of influence that may be exercised by an investor through a single or cumulative influencing link is diminished by one degree. Thus, an enterprise influenced by a controlled affiliate or the group of controlled affiliates (including the investor) is regarded as an influenced (non-controlled affiliate). An enterprise influenced by a non-controlled affiliate or a group of related enterprises including non-controlled affiliates is not influenced by the investor in question, i.e. it is not regarded as an affiliate of this investor within FDIR. A chain of ownership is followed until the degree of influence that may be exercised by the investor is diminished to the point where an enterprise can be categorised as *not influenced*. Under the FDIR, the direct investment relationship extends in both directions along an ownership chain from an investor to cover all of its *controlled, influenced and non-controlled* affiliates. It also covers “across chain” relationships as described earlier.

108. It should be noted that identifying the extent of a direct investment relationship from an investor, B, which is either a controlled affiliate or non-controlled affiliate of another investor, A, may identify enterprises in a direct investment relationship with enterprise B that are not in a direct investment relationship with enterprise A.

109. Recognising practical difficulties compilers may encounter in applying the FDIR in full, two alternative methods are allowed: the equity multiplication method, and the influence / control method. Should compilers choose to apply either of these alternate methods due to practical difficulties, they should include this information in their metadata. However, such countries should endeavour to apply the FDIR over time.

110. Annex 4: Direct Investment Relationship provides more examples of defining the extent of the direct investment relationship under the FDIR and the two alternate methods. It also describes the practical implementation of the FDIR for measuring investment income credits and debits, and for classifying financial account transactions and international investment positions.

Box 5. Definition: Control of a corporation and subsidiary corporation

To classify an enterprise within a country on the basis of the presence or absence of effective ***foreign control***, the criterion recommended for use is whether or not a majority of ordinary shares or voting power (more than 50% of the capital) is held by a single foreign direct investor or by a group of associated investors acting in concert, such as members of the same family or enterprises and their affiliates. Application of this criterion avoids the use of subjective concepts or case-by-case review. The advantage of this absence of subjectivity is to eliminate a potential source of bilateral asymmetry. This recommendation is consistent with MSITS. (OECD *Globalisation Handbook, p.104*)

CHAPTER 4.
FOREIGN DIRECT INVESTMENT COMPONENTS, ACCOUNTS AND SCOPE

4.1 Summary

111. This chapter describes the components, accounts and scope of foreign direct investment.

112. Chapters 2 and 3 emphasized how it is only equity, in particular voting equity, which is used to determine whether a direct investment relationship exists. However, once the relationship exists, measures of the direct investment between affiliates resident in different economies include all immediate equity and debt positions and transactions between the related parties

113. The components of foreign direct investment essentially cover the types of financial instrument involved in direct investment transactions/positions. The accounts represent the three measures concerning foreign direct investment, i.e. foreign direct investment position, foreign direct investment financial transactions and foreign direct investment income. A fourth account is referred as other flows (other changes account). These components and accounts are discussed below.

114. A third part of this chapter will discuss the scope of foreign direct investment in terms of coverage, inclusion and exclusions.

4.2 Foreign direct investment components

115. {The main financial instrument components of foreign direct investment are *equity* and *debt instruments*. *Equity* includes *common and preferred shares* (exclusive of non-participating preference shares which should be included under debt), *reserves*, capital contributions and *retained earnings*. All positions and transactions in equity between affiliated enterprises (see Chapter 2. Main concepts and definitions) are included in foreign direct investment. *Dividends*, distributed branch earnings, *reinvested earnings* and *undistributed branch earnings* are components of foreign direct investment income on equity.

116. Debt instruments include marketable securities such as bonds, debentures, commercial paper, promissory notes, non-participating preference shares and other tradable non equity securities. Debt instruments also include loans, trade credit and other accounts payable/ receivable. All positions and transactions related to these instruments, between affiliated enterprises other than between affiliated financial intermediaries are included in foreign direct investment. The interest returns on the above instruments are included in foreign direct investment income on debt.

117. Neither positions nor transactions in financial derivatives between entities in a direct investment relationship with each other are to be included under direct investment.

118. Foreign direct investment equity and debt involve all transactions that create or extinguish a direct investment relationship and all transactions between enterprises in a direct investment relationship.

119. Direct investment asset and liability classes for both equity and debt can be further classified by the nature of the relationship between the resident and non-resident affiliates, party to the position or transaction.

- *Direct investment asset*s can be classified into the following three groups:

(i) investment by a resident direct investor in its non-resident direct investment enterprises

(ii) investment by a resident direct investment enterprise in its non-resident direct investor(s)

(iii) investment by a resident direct investment affiliate in non-resident other affiliated enterprises

- *Direct investment liabilities* can be classified into the following three groups*:*

(i) investment of non-resident direct investor in resident direct investment enterprises

(ii) investment of non-resident direct investment enterprises in resident direct investors

(iii) investment of non-resident direct investment affiliate in resident other affiliated enterprises

120. These three categories of assets and liabilities form subcategories in the account presentations that follow. These categories are useful for analysis. In the first category, the financing flows in the same direction as the influence or control, from the direct investor to the direct investment enterprise. This is in line with the traditional understanding for direct investment that is a direct investor acquires influence or control through the provision of financing.

121. In the second category, financing flows in the opposite direction as the influence/control. This category sees the reverse of the traditional foreign direct investment financing flows as the direct investor uses its influence to have its affiliated enterprises provide equity or debt financing for its own operations (see Paragraphs 25 and 26 for further details)

122. The last category shows financing between affiliated enterprises that have no influence one upon the other but have a common (immediate or otherwise) direct investor with influence over both.

123. Reinvested earnings and reinvestment of earnings are separately identified components of equity in financial transactions and income. These flows are identified only between the direct investment enterprise and its immediate direct investors (although the value of these flows should reflect income earned through the current operating income concept, see Annex x). In cases where the equity asset holder does not have a 10% voting power (reverse investments and investments in other affiliates), reinvested earnings and reinvestment of earnings are not recorded.

124. Direct investment equity and debt is (a) financing provided by a direct investor to a directly or indirectly owned direct investment enterprise or (b) financing received from a directly or indirectly owned direct investment enterprise by a direct investor or (c) financing provided by a direct investment enterprise to an other related affiliate.

125. Some direct investment enterprises raise loans which they on-lend to their direct investor and other direct investment enterprises make loans to their direct investor from their own resources, so-called reverse investment. Such loans should be treated as direct investment debt and be included in the direct investment statistics.

Box 6. Definitions of instruments related to foreign direct investment

Equity: comprises: (i) equity in branches; (ii) all shares in subsidiaries and associates (except non-participating, preferred shares that are treated as debt securities and included under direct investment, debt instruments); and (iii) other contributions of an equity nature. Ownership of equity is usually evidenced by shares, stocks, participations and similar documents. This category includes proprietors' net equity in quasi-corporations, as well as shares and equity in corporations. It also includes preferred stocks or shares that provide for participation in the residual value on dissolution of an incorporated enterprise.

Distributed incomes. These comprise:

Dividends: the distribution from earnings (and other sources) of an incorporated direct investment enterprise to the owners of its shares and other forms of participation in the equity of incorporated private enterprises, co-operatives, and public corporations.

Remitted profits of unincorporated enterprises, including branches: the distribution from earnings (and other sources) of an unincorporated direct investment enterprise to its owners.

Both dividends and remitted profits of unincorporated enterprises and branches should be recorded on the date they are declared payable, at which point they become an account payable/receivable until the payment is made. Liquidating dividends are not considered to be income but a return of funds to the shareholders**.**

Reinvested earnings and undistributed profit of unincorporated enterprises and branches comprise the imputed income of direct investors, in proportion to equity held, from the earnings that foreign subsidiaries and associated enterprises do not distribute as dividends, and earnings that branches and other unincorporated enterprises do not remit to direct investors.

Reinvestment of earnings: represent the imputed financial account transaction that is the equal and opposite of reinvested earnings and undistributed profits of branches and other unincorporated enterprises.

Debt securities**:** include non-participating preferred shares, bonds, debentures, commercial paper, promissory notes and other non equity securities.

Loans between affiliated enterprises. Loans are financial assets that are created when a creditor lends funds directly to a debtor through an instrument that is not intended to be traded. This category includes all loans and advances (except receivable/payable which are treated as a separate category of financial assets).

Trade credit (receivables and payables) between affiliated enterprises. It represents short-term credit in the ordinary course of business by suppliers/buyers of goods and services. These credits are registered from the time the goods or services are provided until payment is received.

Other accounts receivable/payable includes items such as deferred income and provisions for loan losses and other purposes. It also includes advances for work that is in progress and prepayments for goods and services.

N.B. Financial derivatives are not included in direct investment

126. Direct investors may make loans to or borrow funds from their indirectly owned direct investment enterprises. (An indirect ownership interest exists when a direct investment enterprise that is directly owned, in turn, has an equity holding in another enterprise that also qualifies as a direct investment enterprise, thereby making the first DIE into a direct investor in the second. In this example, the direct investor at the top of the ownership chain holds an indirect ownership interest in the enterprise at the bottom of the ownership chain.). Transactions and positions between all these directly and indirectly owned enterprises should be included in direct investment.

127. If the indirect ownership in direct investment enterprises is not included in direct investment relationships, some transactions/positions between the direct investor and its indirectly owned direct investment enterprises may be excluded from the direct investment statistics as well as the corresponding earnings. Economies which do not require their companies to produce world-wide consolidated company accounts may have difficulties in obtaining information on all indirectly owned subsidiaries and associates in order to produce direct investment statistics according to FDIR.

128. A direct investment enterprise may also have loans or balances due to or from other affiliated enterprises. None of these related enterprises needs to hold a 10 per cent or more voting power in the other as long as they have directly or indirectly the same ultimate direct investor

129. As a result, financial transactions and positions between two affiliated enterprises owned (ultimately) by the same direct investor are part of foreign direct investment, even though there may be no equity participation between them. For example, B, a direct investment enterprise of A, may raise funds which, under instructions from A, it lends to C, another direct investment enterprise of A. Such transactions/positions should be considered direct investment between the economy of B and the economy of C, even though there is no equity participation between B and C**.**

4.3 Foreign direct investment accounts

130. The main accounts for presenting foreign direct investment statistics are foreign direct investment positions, foreign direct investment transactions and foreign direct investment income. These accounts are discussed below along with a description of other changes related to foreign direct investment positions and transactions.

131. Building on the descriptions in the previous section, six basic classes of direct investment assets and six classes of direct investment liabilities can be defined that will serve as the building blocks for the presentations of FDI described in this section. These building blocks are consistent with the information requirements of earlier edits of the *Benchmark Definition*.

Direct investment assets: (FDI Assets = A1+A2+A3+A4+A5+A6)

A1: Equity assets of direct investors in direct investment enterprises

A2: Debt instruments assets of direct investors in direct investment enterprises

A3: Equity assets of direct investment enterprises in direct investor

A4: Debt instruments assets of direct investment enterprises in direct investor

A5: Equity assets of direct investment enterprises in other affiliated enterprises abroad

A6: Debts instruments assets of direct investment enterprises in other affiliated enterprises abroad

Direct investment liabilities: (FDI Liabilities = L1+L2+L3+L4+L5+L6)

L1: Equity liabilities of direct investment enterprises to direct investor

L2: Debt instruments liabilities of direct investment enterprises to direct investor

L3: Equity liabilities of direct investor to direct investment enterprises

L4: Debt instruments liabilities of direct investor to direct investment enterprises

L5: Equity liabilities of direct investment enterprises to other affiliated enterprises abroad

L6: Debts instruments liabilities of direct investment enterprises to other affiliated enterprises abroad

132. These building blocks are based on balance sheet entries of the direct investor or direct investment enterprises and are all that is required for the presentation of data on FDI positions.

133. Each of these classes can be also classified by the industrial activity and residence of the counterparties. Discussion of these dimensions will be covered in a later chapter.

134. These building blocks can be arranged in different presentation suitable for a variety of analytical requirements. Macro economic accounts, Balance of Payments and the SNA present financial data primarily on an asset and liability basis and thus FDI data on this basis are useful when analysing FDI in relation to other macro economic variables. In addition, most FDI data are compiled as part of the Balance of Payments programs in each country and thus this presentation forms the bridge between macro accounts and other presentation.

The *Benchmark Definition* also calls, as prescribed in its earlier editions, for the presentation of FDI statistics according to the directional principle which requires the rearrangement of some of these building blocks. Under the directional principle any reverse investment from the direct investment enterprise in its direct investor is to be deducted from the outward or inward foreign direct investment when the direct investment enterprise holds less than 10% of the voting power in its direct investor. Data presented on the directional principle is better suited for some analysis and in particular is the preferred presentation for industry and country data described later in this manual.

4.3.1 Foreign direct investment positions

135. For positions data, the investment is disaggregated into equity and debt instruments: the accumulation of r*einvestment of earnings (or the closing balance of retained earnings in proportion to the equity held)* is not recorded separately in positions data as it is included in the overall calculation of "equity" when recorded at market value.

136. The tables are included to illustrate how these building blocks are used to construct the various measures of FDI that are required. The standard presentations for reporting FDI statistics are described in Annex 2.

137. To illustrate the asset/liability approach the elements presented above are to be grouped as follows:

Table 1. FDI Positions According to Asset/Liability Principle

Assets	**Liabilities**
Of *direct investors in direct investment enterprises*	*Of direct investment enterprises to direct investor*
A1 Equity	**L1** Equity
A2 Debt instruments	**L2** Debt instruments
Of direct investment enterprises in direct investor	*Of direct investor to direct investment enterprises*
A3 Equity	**L3** Equity
A4 Debt instruments	**L4** Debt instruments
Of direct investment enterprises in other affiliated enterprises	*Of direct investment enterprises to other affiliated enterprises*
A5 Equity	**L5** Equity
A6 Debt instruments	**L6** Debt instruments

138. FDI data using the directional principle refers to two terms often used in relation to foreign direct investment; **Outward foreign direct investment** and **Inward direct investment**. To illustrate these terms, central to the directional principle, the elements of foreign direct investment positions are schematically shown as follows:

Table 2. FDI Positions According to Directional Principle

Outward Foreign Direct Investment	**Inward Foreign Direct Investment**
Outward equity position:	*Inward equity position:*
A1 Equity assets of DI in DIE	**L1** Equity liabilities of DIE to DI
-L3 Equity liabilities of DI to DIE*	**-A3** Equity assets of DIE in DI*
A5 Equity assets of DIE in other affiliated enterprises	**L5** Equity liabilities of DIE to other affiliated enterprises
Outward debt instruments position:	*Inward debt instruments positions:*
A2 Debt instruments assets of DI in DIE	**L2** Debt instruments liabilities of DIE to DI
-L4 Debt instruments liabilities of DI to DIE*	**-A4** Debt instruments assets of DIE in DI*
A6 Debt instruments assets of DIE in other affiliated enterprises	**L6** Debt instruments liabilities of DIE to other affiliated enterprises

* entered as a deduction in outward or inward FDI

139. For positions data, foreign direct investment assets under the asset/ liability principle are greater than foreign direct investment outward position calculated under the directional principle. In the same manner, foreign direct investment liabilities under the asset liability principle are greater than the foreign direct investment inward position calculated under the directional principle. The difference between the two presentations is as follows:

- The asset position is greater than the outward position and the difference is equal to:

  (A1+A2+A3+A4+A5+A6) – (A1-L3+A5+A2-L4+A6) = **A3+L3+A4+L4**

- The liability position is greater than the inward position and the difference is equal to:

  (L1+L2+L3+L4+L5+L6) – (L1–A3+L5+L2–A4+L6) = A**3+L3+A4+L4**

140. The net asset (liability) position is the same for both presentations; the difference between foreign direct investment asset and foreign direct investment liability is equal to the difference between outward foreign direct investment and inward foreign direct investment.

4.3.1.1 Equity position

141. Equity positions cover all components of shareholders' funds (proportionate to the percentage of shares held). They, therefore, include equity, contributed surplus, reinvestment of earnings, revaluations, as well as any reserve accounts (Table 1, items A1 and L1). No reinvestment of earnings is recorded for either reverse investment (items A3, L3) or for voting power between affiliates (items A5 and L5) where neither party holds 10 per cent or more of the voting power in the other. The reason that no reinvested earnings/reinvestment of earnings is imputed in these cases is that, as these parties do not have 10 per cent of voting power in the other, none of them is a direct investor. It is only when there is a direct investor that reinvested earnings/reinvestment of earnings applies. These exclusions only apply if foreign direct investment positions are reported at book value. Since the benchmark definition recommends that foreign direct investment be reported at market value, these reverse investments implicitly include reinvestment of earnings.

142. As noted, equity positions may arise from reverse investment. Reverse investment occurs when a direct investment enterprise acquires a claim on its direct investor. It is narrowly defined because of being limited to reverse equity investments, and equity investments involving affiliated enterprises, of less than 10 per cent. In addition, as stated above, items A3, A5 and L3, L5 consist solely of equity capital, i.e., reinvestment of earnings are excluded when the level of the equity investment is less than 10 per cent of the voting securities of the direct investor or affiliated company (or the equivalent in an unincorporated enterprise). This exclusion would apply only if equity investment is recorded at book value. Since the benchmark recommends market value as the valuation of foreign direct investment positions, this differentiation does not apply. In instances where a direct investment enterprise, holding less than 10 per cent of the voting power in its direct investor, increases that voting power to 10 per cent or more, the direct investment enterprise becomes a direct investor in its direct investor. Similarly, when an affiliated enterprise, holding less than 10 per cent of the voting power in a non-resident affiliated enterprise, increases that voting power to 10 per cent or more, the acquiring enterprise becomes a direct investor in the foreign affiliate. How these transactions and changes are to be recorded is discussed further below (see *Other Changes* and *Foreign direct investment financial transactions* below).

143. In the case where a resident direct investment enterprise acquires a 10 per cent or more equity interest in its direct investor or other affiliated enterprise, it is not treated as reverse equity investment but rather as direct investment asset (item A1), as the threshold of 10 per cent of voting power has been reached to create a direct investor. Similarly, where a foreign direct investment enterprise holds 10 per cent

or more of the equity of the resident direct investor or in other resident affiliated enterprises, the investment should be recorded as direct investment liabilities (item L1), as, by reaching 10 per cent of the voting power in the resident enterprise, the non-resident direct investment enterprise itself becomes a direct investor.

4.3.1.2 Debt instruments positions

144. Inter company accounts should be separately recorded for assets and liabilities. Debt positions include payables and receivables between enterprises in a direct investment relationship arising from loans, debt securities, suppliers' (trade) credit, financial leases, and non-participating preference (preferred) shares.[23] However, debt positions between affiliated financial intermediaries (such as commercial banks, savings institutions, credit unions, mutual funds or finance companies) are excluded from direct investment (though this exclusion does not apply if one of the parties is a holding company). The reason for this is that they are taken to represent "normal banking business", so that their very nature is quite different from that of other direct investment. Consequently, it is felt that the inclusion of debt instruments between affiliated financial intermediaries would produce misleading results.

145. For assets, positions should be recorded separately for the various debt instruments that:

- the resident direct investor holds in its direct investment enterprises
- the resident direct investment enterprises holds on its direct investor(s)
- other resident affiliates hold in other affiliated enterprises abroad

For liabilities, positions should be separately recorded for the various debt instruments that:

- the resident direct investment enterprises issues to its direct investor(s)
- the resident direct investor issues to its direct investment enterprise(s)
- other resident affiliates issue to other affiliated enterprises abroad

4.3.1.3 Other changes in direct investment positions

146. Direct investment positions may change either due to transactions or due to other changes. Transactions arise when parties of two different economies buy, sell, borrow, or lend to one another, and when a resident in one economy provides (or receives) something of value to (from) the other resident in another economy by agreement. Other changes in direct investment positions resulting from changes in foreign currency exchange rates, debt being written off and other types of holding gains or losses are examples of items that should be recorded in these accounts. See section 4.3.4 for a further description of this category

23. Positions in derivative financial instruments are excluded, as they are not considered to be part of direct investment.

4.3.2 Foreign direct investment financial transactions

147. Direct investment transactions are all transactions between direct investors, direct investment enterprises, and/or other affiliated enterprises. In the case of transactions the Equity Asset and Liability classes A1 and L1 are further subdivided into two sub-components:

A1: Equity assets of direct investors in direct investment enterprises

A1.1 Equity transactions

A1.2 Reinvestment of earning

L1: Equity liabilities of direct investment enterprises to direct investor

L1.1 Equity transactions

L1.2 Reinvestment of earning

148. It is recommended that separate figures be collected and published for transactions in equity capital, reinvestment of earnings and debt, and that direct investment assets should be shown separately from direct investment liabilities. To facilitate analysis these items should be recorded gross, showing investment separate from disinvestment.

149. For transactions, the asset liability principle is schematically shown as follows:

Table 3. Foreign Direct Investment Transactions According to Asset/Liability Principle

{Transactions in} Assets	**{Transactions in} Liabilities**
Of direct investors in direct investment enterprises	**Of direct investment enterprises to direct investors**
A1 Equity	**L1** Equity
A1.1 Equity transactions	**L1.1** Equity transactions
A1.2 Reinvestment of earnings	**L1.2** Reinvestment of earnings
A2 Debt instruments	**L2** Debt instruments
Of direct investment enterprises in direct investors- Reverse investment:	***Of direct investors to direct investment enterprises – Reverse investment***
A3 Equity	**L3** Equity
A4 Debt instruments	**L4** Debt instruments
Of direct investment enterprises in other affiliated enterprises abroad	***Of direct investment enterprises to other affiliated enterprises abroad***
A5 Equity	**L5** Equity
A6 Debt instruments	**L6** Debt instruments

150. To illustrate the directional principle for transactions, the foreign direct investment elements are schematically shown as follows:

Table 4. Foreign Direct Investment Transactions According to Directional Principle

Outward Foreign Direct Investment	**Inward Foreign Direct Investment**
Outward equity transactions	*Inward equity transactions*
A1 Equity assets of DI in DIE	**L1** Equity liabilities of DIE to DI
A1.1 Equity transactions	**L1.2** Equity transactions
A1.2 Reinvestment of earnings	**L1.2** Reinvestment of earnings
-L3 Equity liabilities of DI to DIE*	**-A3** Equity assets of DIE in DI*
A5 Equity assets of DIE in other affiliated enterprises abroad	**L5** Equity liabilities of DIE to other affiliated enterprises abroad
Outward debt instruments transactions	*Inward debt instruments transactions*
A2 Debt instruments assets of DI in DIE	**L2** Debt instruments liabilities of DIE to DI
-L4 Debt instruments liabilities of DI to DIE*	**-A4** Debt instruments assets of DIE in DI*
A6 Debt instruments assets of DIE in other affiliated enterprises abroad	**L6** Debt instruments liabilities of DIE to other affiliated enterprises abroad

* entered as a deduction in outward or inward FDI

151. As explained in the section on foreign direct investment positions, the outward foreign direct investment transactions are different from the transactions reported under the foreign direct investment asset presentation. Inward foreign direct investment transactions are also different than the transactions reported under the foreign direct investment liability presentation.

4.3.2.1 Equity and reinvestment of earnings

152. Transactions by a direct investor in the equity of its direct investment enterprises include both reinvestment of earnings and other equity transactions (Table 3 and 4, items A1 (A1.1, A1.2) and L1 (L1.1, L1.2)). Transactions by a direct investment enterprise in the equity of its direct investor (reverse investment; items A3 and L3) or in the equity of a fellow company (items A5 and L5) do not include reinvestment of earnings.

4.3.2.2 Equity transactions

153. Equity increases result (a) from a direct investor's establishment of a new direct investment enterprise, (b) from its initial acquisition of a 10 per cent-or-more ownership interest in an existing enterprise, (c) from its acquisition of an additional voting share ownership interest in an existing enterprise which takes the accumulated holding to at least the 10 per cent equity threshold, and (d) from its equity contributions to an existing direct investment enterprise.

154. Equity decreases result from the liquidation of a direct investment enterprise, from the partial or total sale of an ownership interest in a direct investment enterprise, and from the return of capital contributions. Equity decreases also include liquidating dividends, which are considered to be a withdrawal of equity rather than a distribution of income.

155. For a given category of equity transactions (items A1, A3, A5 and L1, L3, L5), equity increases are netted against equity decreases in deriving the net change. Equity transactions exclude changes in

equity that result from the reinvestment of earnings, which constitute a separate sub-component of the accounts.

156. Equity transactions may arise either from transactions between a direct investor and its direct investment enterprise (such as contributed surplus or liquidations), or from transactions between a direct investor and a third party [such as purchases (sales) of stock in a direct investment enterprise by a direct investor from (to) an unaffiliated third party]. Note that these third-party transactions may need to be based on the records of the direct investor rather than on the records of the direct investment enterprise, because the data on these transactions may not be available from the records of the direct investment enterprise.

4.3.2.3 Reinvestment of earnings

157. Reinvestment of earnings of direct investment enterprises (items A1.2 and L1.2) reflects earnings accruing to direct investors (that is, proportionate to the ownership of equity) during the reference period less earnings declared for distribution in that period. Earnings are included in direct investment income because they are deemed to accrue to the direct investor, whether they are reinvested in the affiliate or remitted to the direct investor. However, because reinvested earnings are not actually transferred to the direct investor but rather increase the direct investor's investment in its affiliate, an entry that is equal to that made in the direct investment income account but that flows in the opposite direction is made in the direct investment financial transactions account. In the direct investment income account, this form of income is referred to as "reinvested earnings." However, in the direct investment transactions account, "reinvestment of earnings" is the term that is used, to more clearly differentiate between the income and financial transactions (See the discussion of reinvested earnings in the direct investment income account for more details)

4.3.2.4 Debt instruments transactions

158. Transactions in debt instruments between affiliated enterprises should be recorded separately as shown in Table 3 and 4 (items A2, A4, A6, L2, L4, L6). However, just as debt positions between affiliated financial intermediaries (such as commercial banks, savings institutions, credit unions, mutual funds or finance companies) are excluded from direct investment (though this exclusion does not apply if one of the parties is a holding company), so are the related transactions. See paragraph 128 for explanation.

- *For debt instruments assets*, included are transactions that increase or decrease:

  (i) the resident direct investor's debt instrument claims on its direct investment enterprise (A2)

  (ii) the resident direct investment enterprise's debt instrument claims on its direct investor (A4)

  (iii) other resident enterprises' debt instrument claims on other affiliates abroad (A6)

- For debt instruments *liabilities*, included are transactions that increase or decrease:

  (i) what the resident direct investment enterprise's owes its direct investor (L2)

  (ii) what the resident direct investor owes its direct investment enterprises (L4)

  (iii) what other resident enterprises owe on other affiliates abroad (L6)

159. When a direct investor lends funds to its non-resident affiliate, the level of the direct investor's assets claim (receivables) on the affiliate increases. Subsequently, when the affiliate repays the principal owed to its direct investor, the level of the direct investor's receivables from the affiliate is reduced. Similarly, when a direct investor borrows funds from its foreign affiliate, the level of the direct investor's liabilities (payables) to the affiliate increase and when the direct investor repays the principal owed to its affiliate, the level of the direct investor's payables to the affiliate are reduced. The same would be applicable two affiliates that are not direct investors.

160. Increases in the resident's receivables from, or reductions in the resident's payables to, its foreign affiliates or direct investor give rise to outflows on inter-company debt accounts. Reductions in the resident's receivables from, or increases in the resident's payables to, its foreign affiliates or direct investor give rise to inflows.

161. The net change in inter-company debt includes changes in the value of financial (or capital) leases between direct investors and their foreign affiliates. Financial leases are treated as loans. A financial lease is a contract under which a lessee contracts to pay rentals for the use of a good for most or all of its expected economic life. The rentals enable the lessor over the period of the contract to recover most or all of the costs of goods and the carrying charges. While there is not a legal change of ownership of the good, under a financial lease the risks and rewards of ownership are, *de facto*, transferred from the legal owner of the good, the lessor, to the user of the good, the lessee. For this reason, under statistical convention and standard accounting rules, the total value of the good is imputed to have changed ownership. So, the debt liability at the inception of the lease is defined as the value of the good and is financed by a loan of the same value, a liability of the lessee. The loan is repaid through a series of payments (which comprise a blend of the accrued interest since the last payment and principal payment elements) and any residual payment at the end of the contract (or alternatively, by the return of the good to the lessor).

4.3.3 Direct Investment Income

162. Direct investment income is part of the return on the direct investment position; that is, it is the return on equity and debt investment. Direct investment income consists of earnings on equity investment (for example, a resident direct investor's share in the net income or earnings of its direct investment enterprises) plus income on debt between direct investment investors and direct investment enterprises and between direct investment enterprises and other affiliated enterprises. Direct investment income payables are calculated in a similar way. Direct investment income is recorded as it accrues. However, as debt instruments between affiliated financial intermediaries are excluded from direct investment, so is the debt income between them. See section XXX for explanation.

163. Direct investment earnings measure earnings from current operations. Therefore, this amount should be calculated before recognition of holding gains and losses and extraordinary items. Operational earnings of the direct investment enterprise should be reported after deducting provisions for depreciation and for corporate taxes charged on these earnings by the government in the host economy. Depreciation should, in principle, be measured at current replacement cost, particularly if market values are available for stock figures. If data on depreciable assets and on depreciation are available only on a book value or historical cost basis, those values should be adjusted to a current replacement cost basis, wherever possible. Compilers should base the estimates of direct investment earnings, and of direct investment positions, on a current market value basis. Estimates at book value should be adjusted to market values if market values are unavailable.

164. The earnings of direct investment enterprises reported using the "Current Operating Performance Concept" (COPC) should exclude:

(i) any gains or losses arising from valuation changes, such as inventory write-offs, write-downs, or write-ups;

(ii) gains or losses on plant and equipment from the closure of part or all of a business;

(iii) writing-off of intangible assets, including goodwill, due to unusual events;[24]

(iv) writing-off of research and development expenditures capitalised in a prior period;

(v) provisions for losses on long-term contracts;

(vi) exchange rate gains and losses incurred by the direct investment enterprise both from its trading activities and from its holdings of foreign currency assets and liabilities

(vii) unrealised gains or losses from the revaluation of fixed assets, investments and liabilities

(viii) realised gains or losses made by the enterprise from the disposal of assets or liabilities

165. The exclusion of realised and unrealised holding gains and losses is applicable to all direct investment enterprises, including those such as banks and securities dealers for whom the making of such gains is an important or even the main part of their business. This promotes consistency with the calculation and treatment of earnings in the national economic accounts, as prepared pursuant to *SNA* guidelines.

166. Some countries apply the All-inclusive concept to measure the earnings where income is estimated after allowing for all items (including capital gains and losses). This method is not recommended by the *Benchmark Definition.* However, because many countries base their earnings data on all-inclusive basis, they are encouraged to provide supplemental data on holding gains and losses and other extraordinary basis.

167. Direct investment income should be separately shown for assets and for liabilities. Income on direct investment assets should be recorded as positive amounts under income receivables, and income on direct investment liabilities should be recorded as positive amounts under income payables. When a direct investment enterprise pays a dividend that is larger than the earnings from current operations (or where it incurs an operational loss), negative reinvested earnings will result. These should be recorded as a negative credits for income on direct investment assets and as positive debits for direct investment liabilities. (All income credits on reinvested earnings (whether negative or positive) should have an equal and opposite entry in the financial account (under "outward foreign direct investment, reinvestment of earnings"). Similarly, all income debits on reinvested earnings (whether negative or positive) should have an equal and opposite entry in the financial account, under "inward foreign direct investment, reinvestment of earnings".

24. The standard amoritization of intangible assets is, however, included as an expense under the COPC.

168. For direct investment income under the asset liability principle, elements are schematically shown as follows:

Table 5. Foreign Direct Investment Income According to Asset Liability Principle

Receivables	***Payables***
Of *direct investors from direct investment enterprises*	*Of direct investment enterprises to direct investors*
A1 Earnings on equity	**L1** Earnings on equity
A1.1 Distributed earnings	**L1.1** Distributed earnings
A1.2 Reinvested earnings	**L1.2** Reinvested earnings
A2 Interest (on debt instruments)	***L2*** Interest (on debt instruments)
Of direct investment enterprises from direct investors- Reverse investment	*Of direct investors to direct investment enterprises- Reverse investment*
A3 Distributed earnings	**L3** Distributed earnings
A4 Interest (on debt instruments)	**L4** Interest (on debt instruments)
Of direct investment enterprises from other affiliated enterprises abroad	*Of direct investment enterprises to other affiliated enterprises abroad*
A5 Distributed earnings	**L5** Distributed earnings
A6 Interest (on debt instruments)	**L6** Interest (on debt instruments)

169. To illustrate the directional principle for direct investment income, elements are schematically shown as follows:

Table 6. Foreign Direct Investment Income According to Directional Principle

Income on Outward Foreign Direct Investment	***Income on Inward Foreign Direct Investment***
Income on outward equity	*Income on inward equity*
A1 Earnings on equity	**L.1** Earnings on equity
A1.1 Distributed earnings	**L1.1** Distributed earnings
A1.2 Reinvested earnings	**L1.2** Reinvested earnings
-L3 Distributed earnings of DI to DIE*	**-A3** Distributed earnings of DIE from DI*
A5 Distributed earnings of DIE from other affiliated enterprises abroad	**L5** Distributed earnings of DIE to other affiliates enterprises abroad
Interest on outward debt instruments	*Interest on inward debt instruments*
A2 Interest receivable	***L2*** Interest payable
-L4 Interest payable of DI to DIE*	**-A4** Interest receivable of DIE from DI*
A6 Interest receivable (on debt instruments)	**L6** Interest payable (on debt instruments)

* entered as a deduction in outward or inward FDI

4.3.3.1 Direct Investment Income on equity

170. Direct investment income on equity (Table 5 and 6, items A1 and L1) – or direct investment earnings – is the return of the direct investor on the equity component of the direct investment position. For investment by a direct investor in its direct investment enterprise (Table 5 and 6, items (A1.1, A1.2) and (L1.1, L1.2)) it consists of "distributed earnings" and "reinvested earnings". For investment by a direct

investment enterprise in its direct investor (A3 and L3) or investment in other affiliated enterprises (items A5 and L5), income on equity consists only of distributed earnings as reinvested earnings are not relevant. The reason for this is that the direct investment enterprise does not hold 10 per cent or more of the voting power in its direct investor, so that reinvested earnings are not attributable to it. If, however, the direct investment enterprise does hold 10 per cent or more of the voting power in its direct investor, it then becomes a direct investor in its direct investor, and reinvested earnings are attributed to it.

171. Earnings exclude currency translation gains and losses and other holding gains and losses, whether or not such gains and losses are included in net income for financial accounting, tax, or other purposes. However, these earnings include the impact of changes in foreign currency exchange rates on the operating revenues and expenses of direct investment enterprises, because these are not from holding gains and losses. This treatment is intended to make income and earnings correspond to the current operating performance of foreign affiliates, in accordance with international guidelines.

172. Direct investment earnings are measured before accounting for (or is gross) of withholding taxes on distributed earnings and interest. Withholding taxes are viewed as being levied on the recipient of the distributed earnings or interest to which the taxes are applied, and thus as being paid across borders even though, as an administrative convenience, the tax payments are actually made by the firm whose disbursement gave rise to them. Thus, foreign withholding taxes on distributed earnings and on interest received by a resident direct investor are recorded as if they were paid by the direct investor, not by the direct investment enterprise. Similarly, the resident economy's withholding taxes of the reporting country on interest payments by resident direct investors or resident direct investment enterprises are recorded as if they were paid by the non-resident, not by the resident.

173. When a direct investment ownership chain exists, direct investment earnings should reflect income from direct and indirect enterprises. All earnings from an ownership chain are geographically allocated to the enterprises directly owned. However, these earnings should include the claims of directly owned enterprises' on the earnings of enterprises below them in the ownership chain, proportionate to the direct investor's ownership of shares. For example, if A (resident in Country A) owns 100 per cent of B (resident in B), which, in turn, owns 100 per cent of C (resident in C), B's retained earnings will include all of the earnings from its current operations, including its investment income, which, by definition, includes all C's retained earnings (as C is 100 per cent owned by B, B will be deemed to receive all C's retained earnings as reinvested earnings). As a consequence, the reinvested earnings receivable by A from its ownership of all the shares in B will include C's reinvested earnings. Therefore, A does not need to seek the information on C's retained earnings directly from C, in order for that income to be measured correctly, but it is recommended that the compiler of direct investment data in Country A makes sure that B understands that it should report C's reinvested earnings, even though it is an imputed transaction. (In instances, where the direct investors do not hold 100 per cent of the equity in the immediate direct investment enterprise, their reinvested earnings receivable should be in accordance with the proportion of the shares they own. The compiler will often find that the information required to determine a direct investor's share of the retained earnings of indirectly owned direct investment enterprises becomes more difficult once its share of indirect ownership falls below 50 per cent. In that instance, it is recommended that it be impressed upon respondents to direct investment surveys of the importance that this information be collected.)

174. Once a direct investment relationship exists, direct investment earnings are based on the direct investor's percentage share in the current earnings of the given direct investment enterprise.

4.3.3.2 Distributed earnings

175. Distributed earnings (items A1.1, A3, A5 and L1.1, L3, L5) consist of dividends and distributed branch profits. Dividends include dividends to shareholders, both common and participating preferred stock, whether voting or nonvoting, according to the contractual relationship between the enterprise and these various types of shareholders, before deduction for withholding taxes. Dividends exclude liquidating dividends and bonus shares (which are dividends in the form of additional shares of stock). Liquidating dividends are excluded because they are a return of equity rather than a remittance of earnings (liquidating dividends are included instead as transactions in the direct investment equity). Distributed earnings can be paid out of current or past earnings and may result in negative reinvested earnings if the distribution of dividends exceeds total earnings. Bonus shares are excluded because they are a capitalisation of retained earnings – a substitution of one type of equity (capital stock) for another (retained earnings); in an accounting sense, they reduce the amount of retained earnings available for distribution but leave total owners' equity unchanged.

4.3.3.3 Reinvested earnings

176. Reinvested earnings of direct investment enterprises (items A1.2 and L1.2) reflect earnings on equity accruing to direct investors less distributed earnings, proportionate to the percentage ownership of the equity owned by the direct investor(s). As noted in the discussion of "reinvestment of earnings," reinvested earnings is included in direct investment income because the earnings by the direct investment enterprise are deemed to be the income of the direct investor (proportionate to the direct investor's holding of equity in the direct investment enterprise), whether they are reinvested in the affiliate or remitted to the direct investor. However, because reinvested earnings are not actually distributed to the direct investor but rather increase the direct investor's investment in its affiliate, an entry that is equal to that made in the direct investment income account but of opposite direction is entered in the direct investment transactions account. In the direct investment income account, this form of income is referred to as "reinvested earnings."

4.3.3.4 Direct Investment income on debt

177. Direct investment interest payables (on liabilities) and interest receivables (on assets) are separately recorded. Thus, interest receivables comprise interest accruing to residents (direct investors and direct investment enterprises) on their debt receivables, and interest payables comprise interest accruing to non-residents (direct investment enterprises and direct investors) on debt payables. Compilers are encouraged to provide supplemental information on interest on long-term obligations and interest on short-term obligations (basing this distinction on the remaining maturity instead of the original maturity of the instrument is preferred).

178. No direct investment interest receivables or payables are recorded when both parties are affiliated financial intermediaries (such as commercial banks, savings institutions, credit unions, mutual funds or finance companies).

179. Interest includes the interest component of transactions under financial leases between enterprises in a direct investment relationship, assuming the outstanding capitalized value of such leases is included in the debt component of the direct investment position at discounted value.

180. The interest component of direct investment income reflects accruals of interest on debt in the current period (i.e. interest accrued), whether or not paid.[25] Interest receivable and payable should be compiled separately. Interest receivable by direct investors from their direct investment enterprises, and receipts from direct investment enterprises from their direct investors and fellow enterprises are included. Payables are calculated in an analogous manner.

181. Interest accruals on marketable securities should be calculated under the debtor basis, not the creditor basis. Under the debtor basis, interest accruals on fixed interest rate securities reflect the amount of interest that the debtor is contractually obligated to pay, and changes in market interest rates since the debt was issued are not taken into account. (In contrast, under the creditor basis, interest accruals on fixed interest rate securities reflect market interest rates in the current period, not the interest rates in effect at the time(s) that the debt securities were originally issued.)

182. Interest on debt accrues continually over the life of the debt and adds to the principal. Thus, actual payments of the debt (as opposed to accruals) are financial account transactions and not interest.

183. Foreign-currency-denominated fixed-rate instruments. At inception, future cash flows are determined in the relevant foreign currency. Interest expressed in foreign currency is to be converted into the domestic currency units at the mid-point market exchange rate for the periods in which the interest accrues.

4.3.4 Other changes

184. All changes in direct investment positions result either from financial flows (in financial transactions, discussed above) or "other changes in financial assets and liabilities". The latter account is subdivided into three components: Exchange rate changes, other price changes, and other changes in volume. These are described in the following sections.

4.3.4.1 Exchange rate changes

185. Exchange rate changes – a component of "other changes in financial assets and liabilities" – may arise from positions between enterprises in a direct investment relationship that are denominated in a currency other than that in which the accounts are compiled. For example, the direct investment enterprise may sell goods or services to its direct investor, and the unpaid amount may be payable in a currency that is foreign to one or both of the transactors. A given amount of debt expressed in units of a foreign currency may translate into different amounts at different times, expressed in units of a home country's currency, solely as a result of exchange rate fluctuations. The impact of changes in exchange rates on the amount owed, as expressed in the home-country's currency, should be excluded from financial flows and instead recorded in this account.

186. A direct investment enterprise also may have positions expressed in units of a foreign currency with an entity other than its direct investor. Changes in exchange rates will have an impact in that direct investment enterprise's assets and/or liabilities, and therefore its net worth. Such increases or decreases are

25. {Accrual accounting records flows at the time economic value is created, transformed, exchanged, transferred or extinguished. This means that flows which imply a change of economic ownership are entered when ownership passes and services are recorded when provided. In other words, the effects of economic events are recorded in the period in which they occur, irrespective of whether cash was received or paid or was due to be received or paid. (*1993 SNA* paragraph 3.94 and *GFSM 2001* paragraph 3.25)}

holding gains that should be excluded from direct investment earnings and instead recorded in this account to the extent they impact the direct investor's equity investment position in the enterprise.

187. It should be noted that operating revenues and expenses denominated in units of a foreign currency will also translate into different amounts, expressed in units of the home country's currency, solely as a result of exchange rate changes. However, these impacts should be included in direct investment earnings in the current period, because they result from actual on-going operations in the current period rather than from holding gains.

4.3.4.2 Other price changes

188. Changes in direct investment positions that result from holding gains or losses, but that do not result from exchange rate changes, should be recorded in this account. For example, direct investment positions may change due to a direct investment enterprise's current-period holding gains and losses, write-offs or write-ups, and other events or price changes that result in it incurring holding gains and losses.

189. Entries in this account may arise under many of the recommended methods for valuing unquoted shares in terms of current period prices. For example, if positions are revalued under the "Net Asset Value, including goodwill and identified intangibles" method, much or most of the change in the direct investment equity position may be recorded in this account.

190. Another example of a transaction that will result in an entry in this account is when a direct investor sells its direct investment enterprise for more (or less) than its value in the direct investment position. The amount received from the sale of the enterprise is recorded as a financial inflow in the direct investment accounts compiled by the country of the direct investor; the difference between the financial inflow/outflow and the value of the direct investment enterprise in the position must be recorded as an "other price change," so as to remove from the position the full value of the sold affiliate. Under the International Financial Reporting Standards, enterprises may keep their books in a currency other than the domestic currency or the currency in which the accounts are compiled. When these enterprises report information to the compiling authority, it may need to be converted to the domestic currency (or the compilation currency). The impact of changes in exchange rates over time to this conversion process is considered a price change rather than an exchange rate change.

4.3.4.3 Other changes in volume

191. Changes in direct investment positions that result from all causes other than transactions and holding gains and losses should be recorded in this account. For example, direct investment asset or liability positions may change due to changes in coverage that result in breaks in series. If historical adjustments and corrections to transactions cannot be made, an entry in this account may be necessary, to reconcile the prior year's ending position with the current year's ending position.

4.3.4.4 Reclassifications

192. As indicated earlier where an investor initially holds equity securities that constitute less than the 10 per cent threshold, but acquires additional equities of that enterprise, the increase in the ownership of shares may qualify for a direct investment relationship if equity holdings reach 10 per cent or more of the voting power in the entity. The total amount of the investment should be included in the direct investment position, as these figures relate to the total position at a given point of time. Thus, if an investor held 5 per cent of the equity of a non-resident enterprise at the beginning of the period (for a value of 100), acquired a further 10 per cent during the period (for 200), thereby making the investor a direct investor, in order to reconcile the opening and closing balances in direct investment (from zero to 300, when only 200 is recorded in financial transactions), an entry of 100 (representing the non-direct investment holding at the

beginning of the period) in this account would provide the missing element. Similar principles apply in the case of the sale or other disposition of a direct investment equity interest that results in a reclassification into or out of direct investment definition.

193. When the acquisition or disposition of an equity interest results in the reclassification into or out of direct investment definition, the reclassifications of debt and equity should be accomplished via adjustments to the appropriate positions and not via transactions. The adjustments should be recorded in "other changes in volume". Corporate restructuring has become a commonplace occurrence. A business may establish a holding company in a foreign economy, and then change its organisational structure in various ways, such as by transferring ownership of directly owned direct investment enterprises to the newly established holding company, with the directly owned enterprises thereby becoming indirectly owned direct investment enterprises. In this circumstance, questions arise concerning whether the change in organisational structure should be accounted for as transactions or as valuation adjustments and, if it should be accounted for as transactions, how to value the transactions and against which economies should the transactions be shown.

194. When changes in the ownership of direct investment enterprises arise as a result of a corporate restructuring, financial flows should be recorded. At a global level, these flows may be largely or entirely offsetting. For example, if a direct ownership interest in a direct investment enterprise resident in Country A were transferred to a direct investment enterprise located in Country B, the transaction should be recorded as a reduction in direct investment in Country A and as an increase in direct investment in Country B.

195. A similar treatment is involved when a *corporate inversion* takes place. A corporate inversion is a specific type of corporate restructuring, and, as with most other types of restructuring, it should be included in transactions. In cases where these transactions are significant, compilers are encouraged to provide explanatory notes.

196. A corporate inversion occurs when a domestic corporation creates a new corporation in another country abroad (for example, for tax reasons or regulatory requirements, but there may be other reasons) and the resulting corporation exchanges shares in itself for the outstanding shares in the enterprise that created it. The accounts for the economy of the original corporation show new direct investment in the reporting economy in the original enterprise by the newly created foreign corporation.

197. In addition, if, as sometimes happens, the corporation that undertook the inversion had been a direct investor and if it transferred its ownership interests in its foreign affiliates to its newly created foreign parent corporation, the contributions of these ownership interests should be recorded as a capital outflow on direct investment liabilities and as a capital inflow on direct investment assets.

198. From time to time, new countries, territories, or currency and economic unions may be formed, or they may cease to exist. For example the European Union has changed its composition several times. Changes in direct investment classification that must be recognized as a consequence of any of these events should be recorded as arising from adjustments to direct investment positions ("other changes in volume") and not as transactions. This is because, under these circumstances, no transaction between a resident and a non-resident has occurred. The previous owning and owned enterprises continue to be the owning and owned enterprises, even though one or both are now classified in a new or different country, territory, or currency or economic union.

4.4 Scope of Foreign direct investment scope

4.4.1 Standard features of FDI statistics

[TO BE COMPLETED FOLLOWING WIIS DISCUSSION SEE DOCUMENT DAF/INV/STAT(2007)3]

4.4.1.1 Aggregate FDI components

4.4.1. 2 Detailed FDI statistics

4.4.2 {Optional} features of FDI statistics

[TO BE COMPLETED FOLLOWING WIIS DISCUSSION SEE DOCUMENT DAF/INV/STAT(2007)3]

4.4.2.1 FDI by type: Mergers and acquisitions

4.4.2.2 FDI according to Ultimate host/investing country

4.4.4 Transactions with indirectly owned enterprises

199. Direct investors may makes loans to or borrow funds from their indirectly owned direct investment enterprises. (An indirect ownership interest exists when a direct investment enterprise that is directly owned, in turn, owns an enterprise that also qualifies as a direct investment enterprise of its own direct investor. In this example, the direct investor at the top of the ownership chain holds an indirect ownership interest in the enterprise at the bottom of the ownership chain.) The *Benchmark Definition* recommends that such transactions be included in direct investment and allocated to the country of the indirectly owned direct investment enterprises (see chapter 3 for a description of the Framework Direct Investment Relationship).

4.4.5 Transactions with other related enterprises

200. Direct investment enterprises may make loans to or borrow funds from other related enterprises. (Other related enterprises are direct investment enterprises, none of which holds a 10 per cent or more voting interest in any other, but that are ultimately owned or controlled by the same direct investor.) The *Benchmark Definition* recommends that such transactions be included in direct investment and allocated to the economy of the affiliated enterprises. Loans made by direct investment enterprises in economy A to other affiliated enterprises in economy B should be included in direct investment asset in economy A and in direct liability in the reporting economy in country B.

4.4.6 Banks and other financial intermediaries

201. The *Benchmark Definition* recommends that, in the case of banks and other affiliated financial intermediaries, all inter-company flows and positions – with the exception of those pertaining to equity investment – with related financial intermediaries should be excluded from direct investment flows. Deposits and other amounts lent by a parent bank or other financial intermediary to its direct investment enterprise located abroad that is also a financial intermediary, and deposits and other borrowings taken from such offices, should also not be classified as direct investment.

4.4.7 Financial leases

202. Wherever an operator (the lessee) acquires an asset under a financial (or capital) lease (as distinct from an operating lease), the legal owner of the assets (the lessor) should be regarded as making a loan to the lessee that the lessee uses to buy the assets. If this arrangement is between a direct investor and its direct investment enterprise, the loan should be included in direct investment, and be treated according to the provisions of this *Benchmark Definition*, in the same way that a conventional loan would be regarded and treated. The SNA guidelines describe financial leases as lease arrangements involving a capital good for most or all of its expected economic life, during which time the lessor expects to recover most or all of the cost of the goods and the carrying charges. Consistent with this description, a financial lease arrangement is to be taken as presumptive evidence that a change of ownership is intended. A change of ownership is imputed because the lessee assumes all rights, risks, rewards, and responsibilities of ownership in practice and, from an economic point of view, can be regarded as the *de facto* owner. The financial lease essentially is a method of financing the purchase of the good by the lessee (as opposed to taking out a loan for the purchase).

CHAPTER 5.
MEASURING FOREIGN DIRECT INVESTMENT

5.1 Summary

203. {This chapter describes the accounting principles and the recommended method for valuating Foreign Direct Investment positions and transactions. For positions, valuation methods for quoted versus unquoted shares are described. Valuation of transactions under transfer pricing is also covered in this chapter.}

5.2 Accounting principles

204. In principle, foreign direct investment transactions are to be recorded when a change of ownership occurs between a resident and a non-resident. The creation, change or extinguishment of foreign direct investment positions results from these transactions. As stated in the SNA93 (§3.12), "a transaction is an interaction between two institutional units by mutual agreement…" It follows that transactions and positions should be recorded on an accrual basis (see SNA93 §3.94) that is when they are incurred rather then when they are settled. While every effort is to be made to obtain data on an accrual basis, it may prove difficult to achieve in practice. Often the sources of information determine the time at which the transactions may be recorded.

205. {Market prices are the appropriate principle for valuation of transactions and positions data. Market prices reflect the command that entities have currently over resources (for assets) and the current charge on their resources required for the liquidation of their liabilities. The use of market prices also serves as the only basis under which all agents can calculate their assets and liabilities consistently, thereby reducing asymmetries between the creditor and debtor. Market prices are used for transactions as they best reflect the mutual exchange of value between two, unrelated entities. In some cases of related entities, however, transaction prices may not reflect market prices. These situations are referred to as transfer prices. Transfer pricing is discussed in section 5.2.2.}

206. Some holdings included in the direct investment position may be denominated in a foreign currency. When these positions must be translated into units of another currency, the closing mid-point between the buy and sell spot exchange rate relevant at the date to which balances relate should be used. Transactions must be converted at the mid-point of the buy and sell spot exchange rates at the time of the transaction.

5.3 Valuation

207. The methodological guidance contained in the *Benchmark Definition* reflects the synthesis of three fundamental goals. First, *market value* is the preferred conceptual basis for measuring all positions and transactions. Second, emphasis on providing practical guidance, to allow compilers to implement the recommendations in ways that are not unduly burdensome or costly. Third, to provide guidance that will result in the compilation of statistics that are comparable across countries. Sometimes there may be conflicts between pure concepts and the other goals of practicality and comparability. When these conflicts occur, compromises have to be made.

208. The fourth edition of the *Benchmark Definition* maintains its recommendation that market value is the conceptually ideal basis for valuing direct investment transactions and positions. Market valuation places all assets at current prices rather than when last purchased or revalued, and promotes consistency of values of assets of different vintages. It also promotes consistency when comparing stocks, transactions and other flows of different enterprises, industries, and countries.

209. Although market value is the recommended basis for valuation, it is recognized that, in practice, values based on the books of direct investment enterprises (or investors) often are used to determine the values of stocks or transactions of direct investment. This is because enterprise balance sheet values – whether they are regularly revalued on a current value basis, reported on a historical cost basis, or reported on some other basis – may represent the only source of information on valuation available in many countries, particularly in regard to unlisted shares. The collection of data from enterprises on a current market value basis is encouraged where feasible. Countries that produce data on a market value basis may also produce data on a book value basis, where the two differ, to provide additional information for cross-country comparisons.

210. As noted in Chapter 4 Scope of FDI, the main components of direct investment are direct investment positions, direct investment income and direct investment transactions. Methodological guidance and other information related to valuation are provided below on each of these components.

5.3.1 Valuation of foreign direct investment positions

5.3.1.1 Equity positions

211. As noted earlier, the basic principle is the market value when measuring equity position. In reality, the actual market value of the equity may not be available and an approximation may be required. The discussion on the valuation of direct investment equity positions focuses on methods that may be used to value *quoted shares*, *unquoted shares*, and *equity in unincorporated enterprises* (including joint ventures and branches) to market value as the main valuation principle of equity positions.

212. When valuing equity positions, a distinction is made between the valuation of listed equity and unlisted equity. This is because listing on an organised market provides a good basis for calculating the market value of equity, while in many cases an approximation will be necessary for unlisted equity. In either case, if there has been a material change in the financial position of an enterprise since the date to which the valuation applies (up to and including the reference date), an adjustment may have to be made. Examples of such material events may include an unexpected decision in a lawsuit, credit downgrade or upgrade, major new invention or mineral discovery, or bankruptcy.

213. As noted earlier, although some methods are not recommended as end-points in valuing direct investment equity for the main accounts, they may nonetheless serve as appropriate starting points. Indeed, such methods may serve as the only basis upon which information can be directly collected from direct investors and direct investment enterprises.

214. For countries that begin their valuation process via the collection of book value[26] information, the books of the direct investment enterprise should serve as the starting point. International comparability of

26. Book value is a term that broadly encompasses many different accounting methods. It represents the values that appear on the books of an entity. It could represent the values on the books of direct investors or on the books of direct investment enterprises. In fact, in common usage, the term may encompass any of the valuation methods described in Annex 5, whether or not recommended for use in the main accounts.

direct investment earnings and direct investment positions is only possible if both the investing and host countries use the same set of books as their starting point for deriving estimates of market values.

215. The books of the direct investment enterprise are usually more comprehensive than those of the direct investor. This is because, under tax and financial accounting rules followed by most countries, the books of the direct investment enterprise will typically reflect current period earnings, from which retained earnings can be readily derived. In contrast, the books of direct investors may not reflect the current period earnings of their direct investment enterprises; particularly in the case where these direct investment enterprises are not majority owned (these investments are sometime carried at cost on the investor's books).

Quoted (or listed) shares

216. Quoted (or listed) shares are equity securities that are listed on an organized stock exchange. Their values can, therefore, be determined by multiplying the number of shares held by the direct investor(s) by the most recent bid/ask prices or at the price at which the shares were last traded. In this manner, a market price value of the holdings of the shares held by the direct investor(s) – and thus the value of the share liability of the direct investment enterprise to its direct investor(s) – can be determined. Usually, the equity securities of only a relatively small portion of direct investment enterprises are publicly traded on organized stock exchanges because most direct investment enterprises are either 100 per cent owned by the direct investor or are closely held by a small group of investors.

217. Compilers should estimate the market value of listed direct investment enterprises by using the mid-point between the most current bid and ask prices, or by using the prices at which the quoted shares last traded on the exchanges. The use of actual market prices will help assure that each share in a given company is valued at the same price, regardless of the extent of the ownership of shares by the direct investor.

Unquoted (or unlisted) shares

218. Unquoted (or unlisted) shares represent equity not listed on an organized or public stock exchange. By their nature, a market valuation estimate is not available for unlisted equity and an approximation to the market value is required to measure direct investment. Several methods for approximating market value are acceptable and are discussed in detail in Annex 5: Market valuation of unlisted equity.

219. In practice, the choice of the method to be used by a compiler will depend on three criteria – (i) the type of information available on which to base an approximation, (ii) how well the method approximates market value, and (iii) the need to allow for comparability across countries and for symmetrical recording by creditors and debtors. In most cases, these arguments are also applicable to the valuation of equity in unincorporated direct investment enterprises. Compilers should be transparent and should state clearly the method(s) they employ in developing their direct investment aggregates.

220. SNA93 is very prescriptive in recommending that "the value of shares in corporations that are not quoted on stock exchanges or otherwise traded regularly should be estimated using the prices of quoted shares that are comparable in earnings, dividend history and prospects…" In the absence of recent transactions prices and/or in order to establish a time series, this method should be supplemented by another approach. It was concluded in a review of the SNA93 benchmark that the approaches should be broadened and generalized (including a discussion of pros and cons).

221. Flexibility in the approaches to valuing unquoted equity is recommended.

222. Methods accepted by the *Benchmark Definition* to approximate unlisted equity positions are the following:

(i) Recent transaction price

(ii) Market capitalization method

(iii) Net asset value

- Including goodwill and intangibles
- Excluding goodwill and intangibles

(iv) Present value

(v) Own funds at book value

(vi) Apportioning market value of global enterprise group to local operation

Each of the above methods is described in Annex 5: Valuation of unlisted equity

223. Other valuation methods are not approved by this *Benchmark Definition* even though they may be the only methods available to the compiler from the information available to them. They could only serve as a starting point to collect foreign direct investment equity data and are not recommended as a proxy to market value. These are the following;

- Historic or acquisition cost
- Accumulation of foreign direct investment equity capital flows
- Stock market price index applied to accumulated direct investment equity capital flows.
- Book value

These methods are also briefly described in Annex 5: Valuation of unlisted equity.

Equity in unincorporated enterprises (including branches)

224. As noted, the above discussion of unlisted shares is also applicable to the equity in unincorporated direct investment enterprises (including branches, unincorporated joint ventures, and limited liability partnerships). It should be stated that Net Asset Value (NAV) is the method recommended by the SNA to value equity in branches. Compilers should clearly state what major assumptions and method they apply in developing their estimates of direct investment equity positions.

5.3.1.2 Debt positions

225. The basic principle is that market value of debt should be used. However, apart from debt securities, international standards (including this *Benchmark Definition*) recommend the use of nominal values as a proxy for market value for all other debt. The use of nominal values in valuing direct investment loans is consistent with international standards for valuation of loans with affiliated and unaffiliated parties. **{**The *Benchmark Definition* recommends that the values of all debt outstanding be inclusive of accrued interest, with foreign currency debt converted to the national currency using the rate of exchange at the close of business on the reference date**.}** The use of nominal values is partly influenced by

pragmatic concerns about data availability and the need to maintain symmetry between debtors and creditors. In addition, because loans are not intended for negotiability and do not have an active market, a market price can be somewhat subjective. Nominal value is also useful because it shows actual legal liability and the starting point of creditor recovery behaviour. In some instances, loans may also be traded, often at discount, or a fair value may exist or would be possible to estimate. It is recognized that nominal value provides an incomplete view of the financial position, particularly when the loans are impaired. Therefore, supplementary information on the fair value of the claims in loans may be useful. In particular, data on the fair value of impaired loans should be included as a memorandum item (see paragraphs 6.xx-xx for the definition of an impaired loan.) Loans that have become negotiable *de facto* should be classified under debt securities (see paragraph 5.xx for criteria for reclassification.)

5.3.2 Valuation of FDI transactions and transfer pricing

226. Foreign direct investment income and foreign direct investment flows are to be recorded when a change of ownership occurs between a resident and a non-resident at market prices which are defined as: "amounts of money that willing buyers pay to acquire something from willing sellers… (BPM)" which can be represented by the value agreed upon by the two parties to the transaction. However, transaction value may not always be at market price, especially if transactions are carried out with related foreign parties.

227. Transactions between affiliated enterprises may often involve transfer pricing that are motivated with income distribution or equity build-ups or withdrawals. Replacing book values (transfer prices) with market value equivalents is desirable in principle, particularly when the distortions are large. Selection of the best market value equivalents to replace book values is an exercise calling for cautious and informed judgment. In most cases, sample surveys, contacts with enterprises and government agencies engaging in international transactions on a large scale, exchanges of information between compilers in partner countries, or similar statistical research will be necessary to provide the basis for such judgment.

228. Entries should be recorded in direct investment transactions (and positions) in the relatively rare cases where transfer pricing is identified and is substantial, and if it can be quantified. In particular:

(i) If a direct investment enterprise is over-invoiced on a good or service provided by the direct investor; or

(ii) If a direct investor is under-invoiced on a good or service provide by the direct investment enterprise,

then the use of transfer pricing acts as a hidden distribution of earnings from the direct investment enterprise, and so distributed earnings should be increased.

(iii) If a direct investment enterprise is under-invoiced on a good or service provided by the direct investor; or

(iv) If a direct investor is over-invoiced on a good or service provide by the direct investment enterprise,

then the use of transfer pricing acts as hidden investment in the direct investment enterprise, and so direct investment equity flows should be increased. An offsetting adjustment should be made to transactions in goods, services, interest, etc., for the amount that is reclassified as a distribution of earnings or equity capital transaction.

229. It is clear that a large number of adjustments are required if compilers adjust data on actual transactions for the existence of transfer pricing. As noted, these efforts are worthwhile where the amount of the adjustment is substantial and can be reasonably accurately quantified.

CHAPTER 6.
SPECIAL ENTITIES

6.1 Summary

230. There are a number of special cases where it may be unclear whether a particular type of enterprise or activity qualifies for treatment as a direct investment enterprise or direct investment. Several of these cases are discussed below.

[SUMMARY WILL BE DEVELOPED FOLLOWING THE RESULTS OF DEVELOPMENTAL WORK]

6.2 {{Special Purpose Entities}}

[THIS SECTION WILL BE REVISED ACCORDING TO THE RESULTS OF THE PG ON SPES.]

231. {{SPEs are legal structures that have little or no employment, or operations, or physical presence in the jurisdiction in which they are created. They are typically used as devices to hold assets and liabilities, and usually do not undertake production. As legal devices, SPEs may be relatively cheap to create and to maintain. They may offer taxation, regulatory, and confidentiality benefits. Incorporation of SPEs is often associated with off-shore financial centres[27] but they may also be found in other jurisdictions.}}

232. {{Multinational enterprises often diversify their investments geographically, through organisational structures. These may include certain SPEs which facilitate financing of investments for the multinational enterprise from sources both internal and external to the enterprise group. Additionally, SPEs also serve other functions such as sale and regional administration including management of foreign exchange risks and other activities aimed at profit maximisation. Special purpose entity is a generic label applicable to these organisational structures, which are also variously referred to as *financing subsidiaries*, *conduits*, *holding companies*, *base companies* and *regional headquarters*. In some instances, multinational enterprises may use existing operational companies to perform functions usually associated with SPEs. }}

233. {{Since SPEs are an integral part of the organisational structure of a multinational enterprise, their transactions arise from direct investment relationships – where transactions and positions are across economies, they should be reflected in direct investment statistics. However, in response to growing users' analytical needs, FDI statistics ***excluding*** transactions and positions of these entities should be shown as [supplemental] items while they may largely distort the geographical and industry analysis of direct investment. }}

234. {{SPEs are residents of the economies in which they are incorporated or organised and, therefore, they may be direct investors or direct investment enterprises. Even if they are shell companies or pass-through entities without any other productive economic activity of their own, they qualify as direct

27. The definition and the geographical coverage of off-shore centres may differ depending on the purpose of the analysis. This *Benchmark Definition* does not apply any specific description of off-shore centres while the focus is rather the entity that qualifies as direct investor or direct investment enterprise but not necessarily their geographical location.

investors or as direct investment enterprises by virtue of being resident in one economy and being owned by, or owning, an enterprise in a different economy. Thus, transactions and positions with direct investors and direct investment enterprises that are SPEs are to be treated in the same way as those with investors and enterprises that are not SPEs. }}

235. {{In recent years, direct investors have made extensive use of SPEs for the purpose of channelling funds to, and for borrowing funds from, third countries, and for the purpose of holding ownership interests in direct investment enterprises. Such transactions/positions on a gross basis may lead to an overstatement of direct investment and distort the economic analysis. In other words, transactions where the SPE is the immediate host or investing entity are usually for simply channelling the funds (but not necessarily with the objective to establish a lasting interest). They do not, in most cases, provide the expected impact of direct investment such as technology transfers, access to competitive markets, poverty reduction, etc. In consequence, there is an increasing user requirement for isolating transactions and positions by SPEs which are purely pass-through capital and which render the data difficult to interpret for policy or other decision making process. }}

236. {{In response to new data requirements, compilers should provide [supplemental] direct investment transactions and positions for "FDI excluding SPEs". Discussions in the international fora concluded that there is no common definition to identify a SPE and there is no single solution to respond to user concerns raised by SPEs. Therefore, for these [supplemental] statistics, compilers should, as a first step, try to identify and exclude "pass-through" transactions and positions. If that information is not available, the compiler should then identify SPEs according to their national definitions of SPEs with a view to excluding their transactions/positions from the [supplemental] data ("FDI excluding SPEs").[28] Furthermore, these [supplemental] data sets should be presented at detailed level by geographical allocation and industry classification. To help compilers in identifying such entities, Annex 7. Special Purpose Entities provides a list of practical examples and the case study of the Netherlands. }}

237. {{Identifying ultimate host and ultimate investing countries to determine geographical allocation are helpful for direct investment positions in addressing some of the concerns raised by SPEs. However, given the complexity of some investment structures and the practical difficulties in implementation, these concepts are still under review by OECD and IMF experts as a part of the future research agenda (see Annex 13). }}

6.2.1 Shell companies, conduits and holding companies

238. {{The term *shell* is used to refer to a company that is formally registered, incorporated, or otherwise legally organised in a non-resident economy but which does not conduct any operations in that economy other than in a pass-through capacity. Shells tend to be conduits or holding companies and are generally included in definitions of SPEs. }}

239. {{A *conduit* is a company that obtains or borrows funds, often from unaffiliated enterprises, and remits those funds to its direct investor or another affiliated enterprise. {{A *holding company* is established to hold, and, in most cases, to manage, wealth. Some conduits and holding companies may have a substantial physical presence as evidenced by office building, equipment, employees, etc. Others may have little or no physical presence and may exist only as shell companies.}} [THIS IS NOT THE SNA DEFINITION – WILL BE REVISED FOLLOWING THE CURRENT DEBATE OF THE SNA/ISIC RECONCILIATION] }}

28. The approach using national definitions is adopted as an immediate response to urgent user needs.

240. {{If a direct investor incorporates a shell company or conduit in a non-resident economy and manages or operates it entirely from its own home economy, it is treated as an incorporated direct investment enterprise in its country of incorporation. If a shell company is incorporated abroad but all of its physical assets, operations, or management activities are in a second foreign country, then it is classified as a direct investment holding company in its country of incorporation, and its activities in the second foreign country would be evaluated to determine whether they may also qualify for as a separate institutional unit and thus be treatment as a direct investment enterprise. Similarly, if a shell company is incorporated abroad and has some physical assets or operations in two or more other foreign countries, the resident unit in the country of incorporation is classified as a holding company, and the activities in each separate additional foreign country are evaluated individually to determine whether they meet the criteria for treatment as a direct investment enterprise. }}

241. {{Central, state, or local governments are direct investors if they hold a 10 per cent or more ownership interest in a non-resident enterprise. In this context, there is also analytical interest in non-resident enterprises established abroad by a central government for the purpose of securitisation of assets, defeasance, and similar functions. }}

6.3 {{Collective investment vehicles}}

AT THE TIME OF DRAFTING THE CLASSIFICATION OF COLLECTIVE INVESTMENT VEHICLES WAS STILL AN UNRESOLVED ISSUE AND THEREFORE THE FALLBACK SCENARIO WOULD BE THE PREVIOUS TREATMENT AS PORTFOLIO INVESTMENT. SOME CLARIFICATION ON THE CURRENT TREATMENT (BPM5 IS EXPECTED FROM BOPCOM] SEE ALSO ANNEX 8.

6.4 Land, structures and other immovable objects

242. Ownership of land and structures, including natural resources, in the compiling economy by a non-resident economy establishes a direct investment relationship. The one-year rule that is usually used to define centre of economic interest (see Section 2.2 Statistical units) does not apply to land and buildings which is present in that economy on a permanent basis. Land is always considered to be the property of the residents of the economy in which these assets are located. The only exception to this general concept is the ownership of land and buildings by foreign governments in the form of embassies, consulates, military bases, scientific stations, information or immigration offices, aid agencies, etc.[29]

243. A non-resident entity may acquire direct ownership (that is, without the creation of a separate legal entity) of land or buildings which should be recorded in direct investment statistics. However, given the specific nature of the acquired assets, a notional resident enterprise is created as the direct owner of the assets and the non-resident direct investor owns the notional enterprise. In other words, land, structures, and other immovable equipments in the host economy that are indirectly owned by a non-resident entity should be regarded as direct investment enterprises, even if the period of ownership is less than one year. Acquisitions of land, mineral rights, and associated assets, and preparatory expenses for future direct investment units should be regarded as direct investment transactions.

244. Land and buildings owned for personal use but not for production or other business purposes are also considered as direct investment enterprises. Holiday and second homes owned by non-residents should therefore be treated in the same way as described above.

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29. The creation or relinquishment of territorial enclaves in the rest of the world should not be included in direct investment.

245. In accordance with the SNA, in contrast to an operational lease, the existence of a financial lease on land and buildings gives rise to the creation of a notional direct investment enterprise {with the understanding that it should be for a very long period rather than for a few years.} [TO BE CONFIRMED]

Box 7. SNA Definition of land

Land is the ground, including the soil covering and any associated surface waters, over which ownership rights are enforced; included are major improvements that cannot be physically separated from the land itself but it excludes any buildings or other structures situated on it or running through it; cultivated crops, trees and animals; subsoil assets; non-cultivated biological resources and water resources below the ground. (SNA § 13.54)

246. Where a direct investment enterprise is established for the purposes of *natural resource exploration*, its exploration expenditures should be capitalised, even if the exploration does not prove sufficient economic resources to be viable, as part of the equity investment in the direct investment enterprise and written off (or written-down), as appropriate. This promotes consistency with the *SNA*, which treats these expenditures as fixed capital formation.

247. For example, assume an oil company incorporates a direct investment enterprise that drills an oil well. Assume also that the direct investor makes an equity investment in its direct investment enterprise of 100 in period 1 (including expenditure on bonus payments made by the direct investor to a resident of the host country, usually the government) for the right to undertake exploration for natural resources), 30 in period 2, and then closes down the operation at the end of period 2 when the well proves to be dry. There is a financial flow from the direct investor to the direct investment enterprise of 100 in period 1 and 30 in period 2 in direct investment accounts of both economies. No further entries for cross-border transactions are recorded after the shutdown of the operation in period 2. Instead, a negative stock adjustment of 130 is made in the direct investment asset position of the economy where the oil company parent is located, and an equal reduction is made in the direct investment liability position of the economy where the affiliate was located.[30]

248. Assume in contrast that the direct investor makes an equity investment in its direct investment enterprise of 100 in period 1 (including expenditure on bonus payments made by the direct investor to the host country for the right to undertake exploration for natural resources), 30 in period 2, and receives natural resources (payments in-kind) as 40 of dividend in periods 3-5 and 10 of disinvestment in the last period. There are receipts of direct investment income and a collection of direct investment (equity capital) as received by the direct investor; a decrease of direct investment asset position is recorded accordingly.

6.5 Construction enterprise

249. A *construction enterprise* in one economy may undertake the construction of plant, buildings, etc. in another economy through subsidiary or associate companies in that economy, through a foreign branch in that economy, or by directly undertaking the work itself. The construction work abroad is to be regarded as a direct investment activity (resident) in the economy in which it is being carried out in the first two circumstances. If the construction enterprise undertakes the work itself (such as through an unincorporated site office), its activities may be regarded either as a direct investment activity or as an

30. Both adjustments should be recorded under "other adjustments" in the international investment position.

export of services by that enterprise, depending on circumstances. If certain criteria are met, such as the maintenance of a complete and separate set of accounts of the activity (i.e., income statement, balance sheet, transactions with the parent company, etc.) and is subject to income taxes in the host country, a substantial physical presence, the receiving of funds for its work for its own account, etc. the work undertaken is to be treated as having involved the creation of a separate institutional unit – a branch – resident in the economy where the activity is being carried out. If the criteria are not met, the activity is to be treated as an export of services by the construction enterprise. Constructions involved with major projects (bridges, dams, power stations, etc.) that are carried out through unincorporated site offices, in most cases, meet the criteria that requires treatment as the production of a resident unit and thus as part of the production of the host economy, not as an export of services to that economy.

250. Where an enterprise resident in one economy installs machinery and equipment in another economy, the *Benchmark Definition* recommends that the work be regarded as services provided to another economy if the installation is carried out entirely, or primarily, by employees of the enterprise who go abroad to do the work and they complete the installation in less than one year (that rule to be applied flexibly).

6.6 Mobile equipment

251. The operator of mobile equipment (such as ships, aircraft, gas and oil drilling rigs) that operate within a single economy for at least one year and that fulfil the criteria for treatment as an unincorporated direct investment enterprise should be treated as direct investment branches (see also section *3.5.1.3 Branches*).

252. Various entities may be involved in the provision of shipping and other transportation services. In shipping, the following entities may be involved:

- *Owner* – holds an asset (the ship) and may be engaged solely in a leasing activity, i.e., the leasing of the ship to an operator.
- *Operator* – is involved in shipping activities such as fishing, drilling or transporting freight and passengers.
- *Ticket sales or business promotion offices* – established either by the owner of the ship (who is seeking operators) or by the operator of the ship (who is seeking passengers, freight, or other business).

253. The flag of a ship determines the authority that is responsible for overseeing the operations of the ship and may help determine the jurisdiction where business disagreements are litigated. The flag is often a “flag of convenience” – that is, neither the ship owner nor its operator may have any business operation in the country whose flag is flown. Therefore the country of registration is not considered in determining the residency of any of the units involved in the shipping activity (that is, the owner or operator of the ship, and the ticket sales and business promotion offices), and so it is not relevant to the discussion of whether there may be a direct investment relationship.

254. If the owner and the operator are the same entity (such as when the owner operates the ship in its own economy of residence), then there is no direct investment. If the owner and the operator are not the same entity (or are not affiliated TO BE CONFIRMED, then they comprise separate institutional units. The owner will typically receive a fee from an unaffiliated operator, reflecting the payment (rental services) for the use of the vessel; in this case, the owner is a lessor, and is not a provider of transportation services. The operator of the vessel provides transportation services; it receives revenues for transporting passengers and/or freight, pays wages to crew members (who may be residents of a different economy than

the operator), and incurs other transportation-related expenses including port expenditures. The relationship between the owner and the operator of the ship is essentially that of a lessor and its lessee, not that of direct investor and a direct investment enterprise, though it is possible that they could be in a direct investment relationship if the lessor owns at least 10 per cent of the voting power in the lessee.

255. An owner may establish an incorporated or unincorporated enterprise that operates the ship. The country of the (affiliated) operator may differ from that of the owner, in which case a direct investment relationship exists. When the ship operations occur in international waters, the activities should be attributed to the economy in which the operator maintains residence.

256. The classification of management offices and business promotion and ticket sales offices also depends upon the criteria listed for direct investment enterprise. In some circumstances, they will qualify for classification as direct investment and, in other circumstances, they will not. Under the criteria used to determine the existence of direct investment (see para. 89), a distinction should be made between those enterprises that engage in real economic activities and have income statements, etc., and units that are set up to increase sales of the institutional units that established them but that have no sales of their own, such as ticket sales offices and business promotion offices.

257. Determining the residence of shipping companies is often a difficult issue. The residence of the owner and of the operator are determined independently from the country where the ship is registered (and whose flag the ship flies), and different types of leasing arrangements may exist that can make it difficult to determine whether the ship is being used under an operational lease or whether it has been effectively sold to the enterprise that operates it (that is, under a financial lease). Also, a ship may operate entirely in an economy outside the one in which its operator is incorporated; in this circumstance, the activity in the economy where the ship operates is a direct investment enterprise that is owned by a direct investor located in the economy where the operator is incorporated.

258. Issues related to owners and operators of ships and complex leasing arrangements and their solutions are applicable to other types of mobile equipment, such as aircraft.

6.7 Other cases

259. The treatment of insurance raises many complex methodological questions. Most of these questions have applicability beyond direct investment, such as to portfolio investment positions, other investment, other investment income, and services. The *Benchmark Definition* is intended to be fully consistent with the other major international standards where cross-cutting questions concerning the handling of insurance and insurance enterprises are more thoroughly discussed.

260. In general, the *Benchmark Definition* recommends that direct investment statistics for insurance companies be defined in the same way as those for industrial and commercial companies. However, compilers should take special steps for their appropriate treatment while positions and transactions involving insurance companies may be quite significant and the accounting principles they follow may not always be fully consistent with preferred direct investment concepts.

261. One complex area involves the treatment of non-life insurance company technical reserves (actuarial reserves against outstanding risks, prepayments of premiums, reserves for with-profits insurance, and reserves against unsettled claims). These reserves should not be included in the direct investment equity position, because these are amounts that are considered to be set aside for eventual payment of claims to policyholders. In the special case of a captive insurance affiliate, however, the policyholder may be affiliated with the insurance enterprise. Businesses may establish or acquire a "captive" insurance company, in order to obtain insurance coverage for unusual types of risk, or for lower premiums than may

be available commercially. In this case, a 10 per cent or more ownership level often is reached, and the captive insurance company then meets the criteria for treatment as a direct investment enterprise.

262. In this circumstance, the technical reserves should be included in the direct investment debt component of the position, unless the policyholder is a financial intermediary.

263. For clarification, non-life insurance companies tend to classify insured losses according to general types. The first type includes losses that arise from events that are expected (from an actuarial perspective) to occur some time in the future. Insurance companies establish and maintain sizable technical reserves largely for the purpose of satisfying future losses from these future events. The second type includes losses that are "incurred but not reported". These are losses from insured events (such as natural disasters) that have already occurred, but the insurance company does not know the size of its losses because claims have not yet been filed (that is, these losses were incurred but were not reported to the insurer). The third are known losses (incurred and reported to the insurer). To be consistent with the treatment of technical reserves (these belong to policyholders and not to stockholders or owners), liabilities arising from all three types of losses should be regarded as debt obligations of the insurance company to its policyholders and not as equity. As noted, in the case of a captive insurance affiliate, the policyholder is the direct investor, and so the debt should be recorded in the direct investment position unless the policyholder is a financial intermediary.

264. *Mutual insurance companies* are owned by their policyholders who tend to be unrelated to one another. Typically, no one resident owns at least 10 per cent of the voting power (or the equivalent, for an unincorporated business enterprise) of a mutual insurance company and so these companies do not usually meet the criteria for treatment as direct investment enterprises.

CHAPTER 7.
ATTRIBUTION TO AN ECONOMY[31] AND INDUSTRY CLASSIFICATION

7.1 Summary

265. One of the analytical benefits of direct investment statistics is the classification of investment activity by partner economy and by economic activity, so that they complement FDI aggregates published as a part of the balance of payments and international investment positions. This chapter describes the recommended methodology for such detailed breakdowns of direct investment statistics.

266. In summary:

(i) FDI statistics are compiled by partner economy and by economic activity. Geographical allocation is based on the immediate host/investing country on the debtor/creditor principle. However, it is strongly {encouraged} that FDI statistics also be compiled on a ultimate host/investing country basis as well;

(ii) Each direct investor/direct investment enterprise should be classified to a single industry, according to the main activity of the enterprise. Industry classification of stocks and transactions should be based on the activity of the direct investment enterprise for both inward and outward investments. It is also encouraged to compile a second set of statistics, based on the activities of the direct investor;

(iii) FDI statistics cross classified by country and industry can be presented at a more aggregate level of industry classification taking into account confidentiality concerns which may limit dissemination of disaggregated data.

7.1 Attribution to an economy

7.1.1 General principles to identify home and host economies

267. Direct investment statistics, financial and income flows and positions, should be compiled and published for all partner countries individually as well as for major geographical regions or economic zones and currency or monetary unions. Country and regional statements are of prime importance to direct investment statistics. In addition to analytical uses of such detailed information (see Chapter 2: Uses of FDI statistics), bilateral data provide valuable information to compilers to identify and to examine, at a more detailed level potential quality concerns in the data when large differences arise in bilateral comparisons.

268. Notwithstanding the general guidance above for compiling direct investment statistics, compilers have obligations to protect confidential of sensitive data. Their obligations to protect data may at times limit their ability to disseminate transactions/positions at an individual economy level. When necessary,

31. Also referred to as partner country attribution or geographical attribution

compilers are encouraged to combine individual country data in aggregates that allow the release of as much geographical detail as is feasible.

269. The changes in organisational structures of MNEs are more and more frequent and may impact the allocation to an economy. The methodology to record the resulting reallocations is described in Chapter 4. FDI components, accounts and scope.

270. There are two principles that may serve as the basis for geographic allocation of direct investment transactions/positions: *debtor/creditor principle* and *transactor principle*. According to the debtor/creditor principle, which is the recommended method, geographic allocation is based on the economy of the direct investment enterprise or direct investor, even if the funds are paid to or received from another economy. According to the transactor principle, direct investment transactions are allocated to the economy, to which the funds are payable or from which the funds are receivable, even if this is not the economy of the direct investment enterprise or the direct investor. In other words, under the debtor/creditor basis, changes in financial claims of the reporting economy are allocated to the economy of residence of the non-resident debtor, and changes in liabilities are allocated to the economy of residence of the non-resident creditor. Under the transactor basis, changes in the claims and liabilities are allocated to the economy of residence of the non-resident party to the transaction (the transactor).

271. {{Within this framework, there are two possible approaches to identify home country (of direct investor) and host country (of direct investment enterprise):

[THE FOLLOWING PARAGRAHS WILL BE REVISED ACCORDING TO THE RECOMMENDATIONS OF THE PROJECT GROUP ON UIC/UHC AND PROJECT GROUP ON SPES]

(i) by immediate host country/immediate investing country (IHC/IIC)

(ii) by ultimate host country/ultimate investing country (UHC/UIC)

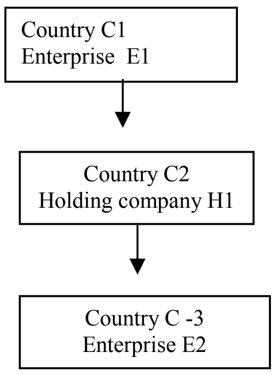
272. As a basic principle, it is recommended that all transactions and positions be compiled by immediate host country and immediate investing country. This parallels the debtor/creditor principle as it is the country to which the funds are payable or from which the funds are receivable that determines the immediate host/investing country. In other words, only directly owned subsidiaries, associates and unincorporated enterprises (including branches) are taken into consideration but not the chain of indirect relations described in the FDIR. For outward investment, this method takes into consideration only the economy of the directly owned non-resident enterprise. For inward investment, geographic classification is allocated to the economy directly owning the domestic enterprise, i.e. the resident direct investment enterprise.

273. In this approach, the consolidated earnings and consolidated net assets cover the directly owned enterprise and all its subsidiaries and associates in its economy and any other economy, all of them being allocated for outward FDI to the economy of the directly owned enterprise, and in the case of inward FDI to the economy directly owning the enterprise.

274. The simple example below is included to demonstrate the basic concept although actual business combinations may be more complex. Parent company in economy C1 (E1) makes an equity investment in its direct investment enterprise in economy C3 (E3) through its holding company in economy C2 (H1). It also makes a loan directly to enterprise E2 in C3. Economy C3 will make the following allocations for its inward direct investment positions depending on the basis used for geographical allocation:

- *To the immediate investing country allocation*:
    - C3 will record the equity transaction and position from the holding company H1 in country C2
    - C3 will record the loan transaction and position from the parent (E1) in country C1.
- To the ultimate investing country allocation:
    - C3 will record the equity transaction and position from the parent E1 resident in country C1 and will attribute the transaction to country C1.
    - C3 will record the loan transaction and position from the parent (E1) in country C1.
    - Inward FDI statistics of C3 will not record any transactions/positions via holding company H1 in country C2.

Figure 3. Example of IIC and UIC



[ULTIMATE INVESTING/HOST COUNTRY EXAMPLES WILL BE ELABORATED ACCORDING TO THE NEW THE NEW RESULTING FROM THE WORK OF THE PG ON UIC/UHC]

7.1.2 {{Ultimate investing/host country}}

THE CONTENT OF THIS SECTION AND THE CORRESPONDING ANNEX WILL BE REVISED ACCORDING TO THE RESULT OF THE PG ON UIC/UHC.

275. {{Direct investment positions are recorded on an immediate counterparty basis, but it is also recognised that there is a substantial analytical need to follow funds back to their origin and also to their

ultimate destination. Supplemental presentations of direct investment positions[32] on an ultimate investing country basis, and on an ultimate host country basis, are strongly encouraged. Such presentations should be developed with the maximum level of detail for individual economies b to be of most help to data users.[33] }}

276. {{Even though this *Benchmark Definition* does not provide the methodology to compile statistics based on ultimate host/ultimate investing country approach, two practical examples are provided in Annex 11 (examples of Austria and the United States) which may provide some practical guidance to compilers.[34] }} [THESE EXAMPLES MAY BE ELIMINATED IN THE FINAL VERSION; ANNEXESWILL PROVIDE EXAMPLES DEMONSTRATING THE METHODOLOGY]

277. {{For outward direct investment, it is more complex to estimate direct investment income and positions on an ultimate host country basis, because the funds that a direct investor in the home economy invests in a directly owned direct investment enterprise may be commingled with other funds available to that enterprise, and these funds may flow down several paths involving majority-owned (or minority-owned) foreign affiliates simultaneously. That is, a single direct investor may obtain or hold majority ownership in several direct investment enterprises simultaneously. The existence of commingled funds and the use of multiple outward paths of investment may complicate the task of recording the ultimate destination of the original funds provided to the original directly owned direct investment enterprise. }}

7.2 Industry classification

7.2.1 General principles to identify industry allocation

278. There is significant interest in the industry classification of both direct investment enterprises and their direct investors. However, direct investment enterprises and direct investors engage in a variety of economic activities. For a comprehensive economic analysis, enterprises should be grouped by type of activity. Under ideal circumstances, data should be available to compilers to classify each direct investor and each direct investment enterprise to the industry of the direct investment enterprise and the industry of its direct investor. For both inward and outward direct investment statistics, where feasible, data pertaining to the direct investment enterprise should be compiled based on both of these bases – that is, based on its own industrial activity in the host country, and based on the industrial activity of its direct investor.

279. If data for both inward and outward direct investment cannot be compiled on both of these bases, it is recommended that data be compiled <u>at least</u> to the activity of the direct investment enterprise, for both inward and outward direct investment. In other words, inward direct investment should reflect the industry of the resident direct investment enterprise and outward investment should reflect the industry of the non-resident direct investment enterprise (i.e. of the foreign affiliate).

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32. *Benchmark Definition* recommends that statistics on direct investment financial flows be compiled only in respect of immediate investing/host country but not in respect of the ultimate investing/host country.

33. Despite this general recognition of the need for supplemental position data, *the Benchmark Definition* has not yet developed a clear methodology to apply ultimate host/ultimate investing country principles. There are generally two possible approaches: limiting the ownership chains to control (ownership of more than 50 per cent) or of influence (ownership 10 per cent to 50 per cent). Another point to take into account is the allocation of the equity either by allocating the share of equity owned (based on FDI principles) or the entire amount to the controlling entity. These yet unresolved questions are further complicated by the difficulties to identify ultimate host country when compiling outward direct investment positions.

34. This issue is one of the priority items of the research agenda (see Annex 14) the results of which will be disseminated to the public as soon as an agreed methodology is developed.

280. Each direct investor and each direct investment enterprise must be classified to a single industry, even though many direct investors and direct investment enterprises are involved in a wide range of activities. The industry classification of the enterprise should be based on its principle activity. Ideally, the principal product or service will be determined with regard to the value added of the enterprise. In some cases, it is recognised that data on value added may not be available and that data on sales, revenues, or payroll or other basis may need to serve as a proxy.

281. It is recommended for FDI statistics that when the enterprise (direct investor or direct investment enterprise) is part of a local enterprise group, the industry classification be that of the local enterprise group's primary activity. This is determined by the local groups principal product or group of products produced or distributed, or services rendered. Again value added weight is idea for this determination.

282. A direct investor involved in a wide range of activities may make its overseas investment in each activity through numerous separate domestic subsidiaries specialising in a given activity, or it may make all of its overseas investment through a single domestic subsidiary established to handle overseas investments or a mixture of these approaches. For data that are presented based on the industry of the direct investor, the industry corresponds to the main activity of the direct investor, including all of its activities in its own country of residence. This approach avoids distortions due to different organisational arrangements.

283. Data that are presented based on the industry of the direct investment enterprise should be based on the reporting enterprise. (If the reporting unit is both a direct investment enterprise and a direct investor, its industry classification should be based on the activities that it conducts and should exclude those conducted by its own foreign affiliates.) In general, direct investment enterprises will reflect its operations in a given economy and in this circumstance it is recommended that the industry of the enterprise represent the primary activity of that the enterprise, including all of its subsidiaries, associates and branches in its country of residence.

284. When a change in the industry classification of a direct investor or direct investment enterprise occurs, the reclassification of positions from one industry to the next should be recorded as arising from volume adjustments which is discussed in Chapter 4. Scope of FDI.

7.2.2 International Standard Industry Classification (ISIC)

285. Countries should compile data by industries that correspond to the major tabulation categories in the United Nations' ISIC. The major categories in ISIC Revision 4 are:[35]

WILL VERIFY WITH THE FINAL SNA PROPOSAL

A – Agriculture, forestry and fishing

B – Mining and quarrying

C – Manufacturing

D – Electricity, gas, steam and air-conditioning supply

E – Water supply, sewerage, waste management and remediation activities

F – Construction

35. Recognising the revisions of ISIC, Benchmark Definition recommends that compilers should adjust industry classifications to all subsequent revisions of ISIC.

G – Wholesale and retail trade

H – Transportation and storage

I – Accommodation and food service activities

J – Information and communication

K – Financial and insurance activities

L – Real estate activities

M – Professional, scientific and technical

N – Administrative and support services

O – Public administration

P – Education

Q – Human health and social work

R – Arts, entertainment and recreation

S – Other services activities

T – Activities of households as employers of domestic personnel; undifferentiated goods- and services-producing activities of private households for own use

U – Activities of extraterritorial organizations and bodies

7.2.3 {{Holding companies}}

286. {{The classification of holding companies merits additional clarification. ISIC4 provides the ability to distinguish between two types of holding activities: financial and management activities[36]

(a) *Holding companies engaged in financial services (-activities of holding companies- 6420)*: units that hold the assets (owning controlling-levels of equity) of a group of subsidiary corporations and whose principal activity is ownership of the group. The holding companies in this category do not provide any other service to the business in which the equity is held.

(b) *Holding companies engaged in management* (a*ctivities of head offices 7010)*: this category includes the overseeing and managing of other units of the enterprise; undertaking the strategic or organisational planning and decision making role of the enterprise. These units exercise operational control and manage the day-to-day operations of their related units. More precisely, they include

- Head offices
- Centralised administrative offices
- Corporate offices
- District and regional offices
- Subsidiary management offices.

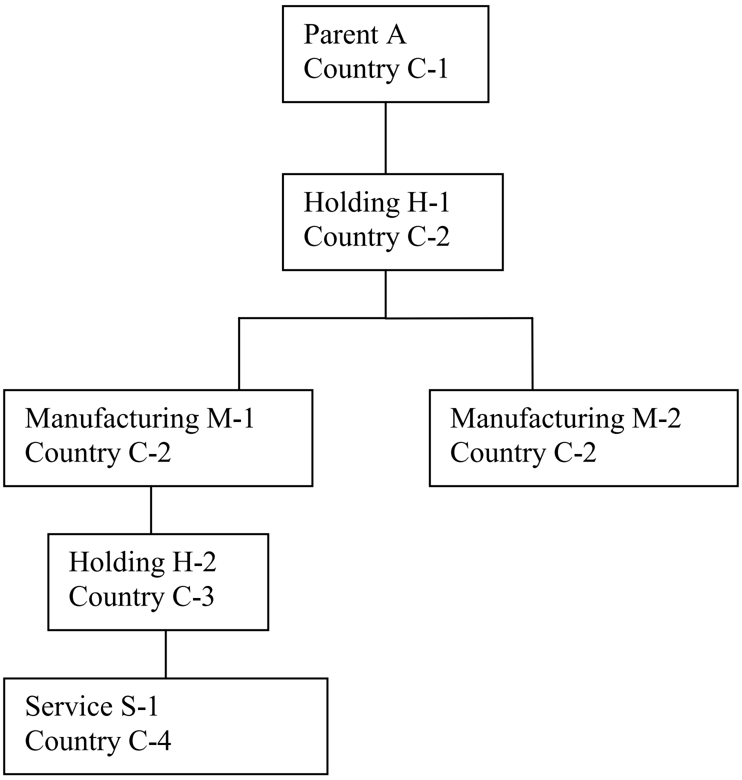
36. The ISIC definition of holdings, applied within the industry classification of FDI statistics is different from the definition in the SNA, used for institutional sector classification. See SNA xxx

287. {{If a holding company has subsidiary operations in the local economy as well as abroad, the approach to classifying the holding company should be based on whether the local or foreign activity dominates. That is, if its operations abroad are large relative to its activities in the local economy, then it should be classified as a holding company. If its operations in the local economy are large relative to its activities abroad, then it should be classified on the basis of the predominant activity of the consolidated enterprise in the local economy.}}

288. To demonstrate this approach consider that direct investor (A – the parent company) is located in country C1 and establishes a holding company H-1 in country C2.

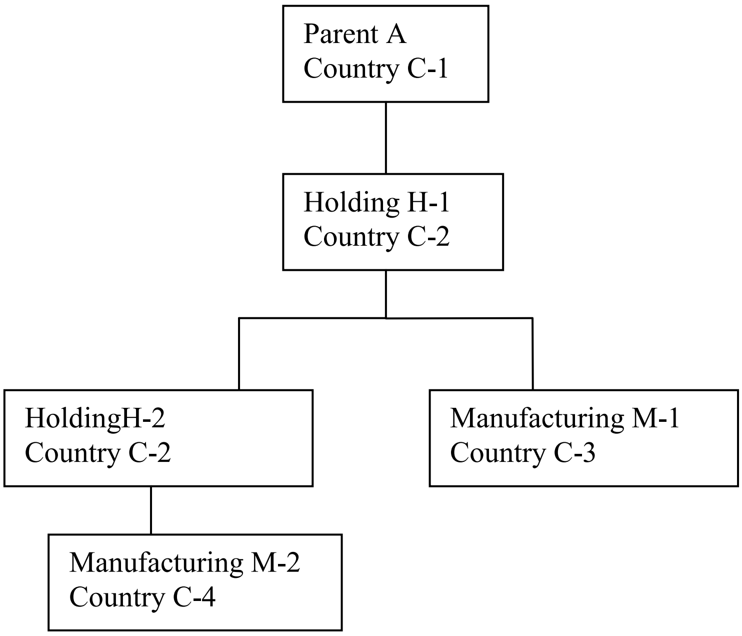
Scenario 1: Holding Company H-1 has two manufacturing subsidiaries, company M-1 and company M-2, both in country C-2. In turn, company M-1 has a holding-subsidiary H-2 in country C-3. *The industry classification of H-1 should be manufacturing*.

Figure 0-1. Industry classification of holding companies (1)



Scenario 2: Holding Company H1 has two subsidiaries of which one is a resident holding company H-2 in country C-2 and a non-resident manufacturing subsidiary M-1 in country C-3. Holding subsidiary H-2 in turn has a non-resident manufacturing subsidiary in country C-4. *The industry classification of H-1 should be holding activities.*

Figure 0-2. Industry classification of holding companies (2)



7.3 Country attribution linked with industry classification

[ADJUST TO THE FINAL VERSION OF TOP-TOP IF THERE ARE CHANGES]

289. Many countries may wish to provide more detailed statistics classifying transactions/positions, not just on the industry classification for their total investments described above, but also to go one step further and cross classify them by industry and by major partner countries. In doing so, compilers provide valuable information for structural analysis of FDI. Nevertheless, they may face limitations due to confidentiality obligations which may prevent them from disseminating such details. In such cases, the classification could be based on more aggregate industry classification according to Top-top aggregation which was also adopted by the SNA.

Top-top aggregation of ISIC:

A	–	Agriculture, forestry and fishing
B, C, D and E	–	Manufacturing, mining and quarrying, and other industry
		Of which: manufacturing
F	–	Construction
G, H and I	–	Wholesale and retail trades, transport, accommodation, and food services activities
J	–	Information and communication
K	–	Financial and insurance activities
L	–	Real estate activities
M, N	–	Business services
O, P and Q	–	Public administration, defence, education, human health and social work activities
R, S, T and U	–	Other services

CHAPTER 8.
FDI AND GLOBALISATION

8.1 Summary

290. The main recommendations of this chapter are summarised below, both for FDI-based indicators of globalisation and for AMNE statistics.

291. With regard to FDI-based indicators, it is recommended that reference indicators proposed in the *OECD Handbook* be compiled. These indicators relate to *i*) the extent of globalisation through FDI, ii) the contribution of host and investing economies or of particular industries to globalisation through FDI, and iii) the return on FDI. Countries that are in a position to do so are encouraged to consider the compilation of some or all of the supplemental FDI-based indicators recommended by the *OECD Handbook*. These indicators relate to concentration of FDI, *ii)* dynamics of FDI in the reporting economy (as indicated by FDI positions relative to domestic balance sheet totals), and *iii)* shares of FDI by category.

292. Several recommendations are provided for AMNE statistics, as follows:

(i) AMNE statistics should cover those affiliates in which the direct investor (or an associated group of investors acting in concert) holds a majority of the ordinary shares or voting power. However, countries that are able to do so may wish to provide supplemental statistics covering cases in which foreign control may be deemed to be present, even though no single foreign direct investor holds a majority stake.

(ii) For statistics on foreign-owned affiliates in the compiling economy (inward AMNE statistics), the first priority for geographical attribution should be the country of ultimate investor. However, to facilitate linkages with FDI data, countries are encouraged also to provide some data in which attribution is based on the country of the immediate investor (first foreign parent). Statistics for foreign affiliates of the compiling economy (outward AMNE statistics) should be attributed based on the country of location of the affiliate whose operations are being described.

(iii) Because it is the basis required for some variables as well as the basis on which data probably are, at present, most widely available, an activity basis is recommended as the initial priority for AMNE statistics. However, the provision of data on a product basis is recognised as a longer-term goal, and countries are encouraged to work toward providing product detail for those variables that lend themselves to this basis of attribution (namely, sales [turnover] and/or output, exports, and imports).

(iv) For reporting to international organisations, AMNE variables should be disaggregated according to the ISIC.

(v) This manual recommends that the AMNE variables to be collected include at least the following basic measures of foreign affiliate activity: (i) sales (turnover) and/or output, (ii) employment, (iii) value added, (iv) exports and imports of goods and services, and

(v) number of enterprises. Additional measures are suggested for countries wishing to expand AMNE data collection beyond this basic set.

293. A variety of sources and methods may be used to collect and compile AMNE statistics. Separate surveys may be conducted or links may be made with domestic enterprise statistics that are already collected. In either case, there are likely to be links with existing data on foreign direct investment.

294. The statistical indicators on foreign direct investment that are at the core of this benchmark definition relate to transactions and positions between direct investors and their direct investment enterprises, rather than to the overall financing and operations of those enterprises. For example, the direct investment position measures the equity and debt financing provided by direct investors and excludes any such financing that may have been provided by other owners or lenders. Similarly, direct investment income includes the direct investors' shares in the earnings and the interest payments of direct investment enterprises, but it excludes the shares of others. Measures of inputs used and output produced by direct investment enterprises, such as employment and value added, fall outside the scope of FDI statistics.

295. While FDI statistics are crucial to an understanding of the direct investment relationship and allow important insights into the economic linkages between home and host economies, additional indicators are necessary to place these statistics into context and to describe the enterprises in which there is direct investment, measure their activities, and assess their economic impact. The need for such complementary indicators arises for two primary reasons. The first is the requirement for a factual foundation to underpin analyses of the globalisation of economic activity – a phenomenon that entails not only the internationalisation of consumption through trade between residents and non-residents, but also the internationalisation of production through FDI. The second is to provide statistical information that can be used in support of international agreements, such as the General Agreement on Trade in Services, which include commercial presence as a mode of supply.

296. For both of these purposes, statistics may be called upon to address a number of questions, which themselves make almost self-evident the kinds of data that are required to address them. For example:

- What is the value of inward and outward FDI relative to the size of home and host economies?

- How does the return on FDI compare to the investment positions from which the return is generated?

- What is the value of goods and services delivered – or sold – by foreign affiliates, both in their countries of location and elsewhere?

- How much of this value represents value added within the affiliates, as compared to value added by the producers that supply affiliates with intermediate inputs or goods for resale?

- What is employment by foreign affiliates, and how does it compare with employment in home and host economies, or with total employment within the multinational firms to which they belong?

- How much international trade is accounted for by foreign affiliates or by direct investors? What is the value of the goods and services that they export and import?

297. The indicators that are suggested to address such questions fall into two major categories—FDI-based indicators and indicators drawn from statistics on the activities of foreign affiliates. International recommendations for the compilation of both types of indicators are found in the *OECD Handbook on*

Economic Globalisation Indicators (OECD Handbook). Guidelines for activity-based indicators may also be found in the international *Manual on Statistics of International Trade in Services (MSITS)*, and in the Eurostat Recommendations Manual on the production of Foreign Affiliates Statistics. With regard to activity-based indicators, all of these guidebooks, in turn, draw upon the *System of National Accounts (SNA)* in identifying the firms that should be covered and defining the indicators that are to be compiled. The present manual draws from and – with regard to *MSITS* – generalizes these existing guidelines, in suggesting basic data and methodology that may be used in creating both FDI-based indicators and indicators relating to the activities of foreign affiliates. Following the *OECD Handbook*, the latter indicators, which may be supplemented by comparable data on the direct investors that own them, will be referred to as statistics on the *activities of multinational enterprises (AMNE* statistics).[37]

298. The discussion that follows is in seven sections. The first identifies a number of FDI-based indicators of globalisation. The second explores the intersection between FDI statistics and AMNE statistics. The third discusses the coverage of AMNE statistics in terms of ownership criteria and the selection of statistical units. The fourth considers the attribution, or classification, of AMNE variables, both geographically and by activity or by product. The fifth identifies and defines economic variables for AMNE statistics. The sixth section provides a brief discussion of compilation issues for AMNE statistics.[38] The final section summarizes the recommendations made in this chapter.

8.2 FDI statistics as indicators of globalisation

299. FDI-based indicators are among the most widely available and commonly used measures of globalisation. They measure the extent of cross-border investments made with the objective of achieving a lasting interest in a business enterprise located in an economy different than that of the investor. They also allow cross-country comparisons based on the importance of FDI measures relative to host-country economies, as measured by their gross domestic product (GDP). Although the FDI measures – such as financial flows, investment positions, and income flows – are not components of GDP, forming ratios of such measures to GDP provides normalized measures that can be compared across countries.

300. The *OECD Handbook* proposes the construction of a number of “reference” indicators of globalisation related to FDI. Reference indicators are the indicators expected to be most commonly used, and are necessary for the analysis of economic globalisation in all or parts of the world economy. The data needed to construct them are generally available in OECD member countries, which are encouraged to produce these indicators as a first priority. The *OECD Handbook* also suggests a number of lower-priority, or “supplemental”, FDI-based indicators. The reference indicators are reproduced below, grouped according to whether they relate to i) the extent of globalisation through FDI, ii) the contribution of host and investing economies or of economic sectors to globalisation through FDI, or iii) the return on FDI.

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37. A variety of other terms also have been used to describe these data, including “foreign affiliates’ trade statistics” (or “FATS”), “establishment trade,” and “financial and operating data” of multinational enterprises.

38. Compilation issues for FDI statistics are discussed elsewhere in this manual, although the manual is not intended as a comprehensive compilation guide for either type of statistics.

Box 8. Reference Indicators of Globalisation Related to FDI

(i) Extent of globalisation through FDI (total FDI or by industry

(a) Inward FDI financial flows as a percentage of GDP Outward FDI financial flows as a percentage of GDP

(b) Inward FDI income flows as a percentage of GDP

(c) Outward FDI income flows as a percentage of GDP

(d) Inward FDI positions as a percentage of GDP

(e) Outward FDI positions as a percentage of GDP

(ii) Contribution of host and investing economies or of industries to globalisation through FDI

(f) Relative share of inward FDI financial flows by partner country as a percentage of total inward FDI flows.

(g) Relative share of outward FDI financial flows by partner country as a percentage of total outward FDI flows.

(h) Relative share of inward FDI positions by partner country as a percentage of total inward FDI positions.

(i) Relative share of outward FDI positions by partner country as a percentage of total outward FDI positions.

(j) Relative share of inward FDI financial flows by industry as a percentage of total inward FDI flows.

(k) Relative share of outward FDI financial flows by industry as a percentage of total outward FDI flows.

(l) Relative share of inward FDI positions by industry as a percentage of total inward FDI position.

(m) Relative share of outward FDI positions by industry as a percentage of total outward FDI position.

(iii) Return on FDI

(n) Inward FDI equity income debits [debits for *a)* dividends/distributed branch profits, plus *b)* reinvested earnings/undistributed branch profits] as a percentage of inward FDI position [rate of return for total inward FDI or by industry or investing country].

(o) Outward FDI equity income credits [credits for *a)* dividends/distributed branch profits, plus *b)* reinvested earnings/undistributed branch profits] as a percentage of outward FDI position [rate of return for total outward FDI or by industry or investing country].

{Add M&As}

301. The supplemental indicators suggested in the *OECD Handbook* relate to *i)* concentration of FDI (for total FDI or by industry or by geographical distribution), *ii)* dynamics of FDI in the reporting economy (as indicated by FDI positions relative to domestic balance sheet totals), and *iii)* shares of FDI by category (components of FDI financial flows and positions relative to their respective totals).

302. The above indicators are suggestive of the ways in which FDI data can cast light upon globalisation phenomena, but they do not constitute an exhaustive list. For particular purposes it might be useful, for example, to identify separately those flows that occur as a result of cross-border mergers and acquisitions (M&As). This would serve to distinguish between FDI in which ownership of existing enterprises is transferred and FDI in which new enterprises are established by direct investors – often termed "greenfield" investments – or in which existing direct investment enterprises are expanded. This distinction would allow insights to be gained into, not only the *amount* of FDI, but also into its likely economic effects.[39] Other breakdowns might be created to segregate FDI flows involving SPEs from other FDI flows. These breakdowns could, for example, provide additional insights into which flows have the greatest potential to result in changes in production in the host economies to which the flows are attributed, and which flows would likely have a greater impact on production in other countries.

8.3 Intersection between FDI and Activities of Multinational Enterprises (AMNE) statistics

303. Before discussing AMNE statistics as a second data set that can be used to assess and analyze the extent and effects of globalisation, it will be helpful to consider how these statistics and statistics on FDI relate to one another. The intersection between FDI and AMNE statistics can be explored by constructing a balance sheet for a hypothetical direct investment enterprise in which assets, liabilities, and owners' equity are broken down on the basis of whether or not they represent positions of, or with, the direct investor(s).

Table 7. Foreign Affiliate Balance Sheet

Assets:	**Liabilities:**
A1 Equity claims on direct investor (reverse investment)	L1 Debt owed to direct investor
A2 Debt claims on direct investor	L2 Other liabilities
A3 Other assets	
	Owners' equity:
	O1 Equity claims of direct investor
	O2 Equity claims of other owners

39. It is sometimes presumed that – other things being equal – expansions and greenfield investments have a greater economic impact on the real capital stock in host countries than M&As, but this is not invariably the case. M&As usually provide financial resources to former owners, which they may invest in ways that contribute to domestic capital formation.

304. Given the accounting identity which states that assets equal liabilities plus owners' equity, it is the case that

(1) $A1 + A2 + A3 = L1 + L2 + O1 + O2$

305. These terms can be rearranged as follows, so that the left hand side of the equation shows the direct investment position:

(2) $L1 + O1 - A1 - A2 = A3 - L2 - O2$

306. That is, the direct investment position – the equity and debt claims of the direct investor on the direct investment enterprise less the equity and debt claims of the direct investment enterprise on the direct investor – equals the assets of the enterprise not representing claims on the direct investor, less equity and debt claims on the enterprise by entities other than the direct investor. Put another way, the direct investment position can be viewed as financing the portion of the "other" assets of the enterprise (A3) that is not financed by other investors and lenders. Included among these "other" assets would be tangible assets, such as plant, equipment, and inventories; intangible assets, such as patents and copyrights; and financial claims – both equity and debt – on entities other than the direct investor.

8.4 Coverage of AMNE statistics

307. Before considering the particular measures that should constitute the AMNE data set, it is necessary to consider which firms that should be covered by these statistics as well as recommendations regarding statistical units.

8.4.1 Ownership criteria

308. Although 10-per cent ownership of the ordinary shares or voting power is recommended as the lower threshold for FDI, this manual follows both the *OECD Handbook* and *MSITS* in recommending that AMNE statistics should be compiled, as a first priority, for the majority-owned subset of foreign affiliates. Majority ownership is already used as the basis for AMNE statistics in key countries that maintain this type of data, and is an operationally practical criterion for the selection of firms that are to be regarded – following a concept found in the *SNA* – as "foreign-controlled enterprises".[40] The Eurostat Recommendations Manual on the production of Foreign Affiliates Statistics foresees the compilation of FATS/AMNE statistics on controlled foreign affiliates, however, majority ownership has been used as a proxy in the joint OECD-Eurostat questionnaire on foreign -affiliate operations used for data collection. Also, statistics based on majority-ownership appear relevant to the needs of the General Agreement on Trade in Services (though it should be noted that the agreement does not contain statistical definitions).[41]

309. Although it may in some respects have been conceptually more appealing to categorise firms on the basis of the actual presence or absence of foreign control, majority ownership of the ordinary shares or voting power by a single direct investor, or by an associated group of investors acting in concert, has been selected as the recommended ownership criterion for AMNE statistics in this manual. Unlike control, its

40. In the *SNA*, subsidiaries and branches are considered to be foreign-controlled enterprises; associates may be included in, or excluded from, this category by individual countries according to their qualitative assessment of foreign control. See *SNA* paragraph 14.152.

41. For a more extended discussion of the rationale for using majority ownership in AMNE statistics, see *MSlTS*, Chapter IV, Section B.1.

implementation does not require the use of subjective criteria, nor does it require that compilers examine the nature of investments on a case-by-case basis. The absence of a subjective factor has the added benefit of eliminating a potential source of bilateral asymmetry – namely, the possibility that the issue of control will be assessed differently by home- and host-country compilers.

310. While the measure of majority ownership recommended by this manual differs from the *SNA* concept of foreign-controlled enterprise, the two concepts are alike in that both refer to ownership by a single investor (or investor group). This approach is followed in this manual not only for consistency with other international guidelines, but also because it is only through a single investor or associated investor group that control can be systematically exercised. However, the relevance of other criteria for selection is acknowledged, and countries that can do so may wish to provide supplemental statistics covering cases in which foreign control may be deemed to be present, even though no single foreign direct investor holds a majority stake.

311. Examples of investments that might be covered on a supplemental basis are majority ownership by multiple foreign direct investors, ownership of exactly 50 per cent by a foreign direct investor, and cases in which a qualitative assessment has been made that effective control has been achieved through a minority stake in an enterprise.[42] Such supplemental statistics on affiliates that are not majority-owned may be particularly relevant where majority ownership by foreigners is restricted.

312. Statistics on foreign affiliates owned by residents of the compiling economy should include all majority-owned foreign affiliates, irrespective of whether the affiliate is held directly or indirectly and irrespective of whether the direct investor in the compiling economy is the ultimate investor or is, instead, an intermediate investor in an ownership chain. However, because the activities of an affiliate held through an ownership chain could be recorded in the outward AMNE statistics of the countries of both the ultimate and intermediate investors, it may be useful to indicate the aggregate share of AMNE variables accounted for by enterprises for which the compiling country is an intermediate rather than final owner. For FDI data, investments in given affiliates may be reflected in the statistics of both immediate and ultimate owners, but due to the difficulties of tracing financial flows beyond their immediate sources and uses, such supplemental information would be more difficult to compile and interpret than in the case of AMNE data.

8.4.2 Statistical units

313. In principle, AMNE statistics could be collected at either the enterprise (company) level or the level of individual business locations or establishments. Neither basis of collection is unequivocally superior to the other; rather, each has its own strengths and weaknesses. For example, some financial indicators, such as total assets, are more naturally collected from enterprises than from establishments. In addition, because FDI statistics usually are collected at the enterprise level, collection of AMNE statistics at this same level facilitates linkages between the two types of data. However, because enterprises are more likely than establishments to have activities in multiple industries, data that are classified on the basis of primary activity can be more difficult to interpret for enterprises than for establishments. Although there may thus be advantages and disadvantages associated with each basis of collection, this manual makes no recommendation as to statistical units. AMNE statistics often will be developed in the context of existing statistical systems, in which the statistical units are already defined, and in these cases there may be little choice in the units that are to be used.

42. These and other special cases are discussed in the *OECD Handbook* and in *MSITS*.

314. Because the statistical units used can have an important bearing on how the statistics should be interpreted, both in isolation and in comparisons with FDI statistics, it is recommended that information on the statistical units used in collecting AMNE statistics be disclosed in explanatory notes.

8.5 Attribution of AMNE variables

315. AMNE variables may be attributed, or classified, in a variety of ways. One way is geographic – that is, in what country did the production take place, and what country is to be regarded as the country of the owner of the producing affiliate? Another way is on the basis of the primary industrial activity of the producer. Some variables may, in addition, be classified by product, that is, according to the types of goods or services produced. Recommendations on each of these bases of attribution are provided in the sections that follow.

8.5.1 By country

316. The issues to be addressed in attributing variables by country differ as between inward and outward AMNE statistics. For inward statistics, a choice must be made between attribution to the immediate investing country and attribution to the ultimate investing country. For outward statistics, the issue is whether to attribute variables to the immediate host country or to the ultimate host country.

317. The need to follow investments to their ultimate origins or destinations reflects both the nature and the uses of the statistics. These issues are discussed below with respect to each type of investment, and recommended bases of attribution are given.

8.5.1.1 Inward AMNE statistics

318. For foreign-owned affiliates in the compiling economy, the question is whether to attribute AMNE variables to the country of the immediate investor (first foreign parent) or to that of the ultimate investor. Commonly, the first foreign parent and the ultimate investor are one and the same, but in many cases they differ.

319. Abstracting from practical considerations, the country of the ultimate investor is conceptually preferable for attribution of variables concerning industrial activity because that is the country that ultimately owns or controls, and therefore derives the benefits from owning or controlling the direct investment enterprise. In light of the relevance of the ultimate-investor basis and the demonstration by a number of countries that compilation on this basis is feasible, this manual recommends the ultimate-investor basis as the first priority for compilation of AMNE statistics and the basis on which estimates should be prepared in the greatest detail. However, considering that information on immediate investors may be available as a by-product of linkages to FDI data, and to facilitate comparisons with these data, countries are encouraged to make available some data classified according to the country of the first foreign parent.

8.5.1.2 Outward AMNE statistics

320. For affiliates owned by residents of the compiling economy, two options for the geographic attribution of AMNE variables are possible. The variables could be attributed to the country of location of the affiliate or, if the ownership is through a directly held affiliate located in another country, to the country of that affiliate. This manual follows other international guidelines in recommending that attribution of AMNE statistics be to the country of the affiliate whose operations are described by the variables, for that is the country in which the foreign direct investor's commercial presence exists, and it is the country where the various activities – sales, employment, and so forth – tracked by the statistics are carried out. This basis of attribution is recommended both in the *OECD Handbook* and in *MSITS*. In

addition, it is consistent with the treatment of foreign-controlled enterprises in the *SNA*, in that the value added in production by the enterprise is attributed in both cases to (i.e., is included in the gross domestic product of) the economy of location of the enterprise. To the extent that the statistics may be used in conjunction with FDI statistics, it should be reiterated that the latter are to be attributed to the immediate host country, as is appropriate for tracking financial flows and positions.

8.5.1.3 Note on the equal ownership of shares by residents of more than one country

321. Ordinarily, AMNE variables for a given foreign affiliate should be attributed in their entirety to a single country of owner. As descriptors of the operations of affiliates, they are not to be factored down by ownership shares. Nor are the values of the variables to be apportioned between the majority owner and any foreign minority owners. However, where supplemental statistics are provided covering cases in which foreign control has been achieved other than through majority ownership by a single investor, classification dilemmas may arise where direct investors of different countries have collectively achieved majority ownership through holdings of equal shares. Because the ownership is evenly split, the determination of the country of owner has to be made using criteria other than ownership percentages.

322. Although it is sometimes difficult to reach a decision in such cases, there is often some factor that would suggest the selection of one country rather than the other. For example, if one owner's interest in the affiliate is held directly and the other owner's interest is held indirectly, the affiliate generally would be classified in the country of the owner holding the direct interest. As another example, if one of the foreign owners is a government entity, then the country of that government most likely would be considered the country of owner. Finally, if one of the foreign owners is a holding company or is located or incorporated in a tax haven country, then the country of the other owner would most likely be considered the country of owner. In the absence of any such factor that could be used as a basis of attribution, the value of AMNE variables may be allocated evenly among the foreign countries of ownership. However, data so allocated may pose problems of interpretation, and efforts should first be made to determine a basis for allocation to a single country.

8.5.2 By activity and by product

323. Ideally, it would be possible to attribute all AMNE variables on the basis of the industrial activities of producers and, in addition, particular variables such as sales or output, exports, and imports by the types of services products produced and sold. Data on a product basis would identify the specific types of goods and services delivered through the commercial presence mode of supply and could most readily be compared with data on goods and services delivered through trade between residents and non-residents. However, some variables, such as value added and employment (discussed below), do not lend themselves to a product classification. Also, for some countries, AMNE statistics may be developed as a subset of domestic enterprise or other statistics that are classified only on an activity basis. On this basis, all of the data for a given enterprise are classified in the single activity – often termed the "primary" activity – that, based on some key variable (such as employment or sales), is the largest. Finally, for some purposes, the data may need to be viewed in conjunction with data on stocks and flows of FDI, which normally would be classified by activity but not by product.

324. Taking these factors into account, an activity basis is recommended as the first priority for AMNE statistics. However, as a longer-term goal, countries are encouraged to work toward providing product detail for the items that can be classified on this basis. Countries that are building on existing data systems that already include product detail likely will wish to use this detail from the outset in their tabulation and presentation of AMNE statistics. Similarly, countries that are building their AMNE data systems from the ground up should consider the feasibility of providing for a product dimension.

8.5.2.1 By activity

325. This manual recommends that, for reporting to international organisations, AMNE variables be classified by activity according to the United Nations *International Standard Industrial Classification of All Economic Activities* (ISIC).

326. Primarily because the activities carried out by a given firm are often not limited to its activity of classification, the data recorded against any given activity must be interpreted as an indication of total activity of firms for which the given activity is the most important, or primary, activity, rather than as a precise measure of the activity itself.[43]

327. It is noteworthy that, even though FDI and AMNE statistics may be classified according to the ISIC, only the latter statistics will uniformly reflect the industries in which direct investment enterprises are producing goods and services. As noted earlier, FDI statistics are attributed to the industries of the enterprises with which direct investors have direct transactions and positions (and, if possible, also on the basis of the industries of the direct investors). Statistics tabulated on this basis show the types of enterprises with which direct investors have financial claims and liabilities. The industries associated with the activities of indirectly held direct investment enterprises will not be reflected in these statistics, but they will be reflected in AMNE statistics. Thus, the industrial classification of AMNE statistics may give a truer picture of the economic nature of the productive activities of foreign affiliates than does that of FDI statistics.

8.5.2.2 By product

328. As a longer-term goal, countries are encouraged to work toward disaggregating by product some or all of the variables – which include sales (turnover), output, exports, and imports – that lend themselves to this basis of attribution. Product-based statistics are free of problems of interpretation related to secondary activities and are consistent with the basis of classification used for trade between residents and non-residents.

8.6 Economic variables for AMNE statistics

329. A wide range of economic data or variables – operational and financial – in regard to AMNE statistics may be pertinent for analytical and policy purposes. The selection of the variables to be collected should be based primarily on their usefulness in addressing questions, such as those posed at the beginning of this chapter, pertaining to the production, employment, and international trade of direct investment enterprises. The practicalities of data availability also must be considered. With such considerations in mind, and in the interests of harmonization with other international guidelines, this manual recommends that the AMNE variables to be collected include at least the following basic measures of foreign affiliate activity: (i) sales (turnover) and/or output, (ii) employment, (iii) value added, (iv) exports and imports of goods and services, and (v) number of enterprises. Although these variables constitute a basic set that can be used in answering a variety of questions, additional measures of foreign affiliate activities may prove useful in addressing specific issues.

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43. For example, computer services may be provided not only by firms classified in the computer services industry, but also by firms classified in computer manufacturing and computer wholesale trading. Similarly (though in reality less commonly), computer services firms may engage in manufacturing or wholesale trade as secondary activities. Statistics shown for the activity “computer services” would misstate the value of the activity by excluding the computer services provided by manufacturers and wholesale traders and by including the manufacturing and wholesale trade activities of computer services firms.

8.6.1 Sales (turnover) and/or output

330. *Sales* and *turnover* are used here interchangeably to mean the same thing. Following the *SNA* (which may be consulted for additional details and examples), output differs from sales because it includes changes in stocks of finished goods and work in progress and because of differences in measurement applicable to activities involving trade or financial intermediation. Output is a superior and more refined measure of activity for most purposes and is recommended as the preferred variable for compilation. However, sales data are easier to collect and may present more options for disaggregation. Thus, there may be a continuing role in AMNE statistics for both measures.

331. For certain services activities, the *SNA* suggests special conventions for measuring output. Services activities do not involve stocks of finished goods, and changes in work-in-progress will usually be impossible to measure. In practice, therefore, measured output will be identical to sales for most service activities. For wholesale and retail distribution, although the sales are of goods, the output is defined as a service, equal not to the total value of sales but to the trade margins realised on goods purchased for resale. For financial intermediaries, output is equal to service charges actually levied, plus *financial intermediation services indirectly measured*, the values of which are estimated from the difference between the property incomes received by financial intermediaries from the investment of borrowed funds, and the interest they themselves pay on such funds. For insurance, output is measured not by total premiums earned, but by a service charge that takes into account the income earned on technical reserves and also the fact that a portion of premiums must be devoted, not to the provision of services, but to the payment of claims. In all these cases, output will generally be considerably lower than sales because it, unlike sales, excludes the amounts – which may constitute a large portion of total operating revenues – that pass through the enterprise without being considered a part of its intermediate consumption.

332. *Sales* measures gross operating revenues less rebates, discounts, and returns. *Sales* should be measured exclusive of consumption and sales taxes on consumers, and value-added taxes. Although lacking the duplication-free quality of value added, the sales variable generally presents fewer collection difficulties and thus is likely to be more widely available than value added. Also unlike value added, sales indicates the extent to which foreign affiliates are used to deliver outputs to customers, irrespective of the extent to which the output originated in the affiliates themselves or in other firms. Further, sales are more comparable than value added with regard to variables such as exports and imports, which themselves mainly arise from sales.

333. In addition to disaggregation by industry and by country (following the principles of attribution discussed earlier), other breakdowns of sales may be useful for particular purposes. One such breakdown is to distinguish among sales within the host country (local sales), sales to the country of the parent enterprise (i.e., the immediate investor), and sales to third countries.[44] All three types of sales result from a commercial presence by the home country in the host country. However, only the local sales represent the delivery of output within host economies. In any analysis of AMNE variables in conjunction with data on the parent country's trade with non-residents, it should be noted that the foreign affiliates' sales to the parent country would appear in both data sets, which may suggest the usefulness of an adjustment to eliminate the duplication, or a memorandum item to identify it.

334. Among other sales breakdowns that may prove useful would be a breakdown of sales within each industry as between sales of goods and sales of services, which would represent a first step toward a

44. In some cases, it might be possible to derive a close proxy for this breakdown by examining data on total sales in conjunction with data on exports. Export data may indicate sales to the country of the parent separately from sales to third countries, and local sales may be derived by subtracting these export sales from total sales.

product breakdown of sales. As a longer-term goal, countries are encouraged to work toward developing product detail on sales.

8.6.2 Employment

335. In an AMNE context, *employment* would normally be measured as the number of persons on the payrolls of foreign affiliates. Employment data are sometimes converted to a "full-time equivalent" (FTE) basis, in which part-time workers are counted according to the time worked (e.g., two workers on half-time schedules count the same as one full-time worker). Although FTE employment may provide a better measure of labour input, this measure is not as widely available as numbers of employees and may be difficult to implement consistently in the context of internationally varied employment practices. For these reasons, the recommendation of this manual is that the employment variable be the number of persons employed. The number should be representative of the period covered, but in the absence of strong seasonal or other fluctuations in employment, it may be measured as of a point in time, such as the end of the year, following national practices.

336. Data on employment by affiliates can be used in several ways. They can be used in determining the share of foreign affiliates in host country employment, or in attempts to determine the extent to which employment by foreign affiliates complements or substitutes for domestic (home country) employment by parent companies or other domestic firms. An industry breakdown of affiliates' employment can yield further insights into the impact of foreign-owned enterprises on specific parts of the economy. Used in conjunction with data on compensation of employees – one of the "additional" variables suggested below – the employment variable may be used in examining compensation practices of affiliates relative to those of domestically owned firms.

8.6.3 Value added

337. The *SNA* defines "the gross value added of an establishment, enterprise, industry, or sector" as "the amount by which the value of the outputs produced . . . exceeds the value of the intermediate inputs consumed." A related concept, "net value added," is defined as gross value added less the consumption of fixed capital. Gross value added can provide information about the contribution of foreign affiliates to host country gross domestic product, both in the aggregate and in specific industries. For this reason, and because it may often be easier to compute (because it does not require estimation of capital consumption) and is thus more widely available, the higher priority should be accorded to the gross measure of value added.

338. Although it is defined in terms of outputs and intermediate inputs, value added also is equal to the sum of primary incomes generated in production (compensation of employees, profits, etc.). In some cases, depending on the particular data that are available, this equivalence may be exploited in deriving estimates of value added. This alternative might be chosen, for example, if data on intermediate consumption were lacking but information on the various incomes generated in production were available.

339. Because it includes only the portion of the firm's output that originates within the firm itself, value added is a particularly useful measure. It is for this reason that it has been included among the "basic" AMNE variables, even though, as a measure that may have to be estimated or derived from other variables, it may be among the more difficult variables to compile. For inward AMNE statistics, value added will often be available from regular industrial or enterprise surveys, but for outward statistics it may have to be derived from other variables or collected in separate surveys.

8.6.4 Exports and imports of goods and services

340. International goods and services transactions of foreign affiliates is another basic indicator of activity. Both balance of payments data and data provided by parent enterprises and affiliates in separate questionnaires may be appropriate sources for such information. To a large extent, the possibilities for disaggregating total exports and total imports may depend on the sources used to obtain the data.

341. Where the data are obtained through linkages with primary data sources for balance of payments transactions, breakdowns by product and by origin or destination will often be possible. In this event, exports and imports might be disaggregated, not only by the primary activity of the affiliate according to ISIC, but also by product.

342. Although linkages with balance of payments data may thus provide useful information, it often will be difficult or impossible to isolate the transactions of foreign-owned firms in these data. Thus, it may be possible to develop the data on exports and imports only through the use of separate questionnaires. In this event, these same breakdowns would be useful, but it is unlikely that a large number of countries would be able to collect the necessary data with the same frequency or in the same detail as provided by balance of payments data. However, it may be possible to disaggregate exports and imports into a few broad categories in which trade with related enterprises would be distinguished from trade with unrelated parties. In addition, trade with the country of the parent enterprise could be distinguished from trade with other countries. If possible, these breakdowns should be obtained separately for goods and services. For inward AMNE statistics, for example, this would mean disaggregating the affiliate's exports of goods and exports of services into (i) exports to the parent enterprise, (ii) other exports to the country of the parent, and (iii) exports to third countries. Imports would be similarly disaggregated.

8.6.5 Number of enterprises

343. The number of enterprises (or establishments, where that is the statistical unit) meeting the criteria for coverage by AMNE statistics is a basic indicator of the prevalence of majority ownership by foreigners in the host economy. This number may be compared with the total number of firms (or establishments) in the economy. It may also be assessed in relation to the other AMNE variables because it allows the computation of ratios – such as value added or number of employees per enterprise – that may be compared with the same ratios for domestically owned firms, thus giving an indication of the behaviour of foreign affiliates.

344. It should be recognised that the number of firms alone may not give an accurate picture of the overall importance of foreign-owned firms, because of differences in size between these firms and those that are domestically owned. If the foreign-owned firms tend to be larger, for example, then their share in the total number of firms would be smaller than their share in the various measures of operations and would thus tend to understate their role and importance in host country economies.

345. Typically, information on numbers of enterprises will be a natural by-product of collection of data on other AMNE variables, rather than a separate object of the data collection effort. As such, the number is likely to be affected, often significantly, by the level of company consolidation and by thresholds for reporting on surveys. To assist users in interpreting counts of enterprises (or establishments), countries are encouraged to indicate in explanatory notes how the numbers were derived.

8.6.6 Other variables

346. Although not included as priority items, there are other AMNE variables of significance, perhaps for certain countries of equal or greater importance than some of those previously discussed. As is the case

for the priority items, comparisons with the total economy and with specific sectors can be made and used for assessing the impact of foreign-controlled enterprises on home and host economies.

347. Among such variables, which are listed and defined below, are those already collected by some countries. (The definitions are drawn from the *SNA*, which may be consulted for additional details.)

- *Assets* – Entities over which ownership rights are enforced and from which economic benefits may be derived by their owners by holding or using them. These include both financial assets and non-financial assets, whether produced or non-produced.

- *Compensation of employees* – The total remuneration, in cash or in kind, payable by an enterprise to an employee in return for work done by the employee during the accounting period.

- *Net worth* – The difference between the value of all assets – produced, non-produced, and financial – and all liabilities.

- *Net operating surplus* – Measured as value added (gross), less compensation of employees, consumption of fixed capital, and taxes on production, plus subsidies receivable.

- *Gross fixed capital formation* – Measured by the total value of a producer's acquisitions, less disposals, of fixed assets during the accounting period plus certain additions to the value of non-produced assets realised by productive activity. (Fixed assets are defined as produced assets that are themselves used repeatedly, or continuously, in processes of production for more than one year.)

- *Taxes on income* – These consist of corporate income taxes, corporate profit taxes, corporate surtaxes, and so forth, and taxes that accrue to owners of unincorporated enterprises as a result of the income of those enterprises. Taxes on income include only taxes in the host country of the affiliate and not any taxes paid by the parent in the home country as a result of income earned or distributed by the affiliate. Taxes on income are usually assessed on the total income of corporations from all sources and not simply profits generated by production.

- *Research and development expenditures* – Expenditures for activities undertaken for the purpose of discovering or developing new products (goods and services), including improved versions or qualities of existing products, or discovering or developing new or more efficient processes of production.

8.7 Compilation issues for AMNE statistics

348. There are two basic approaches, which are not necessarily mutually exclusive, to developing AMNE statistics. The first is to conduct surveys that directly request information on the operations of resident affiliates of foreign firms and foreign affiliates of domestic firms. The second identifies the subset of existing enterprise data that is accounted for by foreign-owned firms.

349. Whichever of these approaches is taken, there are likely to be links to existing data on foreign direct investment. Where there are surveys for AMNE statistics, registers used in collecting FDI data typically would be used to identify majority-owned affiliates for which variables should be collected. Alternatively, key AMNE variables might be added to existing FDI surveys. However, because FDI surveys may be conducted more frequently than AMNE statistics are compiled (e.g., quarterly rather than annually) and require a quick turnaround, as well as because AMNE statistics are needed for only the majority-owned portion of the FDI universe, separate surveys probably would offer a better solution in

most cases. Where existing domestic statistics are used as the source of information, links to FDI data will often provide the means of determining which resident enterprises are majority-owned and should be included, as well as the means of identifying the country of owner. Under this approach, AMNE statistics would be obtained as an aggregation of statistical variables across the foreign-owned statistical population.

350. Each approach has its own advantages and drawbacks, and it is possible to outline some of the intrinsic differences. However, the criteria for deciding whether an enterprise is foreign-owned would be the same in both cases.

351. The FDI framework, whether implemented through adding questions to existing surveys or through institution of new surveys covering the majority owned subset of the FDI population, allows for the compilation of outward as well as inward statistics and provides more options for tailoring the data to specific needs. However, the activity classification used in FDI statistics is generally rather aggregated, and it seems difficult to go beyond basic statistical variables such as turnover and employment without designing completely new surveys, which might raise concerns about resource availability and respondent burden. Also, if this approach is taken, special care will be necessary to ensure compatibility with domestic statistics with which the AMNE statistics may be compared.

352. The picture of AMNE statistics as a subset of enterprise statistics is quite different. The activity classification used may be quite detailed, and product detail may be available for sales or turnover. In addition, a comprehensive set of statistical variables generally can be provided. It is generally easier to provide this information for statistics on inward investment than for statistics on outward investment.

353. In many cases, a mix of the two approaches may work best, with separate surveys being used for the compilation of outward AMNE statistics and for the identification of foreign-owned companies, and the "enterprise statistics" context being used for the compilation of inward AMNE statistics with a more detailed activity breakdown and a more comprehensive set of variables. An extended business register might be a suitable means of maintaining such information. This approach has already been adopted in some countries that use them to maintain data on foreign ownership. This manual bases its recommendations on both approaches, recognising the advantages and disadvantages of each and the need for countries to have flexibility in adapting the recommendations to their individual statistical infrastructures and maximising the use of existing data.

ANNEX 1.
CHANGES FROM BENCHMARK DEFINITION OF FOREIGN DIRECT INVESTMENT, 3RD EDITION – DRAFT OUTLINE

[THESE ARE PRELIMINARY NOTES – THIS ANNEX WILL BE ELABORATED AND COMPLETED FOLLOWING WIIS DISCUSSIONS]

The changes in the 4th edition of the *Benchmark Definitions* relate more to presentation and clarification as compared to methodological changes which are minor

1. Structure of the Benchmark Definition

354. In this edition, chapters are organised differently and new chapters and sections are added: Section 2.1 Statistical units, Chapter 8. FDI and globalisation and Chapter2. Uses of FDI statistics.

355. The Benchmark Definition does not have a compilation guide. Issues related to practical compilation are traditionally discussed in the annexes. In this edition, there are a number of new annexes.

356. This edition also includes a research agenda for unresolved methodological items.

2. Methodological clarifications

357. List of concepts were further clarified: {list}

3. Methodological changes

(i) For aggregate FDI components, introduction of asset/liability principle replacing the directional principle;

(ii) Maintaining the directional principle for FDI statistics by geographical allocation and industry classification {{including improvements by eliminating the effects of pass-through capital - pending the results of the project group and WIIS deliberation }}

(iii) Creation of optional series on M&As transactions by country allocation and industry classification {pending the results of the project group and WIIS deliberation }

(iv) Creation of optional series of FDI positions according to ultimate host/investing country {pending the results of the project group and WIIS deliberation}

(v) Abandon of the permanent debt concept;

(vi) Replacement of the Fully Consolidated System by Framework of Direct Investment Relationship

[TO COMPLETE]

ANNEX 2.
STANDARD PRESENTATION OF FDI STATISTICS

[THIS ANNEX WILL BE REVISED FOLLOWING WIIS DISCUSSIONS]

{{The *Benchmark Definition* recommends two types of standard presentations for the dissemination of foreign direct investment statistics depending on the type of data. Moreover, there are direct investment statistics compiled on a voluntary basis and their reporting is optional. Overall, the presentations for direct investment statistics recommend by this *Benchmark Definition* can be summarised as follows:

(1) Standard FDI statistics

- (i) FDI aggregates for macro-economic statistics (assets/liability principle)
  - (a) Asset/liabilities of FDI
  - (b) Changes in Asset/liabilities of FDI
  - (c) FDI income debits/credits
- (ii) Foreign Direct Investment Statistics (according to directional principle) [the extent of the directional principle in types of transactions -such as pass-through funds- is yet to be determined]
  - (a) Inward / Outward FDI positions : including a memorandum item on SPEs (aggregate)
    - by partner country
    - by industry
  - (b) Inward / Outward FDI Transactions (inflows/outflows): including a memorandum item on SPEs (aggregate)
    - by partner country
    - by industry
  - (c) FDI income: receivables/payables: including a memorandum item on SPEs (aggregate)

(2) Optional FDI statistics

- (i) Mergers and Acquisitions transactions as a part of FDI statistics (directional principle)
  - (a) By partner country (or regions)
  - (b) By industry
- (ii) Inward/Outward FDI positions according to Ultimate Investing/Host Country(directional principle)
  - (a) By partner country (or regions)
  - (b) By industry

I. Foreign Direct Investment Aggregates for Macro-economic Statistics

1. FOREIGN DIRECT INVESTMENT POSITIONS: MACRO-ECONOMIC AGGREGATES	**Period ..**	**Period ..**
Assets/Liabilities (Net)		
1.1 Assets		
1.1.1 Equity (including Reinvestment of earnings)		
1.1.1.1 Direct investor in direct investment enterprises		
1.1.1.2 Direct investment enterprises in direct investor		
1.1.1.3 Direct investment enterprises in other affiliated enterprises		
1.1.2 Debt instruments		
1.1.2.1 Direct investor claims on direct investment enterprises		
1.1.2.2 Direct investment enterprises claims on direct investor		
1.1.2.3 Direct investment enterprises claims on affiliated enterprises		
1.2 Liabilities		
1.2.1 Equity (including Reinvestment of earnings)		
1.2.1.1 Direct investor in direct investment enterprises		
1.2.1.2 Direct investment enterprises in direct investor		
1.2.1.3 Direct investment enterprises in other affiliated enterprises		
1.2.2 Debt instruments		
1.2.2.1 Direct investor claims on direct investment enterprises		
1.2.2.2 Direct investment enterprises claims on direct investor		
1.2.2.3 Direct investment enterprises claims on affiliated enterprises		

2. FOREIGN DIRECT INVESTMENT TRANSACTIONS: MACRO-ECONOMIC AGGREGATES	**Period ..**	**Period ..**
2.1 Changes in Assets (Net)		
2.1.1 Equity (excluding reinvestment of earnings)		
2.1.1.1 Direct investor in direct investment enterprises		
2.1.1.2 Direct investment enterprises in direct investor		
2.1.1.3 Direct investment enterprises in other affiliated enterprises		
2.1.2 Reinvestment of earnings (Direct investor in direct investment enterprises)		
2.1.3 Debt instruments		
2.1.3.1 Direct investor claims on direct investment enterprises		
2.1.3.2 Direct investment enterprises claims on direct investor		
2.1.3.3 Direct investment enterprises claims on affiliated enterprises		
2.2 Changes in Liabilities(Net)		
2.2.1 Equity (excluding reinvestment of earnings)		
2.2.1.1 Direct investor in direct investment enterprises		
2.2.1.2 Direct investment enterprises in direct investor		
2.2.1.3 Direct investment enterprises in other affiliated enterprises		
2.2.2 Reinvestment of earnings(Direct investor in direct investment enterprises)		
2.2.3 Debt instruments		
2.2.3.1 Direct investor claims on direct investment enterprises		
2.2.3.2 Direct investment enterprises claims on direct investor		
2.2.3.3 Direct investment enterprises claims on affiliated enterprises		

3. FOREIGN DIRECT INVESTMENT INCOME: MACRO-ECONOMIC AGGREGATES	**Period ..**	**Period ..**
3.1 Receivables (Net)		
3.1.1 Earnings on Equity		
3.1.1.1 Distributed earnings		
3.1.1.2 Reinvested earnings		
3.1.2 Interest (on debt instruments)		
3.2 Payables (Net)		
3.2.1 Earnings on Equity		
3.2.1.1 Distributed earnings		
3.2.1.2 Reinvested earnings		
3.2.2 Interest (on debt instruments)		

II. FOREIGN DIRECT INVESTMENT STATISTICS

(ACCORDING TO THE DIRECTIONAL PRINCIPLE)

1. FDI POSITIONS

1. 1.1 Foreign Direct Investment Positions by GEOGRAPHICAL ALLOCATION – Inward

Declaring country:			
Partner country: Year:	Equity (Net)	Debt instruments between affiliates (Net)	Total Inward FDI positions (Net)
SEE TABLE xx FOR THE DETAILS OF GEOGRAPHICAL ALLOCATION			
TOTAL			
Memo item: SPEs			

1.1.2 Foreign Direct Investment Positions by GEOGRAPHICAL ALLOCATION – Outward

Declaring country:			
Partner country: Year:	Equity & Reinvestment of earnings (Net)	Debt instruments between affiliates (Net)	Total Outward FDI positions (Net)
SEE TABLE xx FOR THE DETAILS OF GEOGRAPHICAL ALLOCATION			
TOTAL			
Memo item: SPEs			

1.2.1 Foreign Direct Investment Positions by INDUSTRY CLASSIFICATION – Inward

Declaring country: **Partner country:** **Industry:** **Year:**	Equity & Reinvestment of earnings (Net)	Debt instruments between affiliates (Net)	Total Inward FDI positions (Net)
SEE TABLE xx FOR THE DETAILS OF INDUSTRY CLASSIFICATION			
TOTAL			
Memo item: SPEs			

1.2.2. Foreign Direct Investment Positions by INDUSTRY CLASSIFICATION – Outward

Declaring country: **Partner country:** **Industry:** **Year:**	Equity & Reinvestment of earnings (Net)	Debt instruments between affiliates (Net)	Total Outward FDI positions (Net)
SEE TABLE xx FOR THE DETAILS OF INDUSTRY CLASSIFICATION			
TOTAL			
Memo item: SPEs			

2. FDI TRANSACTIONS

2.1.1 Foreign Direct Investment Transactions by GEOGRAPHICAL ALLOCATION – Inward

Declaring country:				
Partner country: Year:	Equity	Reinvest-ment of earnings (Net)	Debt instruments between affiliates (Net)	Total Inward FDI positions (Net)
SEE TABLE xx FOR THE DETAILS OF GEOGRAPHICAL ALLOCATION				
TOTAL				
Memo item: SPEs				

2.1.2 Foreign Direct Investment Transactions by GEOGRAPHICAL ALLOCATION – Outward

Declaring country:				
Partner country: Year:	Equity (Net)	Reinvest-ment of earnings (Net)	Debt instrument s between affiliates (Net)	Total Outward FDI positions (Net)
SEE TABLE xx FOR THE DETAILS OF GEOGRAPHICAL ALLOCATION				
TOTAL				
Memo item: SPEs				

2.2.1 Foreign Direct Investment Transactions by INDUSTRY CLASSIFICATION – Inward					
Declaring country: **Partner country:**		Equity	Reinvest-ment of earnings	Debt instruments between affiliates	Total Inward FDI positions
Industry	**Year:**	(Net)	(Net)	(Net)	(Net)
	SEE TABLE xx FOR THE DETAILS OF INDUSTRY CLASSIFICATION				
	TOTAL				
Memo item: *SPEs*					

2.2.2 Foreign Direct Investment Transactions by INDUSTRY CLASSIFICATION – Outward					
Declaring country: **Partner country:**		Equity	Reinvest-ment of earnings	Debt instrument s between affiliates	Total Outward FDI positions
Industry	**Year:**	(Net)	(Net)	(Net)	(Net)
	SEE TABLE xx FOR THE DETAILS OF INDUSTRY CLASSIFICATION				
	TOTAL				
Memo item: *SPEs*					

3. FDI INCOME

3.1.1 Foreign Direct Investment Income by GEOGRAPHICAL ALLOCATION – Inward				
Declaring country:				
	Income on Equity		Interest	Total FDI income
	Dividends	Reinvested Earnings	On debt instruments	
Partner country: **Year:**	(Net)	(Net)	(Net)	(Net)
SEE TABLE xx FOR THE DETAILS OF GEOGRAPHICAL ALLOCATION				
TOTAL				
Memo item: SPEs				

3.1.2 Foreign Direct Investment Income by GEOGRAPHICAL ALLOCATION – Inward				
Declaring country:				
	Income on Equity		Interest	Total FDI income
	Dividends	Reinvested Earnings	On debt instruments	
Partner country: **Year:**	(Net)	(Net)	(Net)	(Net)
SEE TABLE xx FOR THE DETAILS OF GEOGRAPHICAL ALLOCATION **TOTAL**				
Memo item: SPEs				

3.2.1 Foreign Direct Investment Income by INDUSTRY CLASSIFICATION – Inward				
Declaring country:				
	Income on Equity		Interest	Total FDI income
	Dividends	Reinvested Earnings	On debt instruments	
Partner country: **Year:**	(Net)	(Net)	(Net)	(Net)
SEE TABLE xx FOR THE DETAILS OF INDUSTRY CLASSIFICATION				
TOTAL				
Memo item: SPEs				

3.2.2 Foreign Direct Investment Income by INDUSTRY CLASSIFICATION – Inward				
Declaring country:				
	Income on Equity		Interest	Total FDI income
	Dividends	Reinvested Earnings	On debt instruments	
Partner country: **Year:**	(Net)	(Net)	(Net)	(Net)
SEE TABLE xx FOR THE DETAILS OF INDUSTRY CLASSIFICATION **TOTAL**				
Memo item: SPEs				

4. MERGERS AND ACQUISITIONS – SUBSET OF FDI TRANSACTIONS

[**optional reporting**]

4.1.1 M&A transactions by GEOGRAPHICAL ALLOCATION – Inward FDI		
Declaring country:		
Partner country: **Year:**	Equity 10%-100% (gross) investment &disinvestment	Of which acquisition of + 50 % Equity (gross) investment &disinvestment
SEE TABLE xx FOR THE DETAILS OF GEOGRAPHICAL ALLOCATION		
TOTAL		

4.1.2 M&A transactions by GEOGRAPHICAL ALLOCATION – Outward FDI		
Declaring country:		
Partner country: **Year:**	Equity 10%-100% (gross) investment &disinvestment	Of which acquisition of + 50 % Equity (gross) investment &disinvestment
SEE TABLE xx FOR THE DETAILS OF GEOGRAPHICAL ALLOCATION		
TOTAL		

4.2.1 M&A transactions by INDUSTRY CLASSIFICATION – Inward FDI		
Declaring country:		
Partner country:	Equity 10%-100% (gross) investment &disinvestment	Of which acquisition of + 50 % Equity (gross) investment &disinvestment
SEE TABLE xx FOR THE DETAILS OF INDUSTRY CLASSIFICATION		
TOTAL		

4.2.1 M&A transactions by INDUSTRY CLASSIFICATION – Outward FDI		
Declaring country:		
Partner country: (Net)	Equity 10%-100% (gross) investment &disinvestment	Of which acquisition of + 50 % Equity (gross) investment &disinvestment
SEE TABLE xx FOR THE DETAILS OF INDUSTRY CLASSIFICATION		
TOTAL		

5. FDI POSITIONS ACCORDING TO ULTIMATE HOST/INVESTING COUNTRY

[**optional reporting**]

5. 1.1 Foreign Direct Investment Positions by GEOGRAPHICAL ALLOCATION – Inward (according to ultimate investing country)

Declaring country:			
Partner country: **Year:**	Equity & Reinvestment of earnings (Net)	Debt instruments (Net)	Total Inward FDI positions (Net)
SEE TABLE xx FOR THE DETAILS OF GEOGRAPHICAL ALLOCATION			
TOTAL			

5.1.2 Foreign Direct Investment Positions by GEOGRAPHICAL ALLOCATION – Outward (according to ultimate host country)

Declaring country:			
Partner country: **Year:**	Equity & Reinvestment of earnings (Net)	Debt instruments (Net)	Total Outward FDI positions (Net)
SEE TABLE xx FOR THE DETAILS OF GEOGRAPHICAL ALLOCATION			
TOTAL			

5.2.1 Foreign Direct Investment Positions by INDUSTRY CLASSIFICATION – Inward (according to ultimate investing country)

Declaring country: **Partner country:** **Industry:** **Year:**	Equity & Reinvestment of earnings (Net)	Debt instruments (Net)	Total Inward FDI positions (Net)
SEE TABLE xx FOR THE DETAILS OF INDUSTRY CLASSIFICATION			
TOTAL			

5.2.2. Foreign Direct Investment Positions by INDUSTRY CLASSIFICATION – Outward (according to ultimate host country)

Declaring country: **Partner country:** **Industry:** **Year:**	Equity & Reinvestment of earnings (Net)	Debt instruments (Net)	Total Outward FDI positions (Net)
SEE TABLE xx FOR THE DETAILS OF INDUSTRY CLASSIFICATION			
TOTAL			

Table 8. GEOGRAPHICAL AND ECONOMIC ZONES

	1 - Geographical zones	
E1	**EUROPE**	
A3	BLEU	
BE	Belgium	
LU	Luxembourg	
DK	Denmark	
DE	Germany	
GR	Greece	
ES	Spain	
FR	France	
IE	Ireland	
IT	Italy	
NL	Netherlands	
PT	Portugal	
GB	United Kingdom	
AT	Austria	
FI	Finland	
SE	Sweden	
CY	Cyprus	
CZ	Czech Republic	
HU	Hungary	
MT	Malta	
PL	Poland	
SK	Slovakia	
SI	Slovenia	
E3	***BALTIC COUNTRIES***	
EE		Estonia
LT		Lithuania
LV		Latvia
CH	Switzerland	
IS	Iceland	
LI	Liechtenstein	
NO	Norway	
E2	***OTHER EUROPEAN COUNTRIES***	
AL		Albania
AD		Andorra
BY		Belarus
BA		Bosnia and Herzegovina
BG		Bulgaria
HR		Croatia
FO		Faeroe Islands
GI		Gibraltar
GG		Guernsey
VA		Holy See (Vatican City State)
IM		Isle of Man
JE		Jersey
MK		Macedonia, the Former Yugoslav Republic of
MD		Moldova, Republic of
RO		Romania
RU		Russian Federation
SM		San Marino
TR		Turkey
UA		Ukraine
CS		Serbia and Montenegro
E4	**AFRICA**	
E5	***NORTH AFRICA***	
DZ		Algeria
EG		Egypt
LY		Libyan Arab Jamahiriya
MA		Morocco
TN		Tunisia
E6	***OTHER AFRICAN COUNTRIES***	

AO		Angola
BJ		Benin
BW		Botswana
IO		British Indian Ocean Territory
BF		Burkina Faso
BI		Burundi
CM		Cameroon
CV		Cape Verde
CF		Central African Republic
TD		Chad
KM		Comoros
CG		Congo
CI		Côte d'Ivoire
CD		Congo, the Democratic Republic of the
DJ		Djibouti
GQ		Equatorial Guinea
ER		Eritrea
ET		Ethiopia
GA		Gabon
GM		Gambia
GH		Ghana
GN		Guinea
GW		Guinea-Bissau
KE		Kenya
LS		Lesotho
LR		Liberia
MG		Madagascar
MW		Malawi
ML		Mali
MR		Mauritania
MU		Mauritius
MZ		Mozambique
NA		Namibia
NE		Niger
NG		Nigeria
ZA		South Africa
RW		Rwanda
SH		St. Helena
ST		Sao Tome and Principe
SN		Senegal
SC		Seychelles
SL		Sierra Leone
SO		Somalia
SD		Sudan
SZ		Swaziland
TG		Togo
UG		Uganda
ZM		Zambia
ZW		Zimbabwe
E7	**AMERICA**	
E8	***NORTH AMERICA***	
US		United States
GL		Greenland
CA		Canada
E9	***CENTRAL AMERICA***	
AI		Anguilla
AG		Antigua and Barbuda
AW		Aruba
BS		Bahamas
BB		Barbados
BZ		Belize
BM		Bermuda
VG		Virgin Islands, British
KY		Cayman Islands
CR		Costa Rica
CU		Cuba
DM		Dominica

DO	Dominican Republic
SV	El Salvador
GD	Grenada
GT	Guatemala
HT	Haiti
HN	Honduras
JM	Jamaica
MX	Mexico
MS	Montserrat
AN	Netherlands Antilles
NI	Nicaragua
PA	Panama
KN	St. Kitts and Nevis
LC	Saint Lucia
VC	St Vincent and the Grenadines
TT	Trinidad and Tobago
TC	Turks and Caicos Islands
VI	Virgin Islands, U.S.
F1	***SOUTH AMERICA***
AR	Argentina
BO	Bolivia
BR	Brazil
CL	Chile
CO	Colombia
EC	Ecuador
FK	Falkland Islands (Malvinas)
GY	Guyana
PY	Paraguay
PE	Peru
SR	Suriname
UY	Uruguay
VE	Venezuela
F2	**ASIA**
F3	***NEAR AND MIDDLE EAST***
IR	Iran, Islamic Republic of
IL	Israel
F4	***GULF ARABIAN COUNTRIES***
BH	Bahrain
IQ	Iraq
KW	Kuwait
OM	Oman
QA	Qatar
SA	Saudi Arabia
AE	United Arab Emirates
YE	Yemen
F5	***OTHER NEAR AND MIDDLE EAST COUNTRIES***
AM	Armenia
AZ	Azerbaijan
GE	Georgia
JO	Jordan
LB	Lebanon
PS	Palestinian Territory, Occupied
SY	Syrian Arab Republic
F6	***OTHER ASIAN COUNTRIES***
AF	Afghanistan
BD	Bangladesh
BT	Bhutan
BN	Brunei Darussalam
KH	Cambodia (Kampuchea)
CN	China
HK	Hong Kong, China
IN	India
ID	Indonesia
JP	Japan
KZ	Kazakhstan
KP	Korea, Dem. People's Republic of (North Korea)

KR	Korea, Republic of (South Korea)
KG	Kyrgyzstan
LA	Lao People's Democratic Republic
MO	Macao
MY	Malaysia
MV	Maldives
MN	Mongolia
MM	Myanmar
NP	Nepal
PK	Pakistan
PH	Philippines
SG	Singapore
LK	Sri Lanka
TW	Taiwan, Province of China
TJ	Tajikistan
TH	Thailand
TL	Timor-Leste
TM	Turkmenistan
UZ	Uzbekistan
VN	Viet Nam
F7	**OCEANIA & POLAR REGIONS**
AQ	Antarctica
AS	American Samoa
AU	Australia
BV	Bouvet Island
CC	Cocos (Keeling) Islands
CK	Cook Islands
CX	Christmas Island
FJ	Fiji
FM	Micronesia, Federal States of
HM	Heard Island and McDonald Islands
GS	South Georgia and the South Sandwich Islands
GU	Guam
KI	Kiribati
MH	Marshall Islands
MP	Northern Mariana Islands
NC	New Caledonia
NF	Norfolk Island
NR	Nauru
NU	Niue
NZ	New Zealand
PF	French Polynesia
PG	Papua New Guinea
PN	Pitcairn
PW	Palau
SB	Solomon Islands
TF	French Southern Territories
TO	Tonga
TK	Tokelau
TV	Tuvalu
UM	US Minor Outlying Islands
VU	Vanuatu
WF	Wallis and Futuna
WS	Samoa
Z1	**World not allocated**
A1	**TOTAL WORLD**

	2 - Economic zones
D2	**EU-15**
D4	**Extra-EU15**
Z8	**Extra-EU-15 not allocated**
D3	EU25
D5	Extra EU25
W5	Extra EU25 not allocated
U2	**Euro-zone**
U3	**EU MS not euro-zone**
U4	**Extra-euro-zone**

W4	**Extra-euro-zone not allocated**
A5	**EFTA**
A8	**OECD**
B1	**NAFTA**
B9	**NICs1**
C1	**NICs2A**
C2	**NICs2LA**
C6	**CIS countries**
B3	**ASEAN countries**
B4	**OPEC countries**
C4	**Offshore Financial Centres**
	3 - Additional economic zones
B2	**Latin America countries**
B5	**ACP countries**
B6	African ACP countries
B7	Caribbean ACP countries
B8	Pacific ACP countries
C3	**Mediterranean Basin countries**
C7	**Maghreb countries**
C8	**Mashrek countries**
A9	**Central and Eastern Europe**
C5	**French Franc zone**
C9	**MERCOSUR**
D7	**Mediterranean countries in the Euro-Mediterranean Partnership**
7Z	**International Organisations**

International Standard Industry Classification (ISIC3)

[to be replaced by ISIC4]

CODE	ECONOMIC ACTIVITY	ISIC rev.3
0595	**AGRICULTURE AND FISHING**	sections A and B
1495	**MINING AND QUARRYING**	section C
1100	**Extraction of crude petroleum and natural gas; service activities incidental to oil and gas extraction,**	division 11
3995	**MANUFACTURING**	section D
1605	**Food products**	divisions 15,16
1805	**Textiles and wearing apparel**	divisions 17,18
2205	**Wood, publishing and printing**	divisions 20,21,22
2295	**TOTAL textiles + wood activities**	
2300	**Refined petroleum products and other treatments**	division 23
2400	**Manufacture of chemicals & chemical products**	division 24
2423	**Pharmaceuticals, medicinal chemical and botanical products**	group 242
2500	**Rubber and plastic products**	division 25
2595	**TOTAL petroleum, chemical, rubber, plastic products**	
2805	**Metal products**	divisions 27 and 28
2900	**Mechanical products**	division 29
2995	**TOTAL metal and mechanical products**	
3000	**Office machinery and computers**	division 30
3200	**Radio, TV, communication equipments**	division 32
3295	**TOTAL machinery, computers, RTV, communication**	
3300	**Medical, precision and optical instruments, watches and clocks**	division 33
3400	**Motor vehicles**	division 34
3500	**Other transport equipment**	division 35
3530	**Manufacture of aircraft and spacecraft**	group 353
3595	**TOTAL vehicles + other transport equipment**	
4195	**ELECTRICITY, GAS AND WATER**	section E
4500	**CONSTRUCTION**	section F
5095	**TOTAL SERVICES**	
5295	**TRADE AND REPAIR**	section G
	of which	
5000	**Sale, maintenance and repair of motor vehicles and motor cycles; retail sale of automotive fuel**	division 50
5100	**Wholesale trade and commission trade, except of motor vehicles and motor cycles**	division 51
5200	**Retail trade, except of motor vehicles and motor cycles; repair of personal and household goods**	division 52
5500	**HOTELS AND RESTAURANTS**	section H
6495	**TRANSPORT AND COMMUNICATION**	section I
6395	**Transport and storage**	
6000	**Land transport**	division 60
6100	**Water transport**	division 61
6200	**Air transport**	division 62
6300	**Supporting and auxiliary transport activities; activities of travel agencies**	division 63
6400	**Post and telecommunications**	division 64
6410	**Post and courier activities**	group 641
6420	Telecommunications	group 642
6895	**FINANCIAL INTERMEDIATION**	section J
6500	Financial intermediation, except insurance and pension funding	division 65
6510	Monetary intermediation	group 651
6520	Other financial intermediation	group 659
	of which:	
6524	*Financial holding companies*	part of class 6599
6600	**Insurance companies, pension funds**	division 66
6700	Activities auxiliary to financial intermediation	division 67
7395	**REAL ESTATE & BUSINESS ACTIVITIES**	section K
7000	**Real estate**	division 70
7100	**Renting of machinery and equipment without operator and of personal and household goods**	division 71
7200	**Computer activities**	division 72
7300	**Research and development**	division 73
7400	**Other business activities**	division 74
	of which:	
7410	Legal, accounting, book-keeping and auditing activities; tax consultancy; market research and public opinion polling; business and management consultancy; holdings	group 741
	of which:	
7415	*Management holding companies*	part of class 7414
7440	Advertising	group 743
9995	**OTHER SERVICES**	sections L,M,N,O,P,Q
9200	**of which Recreational, cultural and sporting activities**	Division 92
9996	**Not allocated**	
9997	**SUB-TOTAL**	
9998	**Private purchases & sales of real estate**	
9999	**TOTAL**	

ANNEX 3.
LIST OF BORDERLINE CASES AND EXCLUSIONS FROM FDI

1. List of exclusions from FDI

1.1 Transactions/positions/income between related financial intermediaries

358. Deposits and other amounts lent by a financial intermediary to its controlled or non-controlled affiliate located abroad that is also a financial intermediary, and deposits and other borrowings taken from such offices, should be classified as "other investment" rather than direct investment. By analogy, debt securities between related financial intermediaries are classified as “portfolio investment”. The Benchmark Definition recommends that, in the case of financial intermediaries, all inter-company flows – with the exception of those pertaining to equity finance – with related affiliates should be excluded from direct investment flows.

359. On conceptual grounds, permanent debt between affiliated financial intermediaries represents direct investment. But, the Benchmark Definition recommends that, on grounds of practicality and statistical significance, it should be recorded as either portfolio investment or other investment, depending on the instrument.

360. The definition of the scope of enterprises included under “financial intermediary” should be equivalent to the SNA definitions. The SNA divides financial corporations into three classes namely, financial intermediaries, financial auxiliaries and other financial corporations. Financial intermediaries are institutional units that incur liabilities on their own account for the purpose of acquiring financial assets by engaging in financial transactions on the market. Financial auxiliary activities are institutional units principally engaged in serving financial markets, but do not take ownership of the financial assets and liabilities they handle. Other financial corporations are institutional units providing financial services, where most of their assets or liabilities are not available on open financial markets. The financial corporations sector can be divided into nine sub-sectors according to its activity in the market and the liquidity of its liabilities (see Box 1 below). So, non-equity transactions/positions (and investment income) between two related affiliates that are part of (1) deposit-taking corporations; (2) money market funds (MMFs); (3) non-MMF investment funds or (4) other financial intermediaries, except insurance corporations and pension funds, would be excluded from FDI.

Box 9. **SNA: classification of financial corporations**

1. Central bank

The central bank is the national financial institution that exercises control over key aspects of the financial system.

2. Deposit-taking corporations except the central bank

Deposit-taking corporations except the central bank have financial intermediation as their principal activity. To this end, they have liabilities in the form of deposits or financial instruments (such as short-term certificates of deposit) that are close substitutes for deposits.

3. Money market funds (MMFs)

MMFs are collective investment schemes that raise funds by issuing shares or units to the public. The proceeds are invested primarily in money market instruments, MMF shares/units, transferable debt instruments with a residual maturity of less than one year, bank deposits and instruments which pursue a rate of return that approaches the interest rates of money market instruments. MMF shares can be transferred by cheque or other means of direct third party payments.

4. Non-MMF investment funds

Non-MMF investments funds are collective investment schemes that raise funds by issuing shares or units to the public. The proceeds are invested predominantly in long-term financial assets and non-financial assets (usually real estate).

5. Other financial intermediaries, except insurance corporations and pension funds (ICPFs)

Other financial intermediaries except insurance corporations and pension funds consists of financial corporations and quasi-corporations which are engaged in providing financial services by incurring liabilities, in forms other than currency, deposits or close substitutes for deposits, on their own account for the purpose of acquiring financial assets by engaging in financial transactions on the market.

6. Financial auxiliaries

Financial auxiliaries consists of financial corporations that are principally engaged in activities associated with transactions in financial assets and liabilities or with providing the regulatory context for these transactions but in circumstances that do not involve the auxiliary taking ownership of the financial assets and liabilities being transacted.

7. Other financial corporations, except ICPFs

This sub-sector consists of institutional units providing financial services, where most of either their assets or liabilities are not transacted on open financial markets. It includes entities transacting within only a limited group of units such as with subsidiaries or subsidiaries of the same holding corporation or entities that provide loans from own funds provided by only one sponsor.

8. Insurance corporations (ICs)

This sub-sector consists of resident insurance corporations and quasi-corporations and autonomous pension funds. Insurance corporations consist of incorporated, mutual or other entities whose principal function is to provide life, accident, sickness, fire or other forms of insurance to individual institutional units or group of units.

9. Pension funds (PFs)

The pension funds included here are those which are constituted in such a way that they are separate institutional units from the units which create them. They are established for purposes for purposes of providing benefits on retirement for specific groups of employees. They have their own assets and liabilities and they engage in financial transactions in the market on their own account.

361. The transactions/positions included or not in FDI are summed up in the following table:

Table 1 Overview of transactions/positions included and excluded (yes/no respectively) in FDI

Table 9. Overview of Transactions/Positions Included in and Excluded from FDI

Yes = included; No = Excluded

		Financial intermediaries		**Financial auxiliaries**	**Other financial corporations**
		Except ICPFs	ICPFs		
Financial intermediaries					
Except ICPFs (deposit-taking corporations, MMFs, non-MMF investment funds, other financial intermediaries except ICPFs)	Equity finance	Yes	Yes	Yes	Yes
	Debt (including permanent debt)	No	Yes	Yes	Yes
ICPFs	Equity finance		Yes	Yes	Yes
	Debt (including permanent debt)		Yes	Yes	Yes
Financial auxiliaries	Equity finance			Yes	Yes
	Debt (including permanent debt)			Yes	Yes
Other financial corporations	Equity finance				Yes
	Debt (including permanent debt)				Yes

1.2 Financial derivatives

362. Financial derivatives should be excluded from FDI statistics. However, trade credit, financial leasing, and any other type of inter-company loans should be included in FDI.

2. List of borderline cases

2.1 SPEs and "capital in transit"

363. Financial corporations such as SPEs or conduits that raise funds in open markets to be used by their parent corporation are encompassed in the SNA definition of "Other financial corporations, except ICPFs". So, non-equity transactions/positions between these financial corporations should be included in FDI.

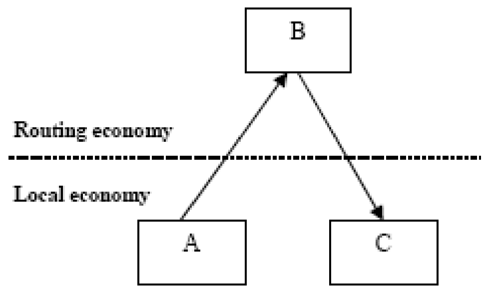
364. More generally, cross-border transactions/positions which are pass-through capital (also referred to as "capital in transit") via structures put in place to facilitate the financing of investment for multinational enterprises are included in direct investment as they are integral parts of direct investment relationship identified according to the FDIR. Nevertheless, these transactions are often going through a country without significantly affecting its economy, and within a limited time frame. Since these transactions may distort the analysis of direct investment positions/transactions, this edition of the Benchmark Definition recommends that countries compile on a supplemental basis direct investment statistics excluding these "capital in transit" transactions/positions. The statistics should be geographically broken down by country of counterpart and by industry classification to facilitate the economic analysis of direct investment.

[WILL BE RE-DRAFTED IN ORDER TO TAKE INTO ACCOUNT THE CONCLUSIONS OF THE SUB-GROUP IN CHARGE OF THE .CAPITAL IN TRANSIT.-SPE ITEM]

2.2 Round tripping

365. Round tripping refers to the channelling by direct investors of local funds and the subsequent return of these funds to the local economy in the form of direct investment. From the perspective of the local economy, the simplest example of round tripping occurs when a domestic investment is disguised as FDI through a controlled or non-controlled affiliate located abroad, in the "routing economy" (i.e. the economy through which the funds are routed) (see figure 1): a company A in the local economy provides FDI funds to a non-resident affiliated company (company B) for investing back in another company (company C) in the local economy.

Figure 0-1. A simple case of round-tripping



366. Of course, the simple group structure shown in figure 1 can be easily extended to cover other more complicated group structures that are conducive to round tripping. Two examples of these structures are given in figures 2 and 3 below:

Figure 00-2. A case of round tripping with many entities in routing economies

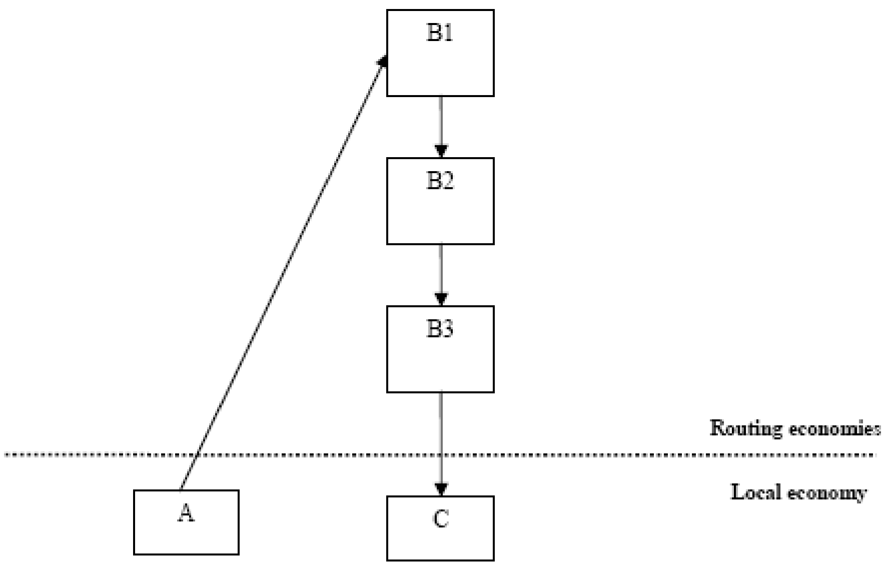
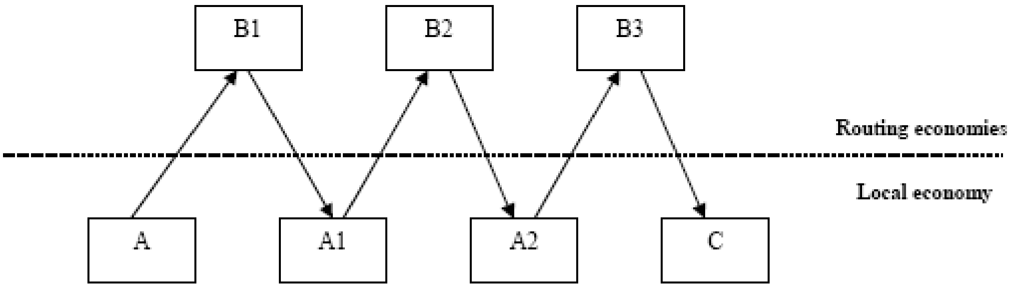


Figure 00-3. A case of round tripping with many entities in routing and local economies



367. There are many incentives for round tripping such as:

- Tax and fiscal advantages: some economies provide preferential policies to attract FDI, including low taxation, favourable land use rights, convenient administrative support, etc. Since it is not always easy for local enterprises to find foreign investors who are willing to invest in them, they may firstly channel capital abroad which is then disguised as foreign capital for local investment to take advantage of the preferential treatments only available to foreign investors;

- Property right protection: infrastructure for property right protection in some economies is not well established. Therefore, the enterprises in these economies may have the motivation to park their wealth in affiliated enterprises set up in overseas economies having better legal and institutional settings for property right protection. Besides, some investors may prefer to keep their identities anonymous by investing through companies set up in offshore financial centres. Capital will then be brought back to the host economies in the form of FDI if there are profitable investment opportunities.

- Expectations on exchange control and exchange rate: some economies have control on capital account and exchange rate. Expectations on changes in exchange control and exchange rate may generate round tripping for larger flexibility in foreign exchange management.

- Accessing better financial services: Financial markets of some economies are not well developed. Enterprises of these economies have to access overseas financial markets for obtaining better financial services, such as listing of companies in overseas stock markets. The funds raised will be brought back to the host economies in the form of FDI. Round tripping may occur as part of this process.

368. As such, round tripping funds flowed between controlled or non-controlled affiliated companies have to be recorded as FDI transactions/positions. For the local economy, they appear as FDI assets for the local funds channelled to routing economies, and as FDI liabilities for the subsequent return of the funds to the local economy. For the routing economy, they appear as FDI liabilities for the funds received from the local economy, and as FDI assets for the return of these funds to the local economy.

369. It may be argued that these round tripping funds lead to an overstatement of the genuine magnitude of FDI. The Benchmark Definition recommends therefore separate supplementary breakdowns when this phenomenon affects significantly FDI data of a country. From the point of view of the routing economy, round tripping may be partly linked with "capital in transit" transactions/positions; in this case,

the Benchmark Definition recommends that round tripping that takes the form of "capital in transit" would be excluded on a supplemental basis from FDI statistics. From the point of view of the local economy, the geographical breakdown according to the Ultimate Host Country (UHC) and the Ultimate Investing Country (UIC) could provide users with very interesting information.

2.3 Collective investment

370. The *Benchmark Definition* recommends that, when collective investment institutions have equity ownership in a non-resident entity of 10 per cent or more, this relationship should be considered as direct investment. More precisely, investment in, and investment by, hedge funds, private investment funds and distressed funds should be included in FDI data if the standard 10 per cent threshold is met.

371. Some concerns have been expressed about the inclusion in FDI of the investments in and by retail mutual funds and master/feeder funds. Although recognising the relevance of such concerns, the *Benchmark Definition* recommends that these investments should not be an exception to the "10 per cent" rule.

[MAY BE RE-DRAFTED IN ORDER TO TAKE INTO ACCOUNT THE CONCLUSIONS OF THE DISCUSSIONS ON THIS TOPIC]

2.4 Payments associated with the acquisition of a right to undertake a direct investment

372. In many developing or transition economies, the government requires the payment of a fixed amount of money by direct investors for the right to undertake a direct investment in the host economy. Often, but not always, these operating or concession rights are related to the extraction of natural resources. In transition economies, compilers refer to these payments as "bonuses". They are legal transactions and should not be associated with poor governance. The issue was to determine whether or not such bonuses constitute direct investment transactions and to recommend a common recording practice for such transactions.

373. The Benchmark Definition recommends that such bonus payments should be recorded as "Direct investment: equity" when there is an intention to establish a direct investment enterprise (such as in the case of a contractual arrangement between the investor and the government).[45]

45. See the IMF BPM6 for the treatment of such bonus payments when no direct investment enterprise is or will be established.

ANNEX 4.
FRAMEWORK FOR DIRECT INVESTMENT RELATIONSHIP

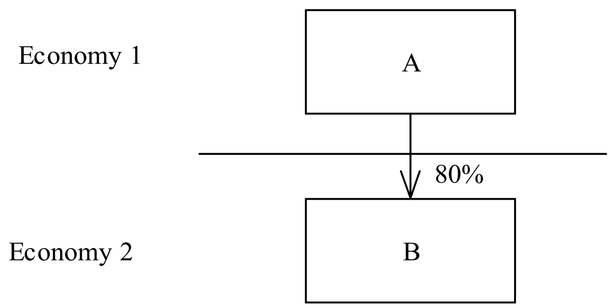
374. This annex presents the Framework for Direct Investment Relationships (FDIR), the preferred method for identifying the extent of direct investment relationships. It also provides information on two alternatives to the FDIR – the Equity Multiplication Method (EMM) and the Influence / Control Method (ICM). The methods are compared in terms of inclusions and exclusions from direct investment. Practical implementation of the FDIR for measuring investment income and classifying financial transactions and positions is also discussed.

1. Framework for Direct Investment Relationships (FDIR)

375. The Framework for Direct Investment Relationships includes in direct investment all controlled and non-controlled affiliates of an investor.

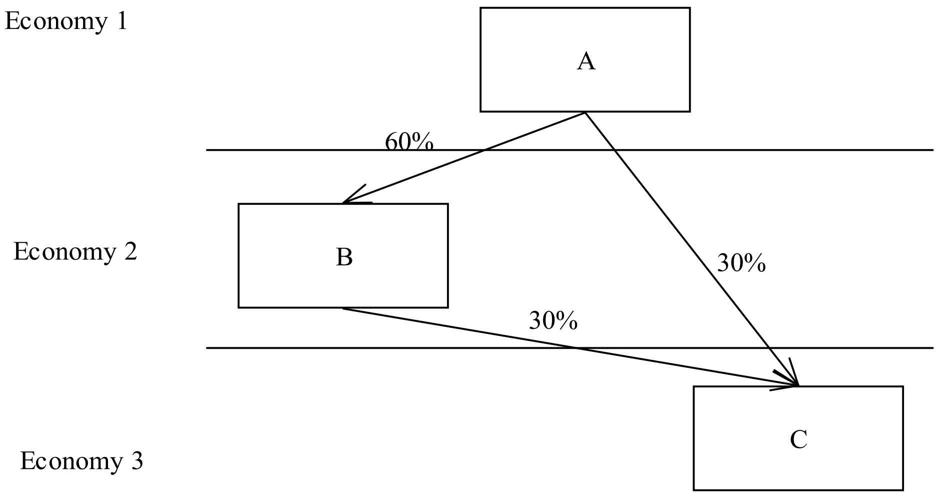
- A *controlled affiliate* is an enterprise in which an investor owns more than 50 per cent of the voting power. Where the investor and the controlled affiliate reside in different economies and the controlled affiliate is incorporated, the controlled affiliate is termed a *subsidiary* of the investor. In Figure 1, B is a controlled affiliate of A.

Figure 1. Controlled affiliate



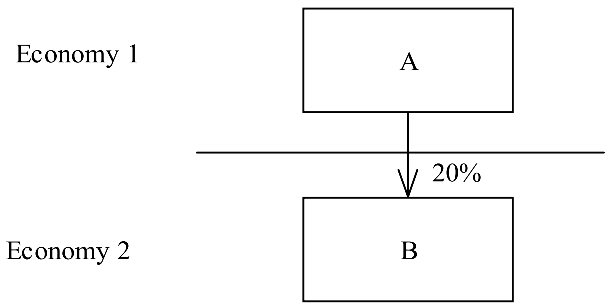
- Where an investor and its controlled affiliates combined own more than 50 per cent of the voting power of an enterprise, the owned enterprise is also regarded as a controlled affiliate of the investor. In Figure 2, C is a controlled affiliate of A.

Figure 2. Controlled affiliate



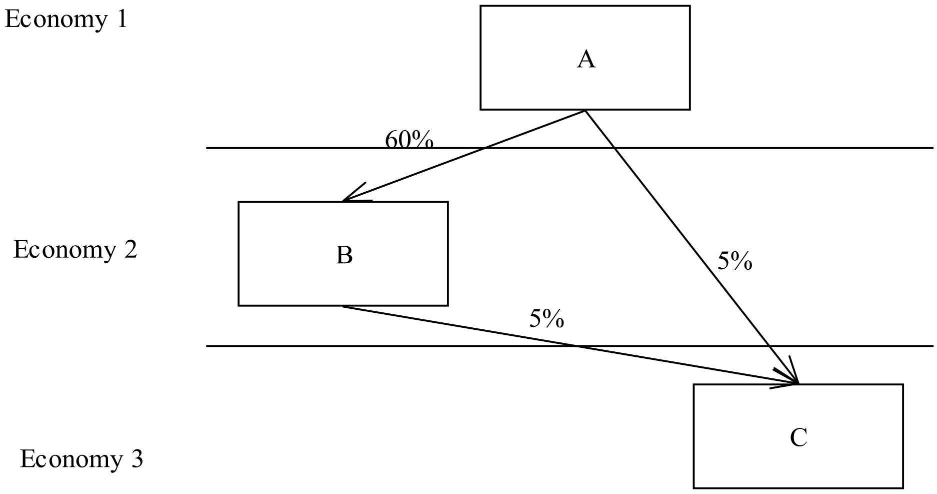
– A *non-controlled affiliate* is an enterprise in which an investor owns at least 10 per cent and no more than 50 per cent of the voting power. Where the investor and the non-controlled affiliate are in different economies and the non-controlled affiliate is incorporated, the non-controlled affiliate is termed an *associate* of the investor. In Figure 3, B is a non-controlled affiliate of A.

Figure 3. Non-controlled affiliate



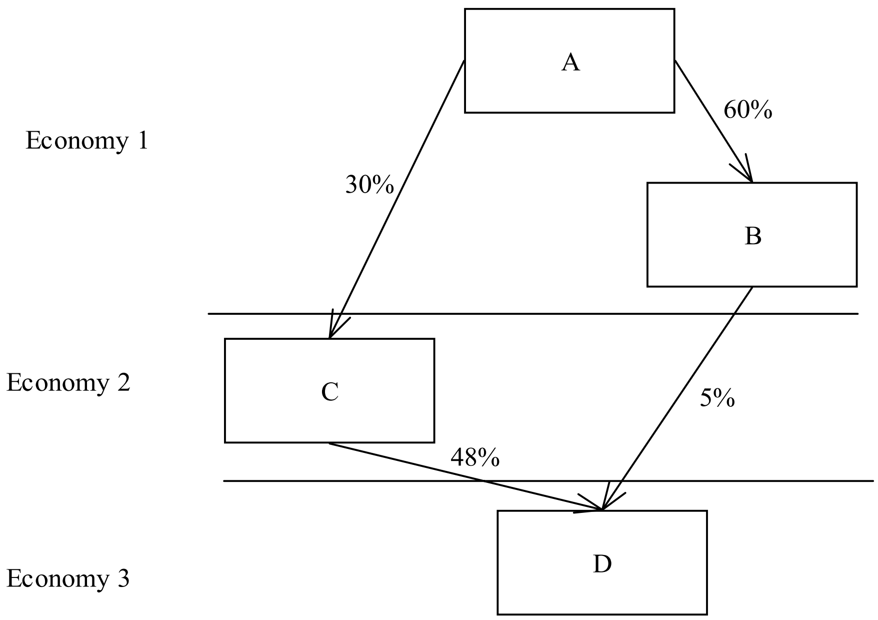
– Where an investor and its controlled affiliates combined own at least 10 per cent but no more than 50 per cent of the voting power of an enterprise, the owned enterprise is regarded as a non-controlled affiliate of the investor. In Figure 4, C is a non-controlled affiliate of A.

Figure 4. Non-controlled affiliate



– Where an investor, its controlled affiliates and its non-controlled affiliates combined own more than 50 per cent of the voting power of an enterprise and the owned enterprise is not otherwise a controlled affiliate, then the owned enterprise is regarded as a non-controlled affiliate. In Figure 5, D is a non-controlled affiliate of A.

Figure 5. Non-controlled affiliate



376. The FDIR identifies all enterprises over which the investor has significant influence. Three degrees of influence are recognised – controlled, influenced and not influenced. It is considered that the degree of influence that may be exercised by the investor through controlling links is not diminished by the existence of multiple links. Thus, an enterprise controlled by a controlled affiliate or by a group of controlled affiliates (including the investor) is itself regarded as a controlled affiliate. An enterprise controlled by a non-controlled affiliate or a group of related enterprises including non-controlled affiliates is regarded as a non-controlled affiliate. The degree of influence that may be exercised by an investor through a single or cumulative influencing link is diminished by one degree. Thus, an enterprise influenced by a controlled affiliate or the group of controlled affiliates (including the investor) is regarded as a non-controlled affiliate. An enterprise influenced by a non-controlled affiliate or a group of related enterprises including non-controlled affiliates is not regarded as an affiliate of the investor. A chain of ownership is followed until the degree of influence that may be exercised by the investor is diminished to the point where an enterprise is not considered to be significantly influenced. Under the FDIR, the direct investment relationship extends from an investor to cover all of its controlled and non-controlled affiliates.

377. Where more than one ownership chain originates from the same direct investor, all entities within each chain that are in different economies are in a direct investment relationship with one another. Note that some of the links in a chain may be within one economy.

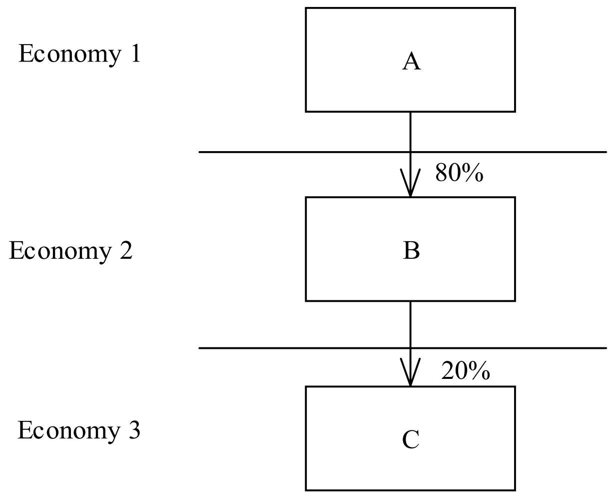
2. Equity Multiplication Method

378. The Equity Multiplication Method (EMM) includes in direct investment all enterprises in which an investor has voting equity participation of at least 10 per cent.[46] The calculation of participation percentage is based on a straight multiplication and summation of direct and indirect participation percentages.

379. More specifically, an indirect participation in a given enterprise at the bottom of a chain of ownership is calculated by taking the investor's participation in the first enterprise, multiplied by the first enterprise's participation in the next enterprise, multiplied by the corresponding percentages for all other intervening enterprises in the chain, multiplied by the last intervening enterprise's participation in the given enterprise. In Figure 6 according to this method, A has a 16 per cent participation in C (20 per cent of 80 per cent). Because this participation is at least 10 per cent, A and C are regarded as being in a direct investment relationship.

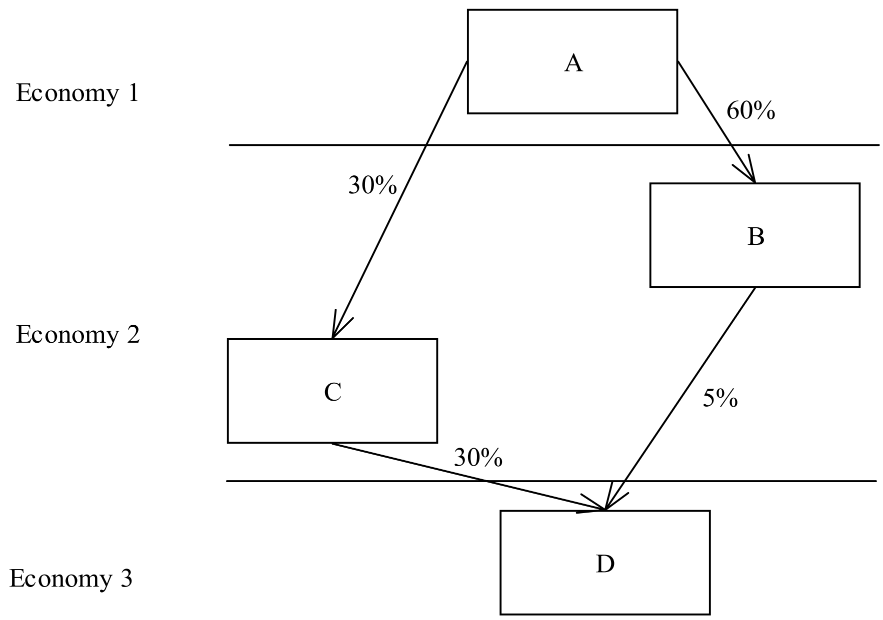
46. In the third edition of the *Benchmark Definition*, this method was referred to as the United States System.

Figure 6. Participation Multiplication Method



380. If the investor's interest is held through more than one participation chain, then the percentages of direct and indirect participation in all chains are summed to determine the investor's total participation percentage. If the combined direct and indirect participation percentage is less than 10 per cent in an enterprise in another economy, then that enterprise is not considered to be in a direct investment relationship with the investor. In Figure 7, A holds 3 per cent of D indirectly through B and 9 per cent of D indirectly through C, so A holds a total of 12 per cent of D from its combined holdings through B and C.

Figure 7. Participation Multiplication Method

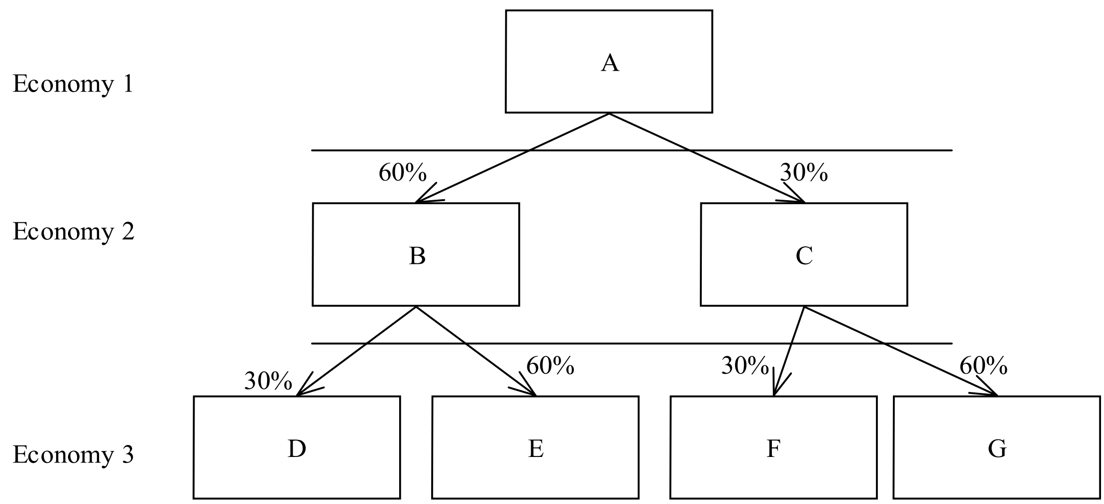


3. Influence/Control Method

381. The Influence/Control Method (ICM) includes in direct investment all enterprises whose voting power are 10 per cent or more *directly* owned, plus all enterprises that are controlled by them (ownership of more than 50 per cent of the voting power), plus all other enterprises in a continuous chain of majority ownership.[47]

382. This method allows the first link in an ownership chain to be a non-controlling (influencing) link, but all subsequent links must be controlling links. Thus the ICM breaks the ownership chain at the second influencing link (as in the FDIR) where the first link from the investor is an influencing link. On the other hand (and contrary to the FDIR), the ICM breaks the ownership chain at the first influencing link where the first link from the investor is a controlling link. As such, the ICM will always identify the enterprises in a direct investment relationship as a subset of those identified by the FDIR. In Figure 8 according to this method, B and C are in a direct investment relationship with A and with each other; E and G are also in a direct investment relationship with A (indirectly), B and C and with each other, while enterprise D is only in a direct investment relationship with B and E, and enterprise F is only in a direct investment relationship with C and G.

Figure 8. Influence / Control Method



383. Methods of dealing with multiple ownership chains are still to be determined within the ICM.

4. Comparing the three methods

384. Figure 9 presents six different relationships between an indirectly held enterprise and an ultimate investor. These relationships are analysed in Table 1 in terms of whether the indirectly held enterprise is in a direct investment relationship with enterprise A.

47. In drafting discussions for this edition of the *Benchmark Definition*, this method was initially referred to as the EU method.

Figure 9. Comparing the three methods

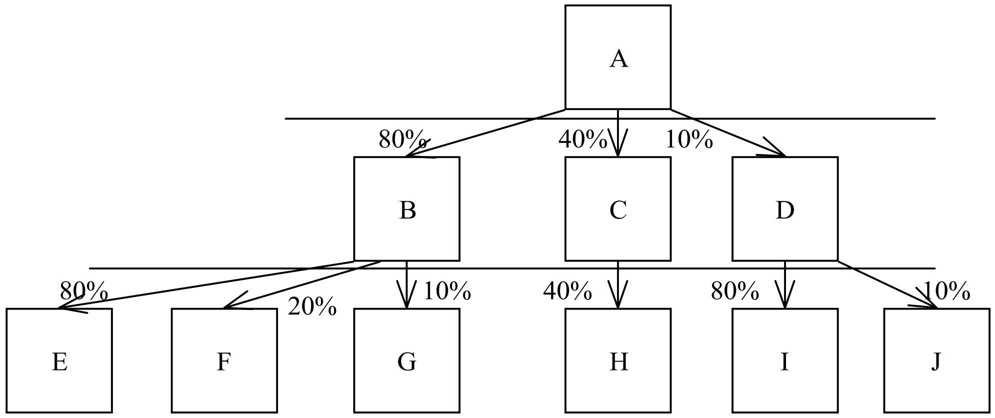


Table 1. Comparing the three methods

Relationship with A	E	F	G	H	I	J
FDIR	Direct	Direct	Direct	None	Direct	None
PMM	Direct	Direct	None	Direct	None	None
ICM	Direct	None	None	None	Direct	None

5. Measuring investment income on direct investment equity using the FDIR

385. Income on direct investment equity is measured on the basis of current operating performance and accrues to the direct investor as it is earned. The operating performance of a direct investment enterprise includes the earnings accruing to it from any enterprises in which it holds equity which are also in a direct investment relationship with the direct investor, be it through direct or indirect ownership.

386. When measuring income credits, the entity resident in the reporting economy that has a non-resident direct investment enterprise is treated as the direct investor in ownership chains. Any income accruing to the resident entity includes the proportional accrued income of all entities in chains of ownership with the resident as the direct investor. All income should be 'equity-accounted' in accordance with accrual principles.

387. When measuring income debits, the degree of influence recognised between the non-resident direct investor and the resident direct investment enterprise is the critical factor:

- If the resident direct investment enterprise is controlled by the non-resident direct investor, ownership chains from the resident direct investment enterprise are followed past the first non-controlled affiliate and broken when the second non-controlled affiliate is reached; while

- If the resident direct investment enterprise is influenced by the non-resident direct investor, ownership chains from the resident direct investment enterprise are broken when the first non-controlled affiliate is reached.

388. In some cases, it may be necessary to go further up the chain of ownership than the immediate investor to identify cases of cumulative ownership.

389. The earnings accruing to the non-resident direct investor are its proportion of the accrued consolidated earnings of the resulting ownership chain.

6. Classifying financial transactions and positions

390. Any financial transaction or position between entities in a direct investment relationship is classified as a direct investment transaction or position, regardless of whether there exists an equity position between the counterparties (the usual exception for debt transactions and positions between financial intermediaries in a direct investment relationship applies).

391. When classifying positions and transactions, all ownership chains of which the resident enterprise is a member have to be considered. The ownership chains are the ownership chain where the resident enterprise is treated as the direct investor, and any ownership chains where the resident enterprise is influenced or controlled. The latter chains are identified by moving 'up' the chain from the resident enterprise, through the first influencing link, and stopping at the highest enterprise before the next influencing link. The resident enterprise is then in a direct investment relationship with all enterprises that are in a direct investment relationship with any enterprise above it in an ownership chain. Note that there may be multiple chains and multiple direct investors identified in this process. This may also result in a number of 'other related enterprises' being identified through going up a chain and coming down another chain originating at the same investor.

2. Equity Multiplication Method (EMM)

392. The EMM includes in direct investment all enterprises whose voting securities are 10 per cent or more directly or indirectly owned. The calculation of voting ownership percentage is based on a straight mathematical calculation of direct and indirect voting ownership percentages.

ANNEX 5.
VALUATION OF UNLISTED EQUITY

1. Introduction

393. The underlying principle for the valuation of equity is the market value of that equity. Listing in an organised market provides a good basis for valuing listed equity. However it can be more difficult to determine a market value for unlisted equity and illiquid listed equity. In any case, if there has been a material change in an enterprise's financial position since the date to which the valuation applies (but before the reference date), an adjustment may need to be made. Examples of such material events include an unexpected decision in a lawsuit, credit downgrade or upgrade, major new invention or mineral find, or bankruptcy.

394. This manual recognises five methods for approximating market value for unlisted equity:

- Recent transaction price
- Market capitalization method
- Net asset value (NAV)
  - Including goodwill and intangibles
  - Excluding goodwill and intangibles
- Present value
- Own funds at book value (OFBV)
- Apportioning global value

395. The choice of method depends primarily on having information available to support the application of the method. In practice, one or more of these methods could be ruled out because of a lack of information available to support the application of the method. Among the methods that could be implemented, the primary consideration should be how well the method approximates market value. A further consideration is the stringency of the requirement for symmetric recording by debtors and creditors.

396. Each method is described in more detail below, giving information on what is needed to apply the method and caveats on its use.

2. Recent transaction price

397. Unlisted equity may trade from time to time, and recent prices at which the equity exchanged hands may be used. The transaction price must represent an 'arm's length' price between an independent buyer and seller, where neither party is under compulsion or duress to engage in the transaction. More recent transactions are preferable, and it is desirable that the transaction should have occurred within the

past year. If the most recent transaction is more than one year old, compilers may wish to consider an alternate method.

Usage: a recent, arm's length transaction price is required.

Caveats: not often available due to lack of frequency of trades in unlisted equity. When a transaction price has been used in the past to value the equity, but the information is becoming dated, a strategy is required to splice the valuation with a valuation calculated from another method.

3. Market Capitalisation method

398. This method proposes the use of a capitalisation ratio as the ratio of the stock exchange market capitalisation to "own funds at book value" for the same set of listed companies. In constructing the capitalization ratio under this method, stock market data for an individual country may be used when the stock market in that country is broad and trading volume is relatively high, and broad regional indexes should be used when these circumstances do not exist. The estimate of market values of direct investment equity in unlisted companies is calculated by multiplying own funds at book value (owners' equity) of unlisted direct investment enterprises by the capitalization ratio (that is, by the stock exchange market capitalisation (numerator) to the own funds at book value of listed companies (denominator)). Capitalisation ratios developed from broad stock exchange data should be adjusted, or individual ratios should be developed for separate industry groups, if the industries represented in the broad stock exchange for a given economy are not representative of the industry mix of direct investment enterprises located in the same economy. Book values that are based on another set of accounting standards – such as U.S. generally accepted accounting principles – that contain major attributes of International Accounting Standards (inclusion of cumulative reinvested earnings; revaluation of financial instruments in current period prices; and inclusion of cumulative depreciation of plant and equipment, including write-offs of worthless assets) may also be used with the capitalisation ratio method.

Usage: useful exercise if the overall enterprises listed in the stock exchange are good representative of the national industry.

Caveats: some very large local foreign direct investment unlisted enterprises might represent almost the entire industry. Another strategy is then required to better reflect the market valuation of that enterprise. Apart from this, some other considerations could be made as caveat of this method, for example, some specialists question the assumption that quoted and non quoted companies should have the same ratio to own funds. Being quoted in a public market means that a company has to comply with more strict rules, provide more detail information to market participants, etc. Moreover a liquid asset (quoted shares) may have a higher value for the fact of being liquid.

4. Net asset value (NAV), including goodwill and identified intangibles

399. Net asset value (NAV) is total assets at current / market value less total liabilities (excluding equity) at market value. Under this valuation method, all financial and non-financial assets and liabilities of the enterprise, including intangible assets, are stated in terms of current period prices. The valuations should be based on appraisals and must be recent – certainly they must be within the prior year, and much more recent is preferable. Appraisals may be conducted by knowledgeable management or directors of the firm, and/or provided by independent appraisers. A capitalisation ratio may be calculated and applied (with or without liquidity adjustments) if sufficient information is available.

Usage: at a minimum, this method requires an asset and liability valuation to be undertaken by the enterprise.

Caveats: NAV provided by an enterprise may exclude some classes of assets (e.g., intangibles), while other assets may be valued using a method that is a distortion from the current market value (e.g., historic cost or nominal value). To the extent that valuations are poor or assets are excluded from the NAV, this method can be a poor approximation of market value and other methods may be more appropriate. Calculation of capitalisation ratios requires a reasonably broad stock market with high trading volume.

5. Net asset value (NAV), excluding goodwill and identified intangibles

400. Under this valuation method, all financial and non-financial assets and liabilities of the enterprise, excluding intangible assets, are stated in terms of current period prices. The valuations should be based on appraisals and must be recent – certainly they must be within the prior year, and much more recent is preferable. Appraisals may be conducted by knowledgeable management or directors of the firm, and/or provided by independent appraisers.

401. Note that the difference between this method, and the one immediately above, is that this method excludes, whereas the earlier discussed method includes, goodwill and identified intangibles. However, it is often very difficult to estimate the value of these assets. Compilers who can develop relatively accurate estimates of unquoted equity that include goodwill and identified intangibles are encouraged to do so. Doing so promotes consistency between the estimates for quoted shares (these shares trade at prices that reflect the value of intangible assets) and the estimates for unquoted shares.

Usage: Compilers who cannot accurately provide estimates that include goodwill and identified intangibles may use this method.

Caveat: Goodwill and intangible assets may account for much or most of the current value of many direct investment enterprises. This valuation might not be representative of market value.

6. Present value / price to earnings ratio

402. The present value of unlisted equity can be estimated by discounting the forecast future profits obtained. This method has at its heart the issue of choosing an appropriate discount rate, which can be inferred from the implicit discount rate obtained for listed equity, and forecasting the future profits. At its simplest, this method can be approximated by applying a market or industry price-to-earnings ratio to the (smoothed) recent past earnings of the unlisted enterprise to calculate a price. In this case, the recent past earnings are used as the basis to forecast the future earnings, and the market price-to-earnings ratio implies the discount rate.

Usage: this method is most appropriate where there is a paucity of balance sheet information but earnings data are more readily available. It also requires an appropriate discount rate or reasonably broad-based price-to-earnings ratio to be calculated.

Caveats: earnings for an individual enterprise generally have a high irregular component and can be negative (leading to negative equity valuations). As a result, if earnings information over a longer period of time is available, the earnings of the enterprise should be smoothed. If earnings for only one period are available or discount rates or price-to-earnings ratios are based on a narrow market, other methods are preferable.

7. Own funds at book value

403. Own funds at book value (OFBV) involves valuing an enterprise at the value appearing in their books following International Accounting Standards. OFBV is based on the books of the direct investment

enterprise. In consequence they are found as part of the liability and shareholder's equity of the direct investment enterprise's balance sheet. The definition of OFBV contains paid-up capital, all types of reserves and net value of non distributed profits and losses (including result for the current year. International Accounting Standards require most assets to be revalued on, at least, an annual basis. A capitalisation ratio may be calculated and applied (with or without liquidity adjustments) if sufficient information is available.

> *Usage:* this method may be used where books are kept on the basis of International Accounting Standards, and access is available to the books of the direct investment enterprise.

> *Caveats:* International Accounting Standards prohibit the recognition of certain intangible assets (e.g. brands, mastheads, publishing titles, customer lists). Goodwill can only be bought; it cannot be internally generated. Assets in some asset classes (loans, assets held to maturity and non-trading liabilities) may be valued at nominal or historic cost. These will all cause distortion from the market valuation. Calculation of capitalisation ratios requires a reasonably broad stock market with high trading volume, but application of a well-based capitalisation ratio may dampen the impact of the other caveats (and improve the ranking of this method).

8. Apportioning global value

404. If the equity in a particular direct investment enterprise is unlisted, but the enterprise belongs to a global enterprise group whose equity is listed, the current market value of the global enterprise group can be calculated and apportioned to the operations in each economic territory. The current market value of the global enterprise group should be based on its market price on the exchange on which it is traded, and the apportionment of this value to each economic territory should be based on an appropriate indicator (e.g. sales, net income, assets or employment).

> *Usage:* current market capitalisation of the global enterprise group is required, as such, this method may only be feasible for outward investment. An indicator that is well-correlated with market value and readily available is also necessary. This is more likely to occur in enterprise groups that are horizontally integrated.

> *Caveats:* weaknesses in the correlation between market value of equity and the variable used for apportioning the global value will lead to distortions - sensitivity to the distortion is greatest when the proportion allocated to an economic territory is small or when different activities take place in different economic territories. In this case, other methods may be preferable. The use for outward investment only may lead to asymmetries in bilateral comparisons.

9. Other methods (not recommended by the *Benchmark Definition*)

405. As stated in part 4 of the manual, there are other methods of valuing equity which are not approved by this manual, however they may be the only methods available to the compiler from the information available to them. These methods include:

- Historic or acquisition cost
- Accumulation of foreign direct investment equity capital flows
- Stock market price index applied to accumulated direct investment equity capital flows.
- Book value

These are briefly described below.

10. Historic or acquisition cost

406. Historic cost as defined here represents the original cost of purchasing a direct investment enterprise, and acquisition cost represents an enterprise's original cost for acquiring major assets and liabilities. These costs are usually based on the books of the investor, and may not reflect cumulative reinvested earnings, current period charges for depreciation, foreign currency exchange rate changes, or the impact of other economic events that may have resulted in substantial changes in the value of direct investment enterprises since their initial establishment or acquisition.

11. Accumulation of foreign direct investment equity capital flows

407. Direct investment equity positions could be compiled by accumulating (or summing) direct investment equity capital flows, and perhaps adjusting this amount for changes in foreign currency exchange rates. This method is not recommended for use in the main accounts. It does not take account of cumulative reinvested earnings, depreciation on fixed assets, direct investment enterprise holding gains or losses, and other factors that often will have a substantial impact on current period values of direct investment equity.

12. Stock market price index applied to accumulated direct investment equity capital flows

408. Direct investment equity positions could be compiled by accumulating direct investment equity capital flows, adjusted as appropriate for changes in foreign currency exchange rates, and then applying changes in a related stock market price index to this amount. Under this method, changes in stock market indexes for large countries or broad regions would be applied to the direct investment equity position. Country indexes would be used when markets in the individual country are broad and trading volume is relatively high, and broad regional indexes would be used when these circumstances do not exist.

409. This method is similar to "accumulation of foreign direct investment equity capital flows," except that it includes an adjustment for changes in stock market price indexes. This method is not recommended for use in the main accounts. It does not take account of depreciation of fixed assets, direct investment enterprise holding gains or losses, and other factors that often will have a substantial impact on current period values of direct investment equity. (To some extent, this method does take account of cumulative reinvested earnings, because a stock market price index will tend to rise due to reinvestment of earnings by companies included in the index. However, the earnings and reinvested earnings of companies in the index are not necessarily correlated with the earnings and reinvested earnings of direct investment enterprises.)

13. Book value

410. Book value is a term that broadly encompasses many different accounting methods. It represents the values that appear on someone's books. It could represent the values on the books of direct investors or on the books of direct investment enterprises. In fact, in common usage, the term may encompass any of the valuation methods described in this section, whether or not recommended for use in the main accounts

411. For countries that begin their valuation process via the collection of book value information, the *Benchmark Definition* recommends that the books of the direct investment enterprise serve as the starting point. International comparability of direct investment earnings and direct investment positions is only possible if both the investing and host countries use the same set of books as their starting point for deriving estimates of market values.

412. The books of the direct investment enterprise are usually more comprehensive than those of the direct investor. This is because, under tax and financial accounting rules followed by most countries, the books of the direct investment enterprise will typically reflect current period earnings and reinvested earnings. In contrast, the books of direct investors may not reflect the current period earnings or reinvested earnings of their direct investment enterprises, particularly in the case where ownership interests are less than 20 per cent (these investments are frequently carried at cost on the investor's books).

Box 10. Accounting Standards

Note on the use of different accounting standards and their impact on FDI reported data [TO COMPLETE]

ANNEX 6.
REINVESTED EARNINGS/REINVESTMENT OF EARNINGS – DRAFT OUTLINE

1. Definition

413. In a direct investment relationship, the net current earnings of a direct investment enterprise (DIE) that are not distributed as dividends to the shareholders (or the equivalent in the case of quasi-corporate enterprises) are deemed distributed, as investment income, to the direct investor(s) (DI(s)), proportionate to its (their) holdings of shares (or equivalent) in the DIE.[48] As this is an imputed transaction, a counterpart imputation (of equal and opposite value) is required in the financial account representing the reinvestment of the funds back into the DIE. The income imputation is referred to as *reinvested earnings*, while the financial account entry is referred to as *reinvestment of earnings income*, to differentiate it from the income transaction.

Box 11. Reinvested earnings on direct investment

Text Box I. Reinvested earnings on direct investment:

The net[49] operating surplus/deficit of the DIE

plus:

property income receivable[50] and current transfers receivable

minus:

property income payable (including dividends payable to DI(s)[51]), current transfers payable, including current taxes payable on the income, wealth, etc., of the direct foreign investment enterprise, but excluding withholding taxes[52] and taxes on holding gains.

times

the DI's (DIs') share of the DIE's equity (or equivalent)

equals

Reinvested earnings payable

48. That is, shares on issue for an incorporated enterprise, or the equivalent for an unincorporated enterprise. Where the proportion of shares (or equivalent) differs from voting power, the same principle for the distribution of dividends should be used. For the most part, it is the DI's (DIs') percentage of shares on issue (or equivalent) that determines the ratio under which reinvested earnings are deemed distributed, not the level of voting power.

49. *Net* in this context refers to net of charges for consumption of fixed capital.

50. For a DIE, the property income receivable includes reinvested earnings from any DIE in which it is a DI.

414. It should be noted that RE (and reinvestment of earnings) can be both negative or positive for both the DI and the DIE. Typically, RE will be a debit for income by the DIE, payable to the DI, and a credit for such income receivable by the DI (with the entries for reinvestment of earnings in the financial account the other way round for each). However, if a DIE is losing money from its current operations (that is, the sum of its operating surplus and its net property income), or it declares a dividend for more than it has earned in the current period, a negative debit should be recorded under RE for the DIE (and, correspondingly, a negative credit for the DI). An offsetting negative entry should also be recorded in the financial account of the DIE's economy under DI in the Reporting Economy Liabilities for the reinvestment of earnings; correspondingly, a positive entry for the same amount should appear in the financial account of the DI's economy under DI Abroad Assets.

415. Where a DIE is 100 per cent owned by its DI(s), it will have no net saving of its own, but where there are non-DI shareholders (whether portfolio investors, if residents of economies other than that of the DIE, or other shareholders who are residents of the same economy as the DIE), the DIE will have saving of its own.

416. To illustrate the recommended treatment, take for example, a direct investment enterprise which is 75% owned by a direct investor and for which the remaining 25% of the equity is held by small investors (resident or non-resident). If the profits (calculated as described) in a reference period are 1,500 units and 500 units in dividends are paid out to all investors, the direct investor's share of reinvested earnings is calculated as

417. *75% of profits (i.e. direct investment income on equity amounts to 0.75 x 1500 = 1125) less 75% of dividends (i.e. 0.75 x 500 = 375) which equals 750. This is shown in diagrammatic form below.*

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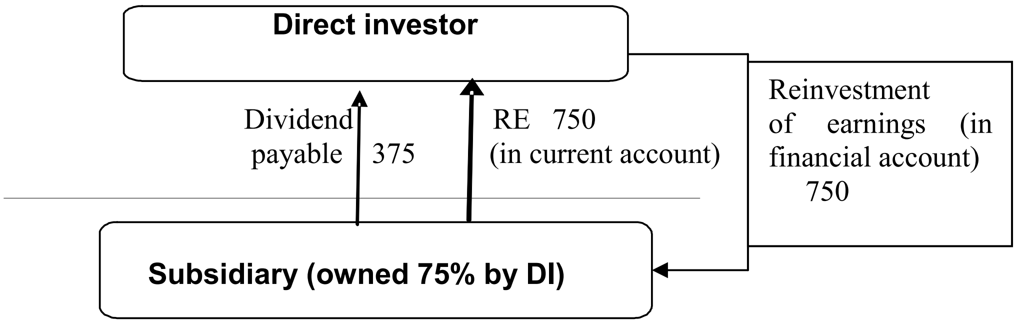
51. But not including reinvested earnings payable

52. Withholding taxes are deemed to be paid by the non-resident owner, not by the resident entity



Net operating surplus *plus* net interest income receivable *plus* dividends receivable and remitted profits of quasi-corporations *plus* reinvested earnings receivable *less* net transfers payable	*less*	Dividends payable or remitted profits of quasi-corporates	*less*	Reinvested earnings (75 percent of 1000)	*equals*	Net saving of DIE
1500	*minus*	500	*minus*	750	=	250

2. Components

1. Net operating surplus

418. It is recommended that net operating surplus (NOS) be recorded on the same basis as in the national accounts, that is, all value added from the operations of the enterprise (that is, gross output less intermediate inputs) *less* consumption of fixed capital. NOS does not include property income (receivable or payable) or any realised or unrealised holding gains or losses arising from valuation changes, exchange rate changes, write-offs, etc..

2. Net interest income receivable

419. Net interest income receivable is the difference between the accrual, during the current period, of interest receivable on all interest bearing financial assets *less* the accrual, during the current period, of interest payable on all interest bearing liabilities, regardless of whether any payments have been made. Included is all interest payable or receivable to/from DIs and/or DIEs.

3. Dividends and distribution of profits of quasi-corporations receivable and payable

420. Dividends are paid to the shareholders from the equity capital. Dividends may be declared payable from current period operations, but they may also be financed from other sources e.g., from reserves developed during a longer period or from capital sales or realized capital gains. Dividends may be declared payable even if the enterprise is losing money. For quasi-corporations, remitted profits are treated in the same manner.

4. Net current transfers receivable

Net current transfers is the difference between current transfers receivable and current transfers payable. It covers all items for which there is no quid pro quo of a current nature. Most common are corporate income taxes and other kinds of tax payable, but withholding taxes and taxes on capital gains are not included. These are deemed payable by the shareholders.

5. Current Operating Performance Concept

421. *Direct investment income on equity* as defined under the Current Operating Performance Concept (COPC) covers the sum of NOS *plus* net interest receivable *plus* dividend income receivable *plus* reinvested earnings receivable *plus* net current transfers receivable. It does **not** include any realised or unrealised holding gains or losses arising from valuation changes, exchange rate changes, write-offs, etc. *See para. XX for the full definition.*

3. Accounting practices

422. Accounting practices vary across the world, so it is recommended that direct surveys of both DIEs and DIs be conducted, to obtain the data on the appropriate conceptual basis, as set out in the schematic above. However, in some instances, it may not be possible to conduct direct surveys and recourse may have to be made to other sources of information, most notably, annual reports. However, in many cases annual reports do not include an aggregate that fully complies with the COPC, even though income for the year is calculated and published with a number of subcomponents and sub-aggregates. Accordingly, it will be necessary for the compiler to make calculations in order to move from the aggregates published to the COPC.

423. If, for example, companies publish an aggregate of profit/loss after financial items, the link to COPC will be as follows:

Box 12. Profit/loss after financial items[53]

Plus share of profits of associates (proportionate to holdings of shares on issue[54]

Plus Realised capital losses

Plus Unrealised capital losses

Minus Realised capital gains

Minus Unrealised capital gains

Minus Realised exchange rate gains

Minus Unrealised exchange rate gains

Plus Realised exchange rate losses

Plus Unrealised exchange rate losses

Plus Write-down/write offs (excluding consumption of fixed capital as a charge has already been made for this in the calculation of "net profit/loss after financial items")

Minus Any extraordinary or exceptional income included in profit/loss after financial items and not included in the adjustments above

Plus Any extraordinary or exceptional expense included in profit/loss after financial items and not included in the adjustments above

Minus net interest receivable on financial derivative contracts[55]

Plus net interest payable on financial derivative contracts

Minus Current taxes on profit for the period (excluding withholding taxes and taxes on holding gains)

= Income for the period, using the COPC

53. This item is obtainable from company accounts and normally represents, for the reference period, all revenue arising from trading activity including revenue from extraordinary and exceptional items as well as relevant capital or currency exchange gains/losses and interest or other income receivable from financial assets; *less* associated expenses arising from such trading activity including extraordinary and exceptional expenses as well as any interest payable or other expenses on loans or other debt. It is calculated before deduction of any taxes.

54. It is assumed that the profit/loss of controlled enterprises has already been included in the profit/loss after financial items. If this is not the case, it should be included in this line.

55. In the balance of payments and national accounts, net interest receivable and payable on financial derivative contracts are not treated as income. The treatment here is to remove them from the books of those enterprise accounts that treat them as if they were income.

424. If there is no sub-aggregate available, the calculations may have to be made from the total profit published (the so-called "all inclusive"), which adds some more variables:

Box 13. Net profit/loss for the year

Plus Realised capital losses

Plus Unrealised capital losses

Minus Realised capital gains

Minus Unrealised capital gains

Minus Realised exchange rate gains

Minus Unrealised exchange rate gains

Plus Realised exchange rate losses

Plus Unrealised exchange rate losses

Plus Write-downs/Write offs (excluding consumption of fixed capital as a charge has already been made for this in the calculation of "net profit/loss")

Minus Extraordinary income,

Plus Extraordinary expenses,

Minus Other current taxes (excluding withholding taxes and taxes on holding gains)

= Income for the period, using the COPC

4. Recording in the Balance of Payments

425. In principle, income on direct investment is recorded in the balance of payments at the time it is earned. However, actual data for the calculation of income are often only available on an annual basis, with a considerable time lag; in the meantime, it is necessary to provide estimates of the net disposable income (COPC) for the current period, often on a quarterly basis. In that case, information should be sought directly from the DIEs and the DIs resident in the economy, from which indicators may be developed to calculate dividends payable and reinvested earning. These indicators might include estimates of gross and net value added, net income receivable, and net current taxes. In addition, an indication from past practice of dividend payments might also be used – companies often maintain the same dividend, regardless of the underlying earnings of the enterprise, for many years. But as both dividends and reinvested earnings are both components of income, approximating the totality of dividends and reinvested earnings is more important than approximating the components. While preliminary, and subject to revision, this approach is preferable to merely extending the data for past year(s) to the current period (and dividing by four to provide quarterly estimates), until the information is available from the respondents' complete annual reports and/or tax returns.

5. Consolidation

426. In line with the Framework for Direct Investment Relationships (see Annex ?), 4), the RE of each enterprise "down the ownership" chain should be attributed to each of the direct investors up the chain. Accordingly, if A (Level 1) is owned 100 per cent by B (Level 2), B is owned 50.01 per cent by C (Level 3), and C is 40 per cent owned by D (Level 4), then A's RE represent part of the net investment income of

B, and, as a result, they are part of the sources of revenue that form part of the RE that are deemed distributed to C by B, and then as part of B's RE that are deemed distributed to A. See Text Box IV. Where ownership is less than 100 per cent, the proportional ownership should be applied, even when there is more than one DI. This principle applies whether A, B, and C are each in separate economies from D, or are in the same economy, but separate from D.

Box 14. Calculation of reinvested earnings along a chain of related direct investment enterprises

	Level 1	Level 2	Level 3	Level 4
	A	B	C	D
Ownership by next level	100 per cent	50.01 per cent	40 per cent	
NOS	200	250	300	350
Minus Corporate taxes payable	-50	-60	-70	-90
Plus Dividends receivable from DIE		+50	+60	+100
Minus Dividends payable to all shareholders	-50	-120	-250	
Plus Reinvested earnings receivable from DIE		+100	+110	+60
Minus Reinvested earnings payable to DI	-100	-110	-60	
Equals Net saving	0	110	90	420
In financial account				
Direct investment in reporting economy liabilities: reinvestment of earnings	+100	+110	+60	
Direct investment abroad assets: reinvestment of earnings	0	-100	-110	-60

427. In the situation where enterprise C owns 50% or less of B, then enterprises A and B are not in a direct investment relationship with enterprise D under the FDIR. As enterprise D is not considered to have significant influence over enterprise B, enterprise D cannot be considered to have significant influence over the earnings distribution and savings decisions of enterprise B. As a result, the reinvested earnings that accrue to enterprise C from enterprise B are not considered part of enterprise C's current operating profit that accrues to enterprise D. The calculation in text box IV would show 16 in reinvested earnings accruing to enterprise D from enterprise C (rather than 60) with 16 being reinvested by enterprise D in enterprise C.

428. Normally, when companies perform elimination of group transactions, they use data on the *total* profits, including holding gains and losses, foreign exchange gains and losses, write offs and write downs, and dividends. It is, therefore, imperative that clear instructions be provided to respondents to enable them to report on the required basis.

ANNEX 7.
{{SPECIAL PURPOSE ENTITIES (SPE)}}

[THE CONTENT AND COVERAGE WILL BE REVISED FOLLOWING WIIS DISCUSSION]

429. Having agreed that there is no common definition to identify SPEs and there is no single solution to respond to user concerns raised by SPEs, The Benchmark Definition recommends that, compilers should provide supplemental direct investment transactions and positions for "FDI excluding SPEs" according to national definitions. The *Benchmark Definition* also recommends that these supplemental data sets be presented at detailed level by geographical allocation and industry classification.

430. The purpose of the present annex is to provide practical information to facilitate the task of compilers in applying the above recommendation. The annex is divided into two parts:

(i) Generally recognised criteria to identify SPEs

(ii) The statistical treatment of SPEs in the Netherlands

1. Generally recognised criteria to identify SPEs

431. Most countries do not have a legal or statistical definition of SPEs. There is also no single internationally recognised definition of SPEs. General characteristics of SPEs are summarised under section 2.2 describing the definition of SPEs in the Netherlands. Even though this list is not exhaustive for all countries, it provides most common characteristics.

432. In practice, the following entities are some examples of SPEs identified in the OECD area: [WILL COMPLETE TO PROVIDE DESCRIPTION OF EACH OF THE FOLLOWING]

- Financial holding companies
- Management holding companies
- Conduits
- Captive insurance/re-insurance companies
- Asset finance companies
- Investment funds

2. Special Purpose Entities in the Netherlands

433. This part of the annex provides information on Special Financial Institutions (SFIs) in the Netherlands. The importance of SFIs in the Dutch balance of payments is high (section 1), which explains why for the Netherlands in particular a clear definition of SFIs is very relevant (section 2). Several types of SFIs can be distinguished (section 3). However, some awkward borderline cases remain (section 4). Apart

from these borderline problems, one may wonder how transactions of SFIs should be included in the balance of payments (section 5), in view of their large, inflationary impact on total b.o.p. flows as compared to their modest impact on the Dutch economy from an analytical point of view. Finally, we present some specificities concerning the reporting by SFIs to DNB (section 6).

2.1 SFIs in the Dutch balance of payments

434. In the Dutch balance of payments, gross transactions of SFIs are quite substantial relative to those of non-SFIs, as is shown in the table below for 2004. Direct investment flows in particular are dominated (inflated) by SFIs and the same applies to stocks. To get a "cleaner" picture for analytical purposes, national b.o.p. publications are still often restricted to non-SFIs.

435. In principle, the balance of transactions SFIs should be zero or close to zero, as for SFIs the Netherlands should merely serve as a transit country (apart from the payment of some administration cost and taxes). In practice, however, the net outcome of their transactions may deviate from balance during certain periods, due to time differences in reporting.

Balance of payments of the Netherlands in 2004 (€ billion)*

	Gross flows			*Balances*		
	SFIs	non-SFIs	Total	SFIs	non-SFIs	Total
Goods account	0	530	530	0	35	35
Services, income, income transfers	119	253	372	4	9	13
Direct investment abroad	1132	773	1905	-14	-14	-28
Direct investment in the Netherlands	1006	456	1462	11	0	12
Foreign securities		**		5	-79	-74
Dutch securities				-4	53	49
Financial derivatives – assets	16	144	160	1	133	134
Financial derivatives – liabilities	5	144	149	-1	-134	-135
Other investment – assets	976	2050	3026	0	-53	-54
Other investment – liabilities	94	1897	1991	1	51	51

* Excluding official reserves.

** Figures not shown because of inflation as a result of (daily) repurchase agreements.

2.2 The definition of an SFI used by DNB

436. Special Purpose Entities (SPEs) are still not defined in international guidelines, but they are often described as entities which

- are legal entities;
- are part of a multinational group;
- are established in an other economy than the parent company;
- have no strong links with the host economy;
- have no or limited physical presence in the host economy;
- have little or no employees in the host economy;

- are involved in group financing or holding activities;
- are hosted in an economy because of fiscal advantages;
- and, finally, in whose daily activities managing and directing plays only a minor role

437. In line with the criteria above, DNB has defined Special Financial Institutions (SFIs) as companies or institutions that meet three criteria:

- they are established in the Netherlands (their legal form does not matter),
- their shares are directly or indirectly held by non-residents and
- their core business is to channel funds from non-residents to other non-residents.

438. SFIs may also be involved in the managing of participations outside the Netherlands on behalf of the parent company.

439. According to the "Balance of Payments Reporting Instructions 2003", which is based on the "External Financial Relations Act 1994", SFIs are obliged to register at De Nederlandsche Bank (DNB). By the end of 2004 some 9 000 SFIs were registered at DNB. Around 60 per cent were represented by trust companies.

2.3 Types of SFIs in the Netherlands

440. Depending on their activities, three types of SFIs can be roughly distinguished in the Netherlands, although the borderlines are not clear-cut and all kinds of mixed forms co-exist:

- *Financing companies*, representing the largest category in terms of transactions, are engaged in raising funds within the group to which they belong or on the international capital markets and channelling those funds via the Netherlands to other group companies.
- *Sub-holding companies*, the second largest category, manage participations outside the Netherlands on behalf of their parent companies. They play a role in the distribution of acquisitions and the distribution of dividends by the parent company. Inward and outward stocks of this category are substantial. However, their transactions, which often have a one-off character, are modest as compared to those of the above mentioned financing companies.
- *Royalty and film right companies* represent only a small share in the total transactions and positions of SFIs. They exploit the licences, patents and film rights for their parent companies or shareholders.

441. Some multinationals own more than one SFI in the Netherlands. Their SFIs may be financially related to each other through loans or participations. These SFIs are called multistage SFIs, because money flows may enter the Netherlands through one SFI and leave the country through another one, making the additional money flows between them an additional stage. By considering such related SFIs as a group, statistical problems can easily be avoided. However, the situation is less clear if an entity reports both holding and production activities (e.g. of its daughters in the host economy). There is still no international agreement on this issue – i.e. should such an entity be considered an SPE or not? – Therefore, the Netherlands Bank, in close co-operation with Statistics Netherlands, is trying to further refine its own criteria.

2.4 The appropriateness of criteria for residency

442. All SFIs established in the Netherlands are considered as Dutch residents. Strictly speaking, however, not all SFI's could meet the earlier BPM criteria for residency The focus is on "location" and the centre of economic interest, but SFIs may not be physically present in the Netherlands or, in exceptional cases, be exempt from tax paying in the Netherlands. An SFI may not even have economic ties with the Netherlands but have connections with several other economies, instead. Therefore, at first sight, it might look difficult to follow the principle that an SPE "be a resident of one and only one territory". However, we think this kind of borderline cases is appropriately dealt with by the revised BPM standards. First, by the addition of the criterion of predominance, or the "strongest link", which may serve as a solution for entities which have economic connections with more than one economy. Second, when SFIs are not physically present in an economy, by making their residency dependent on the territory of incorporation/registration or, in the absence of these, the legal domicile, i.e. the jurisdiction the SFIs is subject to. Actually, the application by DNB of the criteria for residency in the balance of payments statistics is in line with the BPM. They proved appropriate, even for the few borderline cases that still remain. The following are two examples:

(i) The first concerns a limited partnership (in Dutch: a CV)

- with general partners established in the US;
- engaged in cross border holding transactions and financial transactions with affiliated companies;
- registered at the Chamber of Commerce in the Netherlands,;
- established according to Dutch law;
- with a mailing address in the Netherlands;
- with an administration and bookkeeping done in the US;
- with consolidated annual accounts of itself and its subsidiaries that are compiled and audited according to Dutch GAAP;
- no personnel in the Netherlands neither any physical presence;
- not subject to Dutch tax laws.

It was decided to consider this entity as a Dutch resident, mainly because of its registration at the Chamber of Commerce.

(ii) The second example concerns a private limited company (in Dutch: a BV),

- owned by non-residents;
- mainly engaged in holding activities;
- registered at the Chamber of Commerce in the Netherlands;
- established according to Dutch law;
- with an address in Singapore;
- links to other group companies in the Netherlands which do the bookkeeping;
- an establishment in Singapore with some personnel, engaged in marketing activities;

- without any personnel in the Netherlands;
- subject to taxes in the Netherlands;

It was decided to consider this holding company as a Dutch resident (and the establishment in Singapore as a foreign branch of the BV) also on the basis of its registration at the Chamber of Commerce.

2.5 Including or excluding SPEs in nation publications?

443. For a long time, transactions of SFIs, being very substantial but hardly linked to the Dutch economy, used to be *excluded* from the Dutch balance of payments and international investment positions, in order to prevent them from hampering economic analysis. As a result, Dutch figures were not comparable to those of other countries who did include the transactions of Dutch SFIs. Since the start of EMU, however, DNB also includes them in its figures reported to the ECB (1999) and Eurostat (2003), allowing these institutions to compile a consistent balance of payments for the Euro-area and the EU respectively. Tables including and excluding SFIs will be published by DNB in its Statistical Bulletin as from December 2005. At the national level, Statistics Netherlands too has already started, in May 2005, to publish (revised) National Accounts including SFIs as a separate sub-sector of Other Financial Institutions/Intermediaries.

2.6 Some reporting issues specific to the Netherlands

444. In April 2003, a new system for the collection of b.o.p. figures was introduced in the Netherlands, based on fully reconciled statements of positions and transactions for each balance of payments item in the financial account. Which statements (i.e. forms) an entity has to submit, depends on its so-called profile, which in turn depends on the sector in which it is classified. SFIs, for instance, represent a specific profile, as do different types of non-SFIs. Although their reporting obligations have much in common, there are some differences:

- The monthly reporting by SFIs is confined to transactions, whereas non-SFIs also report on stocks, allowing for a fully reconciled statement. SFIs do report on stocks, but only once a year, as most of them do not keep accounts on a monthly basis (for similar reasons, non-SFIs also need to report on their stocks of capital participations only once a year, after annual profits have been added, revaluation figures have been calculated etc).
- For the same reason, SFIs report on the interest *actually* paid or received. Non-SFIs are supposed to be able to report on the interest *accrued* during the reporting period.
- Once a year each SFI has to report on its *domestic* assets and liabilities, so that DNB can check if it is still an SFI. These figures are also used by Statistics Netherlands in the National accounts.
- For practical reasons, SFIs also report on trade in services to DNB, not to Statistics Netherlands. Contrary to non SFIs, they do not have any other statistical obligation to Statistics Netherlands.

445. About 90 per cent of all SFIs is exempt from monthly reporting obligations. Their stocks and flows are lower than a certain threshold, obtained from biennial benchmark surveys and fixed in a way to ensure that stocks and flows of these SFIs represent only 5 to 10 per cent of the totals. The group of SFIs with an obligation to report is updated biennially on the basis of a benchmark survey.

ANNEX 8. COLLECTIVE INVESTMENT INSTITUTIONS

1. Description of collective investment institutions

446. The term collective investment institution (CII) refers to incorporated investment companies and investment trusts, as well as unincorporated undertakings (mutual funds or unit trusts), that invest in financial assets (mainly marketable securities and bank deposits) and real estate using the funds collected from investors by means of issuing shares/units (other than equity). The CII can be open-ended, if there is no limit to the number of shares/units on issue, or closed-ended, where the number of shares/units on issue is fixed. The shares/units can be quoted or unquoted. The CII may pay periodic dividends, capitalise the income or a combination of those approaches, depending on the terms set out in its prospectus.

447. The prospectus also sets out the investment policy or strategy of the CII in terms of the types of financial instrument or other assets to be acquired (such as bonds, equities, real estate) and their geographical (e.g., Asian, American, European, emerging markets) or currency make-up, or any other investment strategy. CIIs may have different objectives. For example, some CIIs may target capital growth and be generally characterised as "growth" funds, whereas others may be structured to produce a regular stream of income, through interest and/or dividends) and be characterised as "income" funds. The prospectus indicates whether the CII can undertake any leveraging activity and how it might do so (e.g., through straight borrowing, through repurchase agreements, or by using financial derivatives). The terms and conditions for redemption (for open-ended schemes) or the means of sale (for closed-ended schemes) are also set out in the prospectus.

448. CIIs, being "brass plate" enterprises, are managed by professional investors who may offer a variety of funds with their own market orientation and who make investment decisions on behalf of investors. Administration, management, custodial and trustee services may be provided to the CIIs by separate service providers, some of whom may be located in different jurisdictions. For example, a CII may be domiciled or registered to operate in one country and may be managed by a service provider in another country with custodial services being located in a third country. The location or domicile of a CII may be decided by its promoter in the context of optimising its tax liabilities or of utilising preferential securities regulation arrangements in the process of asset-management. Cross-border transactions may, and frequently do, occur.

449. At the outset, CIIs may be classified broadly into two main categories: (a) ordinary or retail type entities and (b) other types of CII. The ordinary/retail type CII may in turn be a contract type or a corporate type, the assets acquired in both cases tending to be highly liquid. In both cases also, investment subscriptions (and, later, redemptions) are made by a large number and variety of investors. The investments are made generally in order to gain a short-term interest, via contract-type or corporate-type investment trusts, in portfolio securities. There may be significant diversification of the asset classes, for example, mainly by country/economic zone, by type of financial instrument (equity, bonds, money market instruments, derivatives, etc.). A contract-type retail CII is generally a mutual fund or unit trust (see further details below). A corporate-type CII may be an investment trust or a corporation acting as an investment vehicle.

450. There is a variety of other types of CII which cannot be considered as retail in nature. The investors into these CIIs can vary from private households to corporate entities and the asset classes acquired can also vary considerably from liquid to illiquid types. Their legal structures, trading practices, investment policies and operations generally need to be considered by compilers in order to decide the classification for balance of payments statistical purposes of the entities involved and their investment and other economic transactions.

451. A number of different types of financial institution fall within the scope of the description collective investment institution (or collective investment scheme). Included are:

- Mutual funds
- Unit trusts
- Variable capital companies
- Investment limited partnerships
- Feeder/master funds, umbrella funds/sub-funds, funds of funds
- Hedge funds
- Professional investor funds
- Private equity funds
- Property and real estate funds
- Distressed funds
- Money market funds.

452. A mutual fund (MF) can be defined as an entity that issues shares or units, which are purchased by investors. The subscriptions collected may be invested in different types of assets (non-financial as well as financial) and the investors may receive either regular income or, at redemption, holding gains (or losses) or a combination of both. The MF can be open-ended or closed-ended and the shares/units can be quoted or unquoted.

453. A unit trust (UT) operates as an investment fund established under a trust deed made between the fund's management company and its trustee. The legal structure of a unit trust may vary between countries but, in general, it would appear that the trustee acts as the legal owner of the fund's assets on behalf of the group of investors who are each entitled to an undivided beneficial interest in the fund. Similar to shareholders in an investment company, the unit holders are entitled to attend and vote at meetings on matters affecting the fund. The trust deed is the primary legal document which constitutes the trust and it sets out the various rights and obligations of the trustee, the management company and the unit holders.

454. A variable capital company (VCC) is normally set up to invest its funds and property with the aim of spreading investment risk. It is managed by a management company for the benefit of its shareholders who enjoy limited liability status. The characteristics of VCCs are that they can repurchase their own shares and that the issued share capital must at all times be equal to the net asset value of the underlying assets.

455. An investment limited partnership (ILP) is a partnership of two or more persons having as its principal business the investment of its funds in property of all kinds and consisting of at least one general partner and at least one limited partnership. The limited partner is equivalent to the shareholder in a company whilst the general partner is generally the equivalent of the management company in a unit trust. The ILP does not have an independent legal existence in the way that a company does. All of the assets and

liabilities belong jointly to the individual partners in the proportions agreed in the partnership deed. Similarly the profits are owned by the partners.

456. Feeder/master funds (FF, MaF), umbrella funds (UF) and funds-of-funds (FoF) are set up with one of the main objectives being the facilitation of access by investors to greater asset diversification than would be available through the more conventional collective investment vehicles. All types of structures exhibit the characteristic that one fund invests in one or more other funds. The arrangement must meet the statutory regulatory requirements of the authorities where the funds are domiciled (i.e. legally registered). In this context, the different funds in a particular investment arrangement may be domiciled in different jurisdictions and may also have different legal structures. In general, the country of registration of the entity concerned is taken to be the country of domicile of the fund.

457. Hedge funds (HFs) tend to use highly sophisticated investment schemes involving assets which are illiquid. They are set up to use one or more alternative investment strategies, including hedging against market downturns, investing in asset classes such as currencies or distressed securities, and utilising return-enhancing tools such as leverage, derivatives, managed futures and arbitrage (e.g. bonds, stocks and risk arbitrage). Many HFs target consistency rather than magnitude of return as their primary goal.

458. A professional investor fund (PIF) is a fund authorised to require a relatively high level of minimum subscription from eligible investors. Borrowing restrictions applied to other more usual collective investment schemes may also be relaxed.

459. A private equity fund (PEF) is established to enable partnerships of qualifying individual investors or groups consisting of up to 100 qualifying individual investors to participate. Such funds can include venture capital funds, as well as buying-out funds, whose investors tend to be mainly institutional investors acquiring and selling shares in order to gain a long-term interest through participation in the control or management of an enterprise for a specified period to enhance its value.

460. Distressed funds (DF) are established to invest at deep discounts in equity, debt, or trade claims, of companies undergoing or facing bankruptcy or reorganisation.

461. In a property or real estate fund (PF or REF), the term property is generally defined as a freehold or leasehold interest in any land or building, with a specified minimum un-expired lease period. Partly paid shares may be issued.

462. A money market fund (MMF) is a very special type of mutual fund. It invests in short-term securities (generally with a maturity of 180 days or less) that are low risk and pay a modest rate of interest. In some jurisdictions and depending on their set-up constraints, some MMFs are classified as monetary financial institutions.[56]

463. The various collective investment schemes described can exist under a variety of names or labels which may give some indication of the type of scheme or of the type of investment orientation or of the main objective of the fund (e.g. venture fund, futures and options capital protected fund, bond fund, balanced fund, growth fund, index fund, sector fund, international or regional funds, junk bond fund). Within the European Union and under its relevant legislation, a certain type of collective investment

56. Monetary financial institutions cover two types of entities: (a) credit institutions whose business is to receive deposits or other repayable funds from the public and to grant credit for their own account, and (b) other financial institutions whose business is to receive deposits or close substitutes for deposits from entities other than monetary financial institutions and to grant credit for their own account or to make investments in securities.

scheme is known as a UCITS i.e., an undertaking for collective investment in transferable securities. It may be authorised by any of the EU national financial regulatory authorities to offer its units for sale to members of the public in other member states of the European Union without the requirement for further authorisation in those other countries.

464. In general on the liability side, investment into collective investment schemes involves the pooling of the investments of a number of investors so that the units/shares acquired by each individual account for a very small proportion (generally much less than 10%) of the total number of units/shares issued by the scheme. There are some collective investments vehicles, however, which may have a small number of investors (e.g. property/real estate funds, private equity funds, distressed funds?) and the investors in individual cases may contribute sizeable proportions (more than 10%) of the overall capital invested. A CII may have resident investors, non-resident investors or a mixture of both.

465. On the assets side, a CII can invest in both resident and non-resident financial securities or other assets. There tends to be very little or no concentration of the pooled investment into significant proportions (10% or more) of the shares issued by individual enterprises which are acquired by the CII.

2. Relevance of CIIs for categorisation under direct investment

466. The classification of CIIs can differ across countries for a number of reasons e.g. in the context of differences in taxation systems or in securities investment legislation, and their classification according to functional type of investment category can present difficulties. Whether all types of CIIs, which have different features or economic natures, should be recorded as portfolio investment (PI), regardless of the percentage of equity ownership becomes debatable. There may be cases where classification of a CII to direct investment (inward or outward) may be appropriate.

467. The criteria for classifying CIIs according to functional type of investment may be described below:

(a) The application of the 10 per cent criterion with an exception for CIIs which are regarded as ordinary or retail CIIs (e.g., retail mutual funds, or akin to such entities). Investment in/from such CIIs should be recorded as portfolio investment, regardless of the percentage of equity ownership into or by the CII.

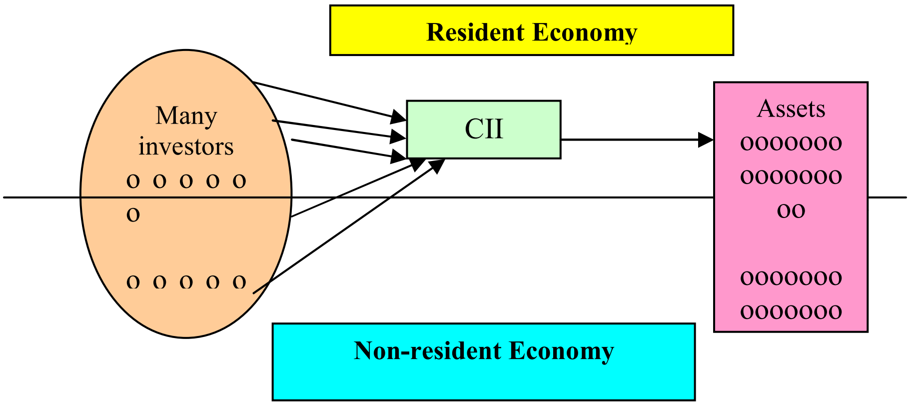
(b) The application of the 10 per cent criterion and specific investment policy criterion for all other types of CII. Where investment in/by a CII involves an equity ownership of 10 per cent or more and is regarded as *de facto* direct investment, it should be recorded as such. Where investment in/by a CII is regarded as *de facto* portfolio investment, it should be recorded as equity portfolio investment regardless of the percentage of equity ownership into or by the CII.

468. To facilitate a decision, it should be possible to classify CIIs initially at least and, depending on their features or economic natures, into the two main classes mentioned earlier i.e. (a) ordinary or retail CIIs, and (b) other types of CII. For the latter, a more rigorous application of the direct investment definition along with the underlying principles underpinning the concept of direct investment is needed.

469. In applying the classification criteria, it must be remembered that, fundamentally, direct investment is meant to reflect a long-term interest as well as a significant degree of influence on the part of the direct investor (located in one economy) in the management and performance of the direct investment enterprise (located in another economy). A 10% or more equity holding by the investor is taken as the practical criterion for the existence of direct investment.

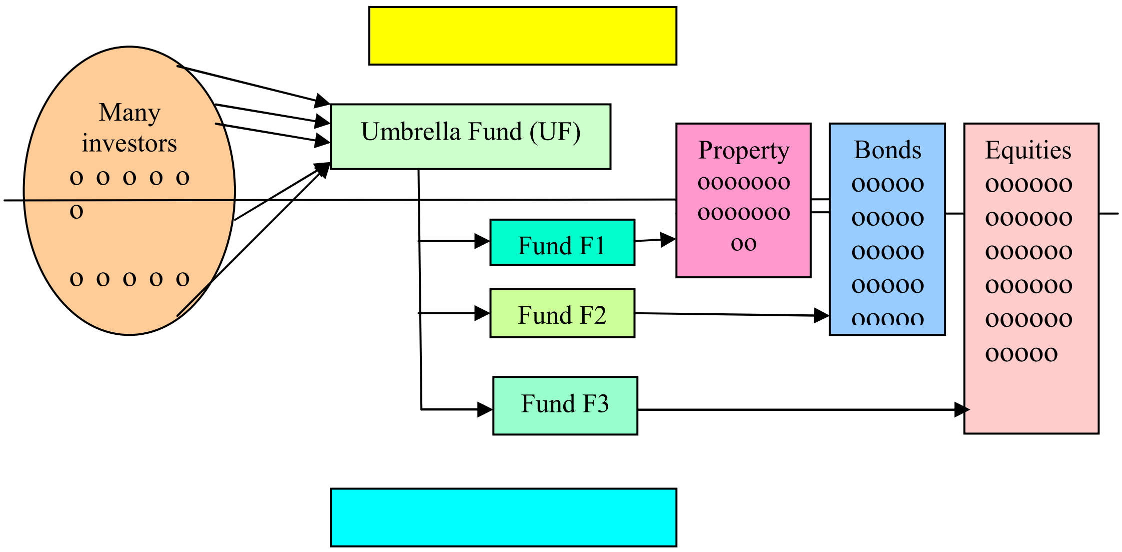
470. In general, retail-type CIIs do not appear to exhibit these characteristics either in terms of the motivation of those investing into the schemes or of the investment objectives or strategies of the schemes themselves. These institutions tend to exhibit the characteristics of portfolio investment on both the assets and liabilities sides (see Figure 1.).

Figure 1.



471. However, certain arrangements and structures which exist for some more specialised schemes need to be considered as the "10% rule" can be breached (see Figure 2).

Figure 2(a).



472. Figure 2(a) illustrates the situation where investors invest into an umbrella fund/sub-fund scenario. The umbrella fund (UF) in turn invests significant proportions of the total pooled investments of its unit holders into three non-resident funds (e.g. say 15% holding of the units in F1, 25% in F2 and 60% in F3). These three funds invest individually in different types of resident and non-resident assets (property, bonds and equities). It is assumed that, in the case of equities, the fund F3 has no holding

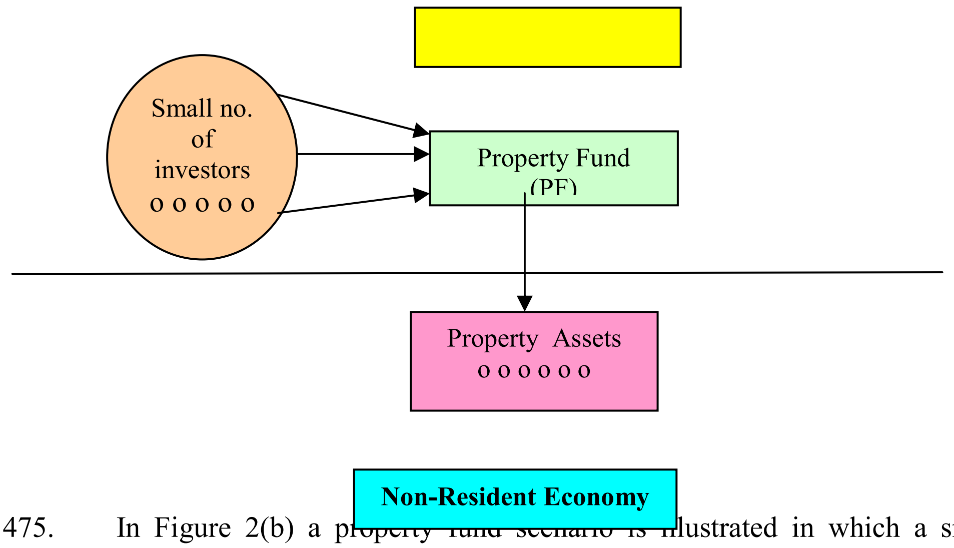
amounting to 10% or more of an individual company, i.e., the assets of all three feeder funds are portfolio in nature. Does the investment by the UF into the three non-resident funds constitute direct investment?

473. Firstly and importantly, before applying the criteria for classification to direct investment, it is necessary to establish whether the UF and the three funds qualify as statistical institutional units on the basis of the internationally recognised criteria (see paragraphs NNN of the main text). Three basic scenarios are possible:

- If, in the unlikely situation that the UF and the sub-funds do not qualify as statistical units, and then the structure simplifies to portfolio investment on both the assets and liability sides, as the compiler effectively can "look through" the fund structure.
- If the UF meets the criteria for a statistical unit but the three investment funds do not, or vice versa, the structure also simplifies to portfolio investment on both the assets and liabilities sides.
- If both the UF and the three funds qualify as statistical units, then a rigorous interpretation of the criteria for the existence of direct investment is needed.

474. In this latter situation, the underlying motivation for the investment as well as the rationale behind the structuring arrangement must be considered. The primary investors holding units in the umbrella fund (UF) in general are simply interested in a return on their investment either through regular income receipts or through capital gains. They cannot be considered as individually having a lasting influential interest in the affairs of the UF. The fund structure can be considered as simply a device to provide more flexible investment strategies for the primary portfolio investors so as to have access to different types of financial (or non-financial) assets, to invest in enterprises in different regions/countries, or for some other objective (capital growth, regular income returns, etc). On this basis, the normally accepted criteria for direct investment do not appear to exist, and the investment should appropriately be classified on both the assets and liabilities sides as portfolio investment.

Figure 2(b).



475. In Figure 2(b) a property fund scenario is illustrated in which a small number of resident investors pool their investments into a resident property fund (PF), which in turn invests in a number of overseas commercial or residential properties. In this scenario, the PF may hold 10% or more of the equity in some or all of the individual properties acquired. The PF may or may not qualify as a statistical unit. Whether it does or not may be immaterial. Assuming that the primary investors' motivation is to have a long-term interest in these properties as well as a significant degree of influence on how they are managed,

the basic conditions for the existence of direct investment would appear to be present, whether (some or all of) the primary investors are direct investors or whether the PF is a direct investor. The situation is largely unaltered if the residency of the PF is different to that of the primary investors.

476. This approach may also apply to other specialised CIIs (private equity funds, professional investor funds, distressed funds, and investment limited partnerships).

477. For each case encountered, in order to enable a decision on whether a particular collective investment arrangement qualifies either on the asset or liability side as direct investment, the compiler of direct investment statistics needs in principle to:

- understand the investment rationale and objectives of the primary investors
- understand the legal and operational structures of the relevant investment vehicles and the assets in which they invest
- determine whether the entities making up the investment structure qualify as statistical institutional units or not.

478. In practical terms, the ultimate decision may in some cases be somewhat subjective and may also be influenced by the statistical and economic materiality of the investment structures themselves.

479. The following table is designed to help this process. It highlights the particular characteristics of the types of CII illustrated and suggests their appropriate classification according to functional type of investment.

[NB: Readers should be aware that the BPM references indicated refer to the 5th Manual and will need to be changed when it is updated]

Table 10. Proposed treatment of selected CIIs in balance of payments statistics

	Definitions noted in BPM5 and features of direct investment (DI)			Definitions noted in BPM5 and features of portfolio investment (PI)		Proposed treatment in balance of payments statistics
	Existence of a long-term relationship (para. 359)[57] -indications of carrying on investments for a certain period -existence of certain lock-up period	A significant degree of influence on the management of the enterprise (para. 359) -a certain amount of capital participation (10 per cent or more) -dispatch of board members -introduction of unified corporate/product brands, technical know-how, management style etc. - an active DI relationship	Deriving extra benefits from the investors' associations, in addition to the investment income (para. 361)[58] -attachment importance to transactions related to royalties and license fees, management fee etc., among group companies -development of business synergies among group companies	Concerning about the safety of their capital, the likelihood of appreciation in value, and the return generated (para. 361) -use of various market indices for evaluating investment returns	Evaluating the prospects of each independent unit and may often shift their capital, affected by short-term developments in financial markets (para. 361) -use of various market indices for evaluating investment returns	

57. "Direct investment is the category of international investment that reflects the objective of obtaining a lasting interest by a resident entity in one economy in an enterprise resident in another economy. The lasting interest implies the existence of a long-term relationship between the direct investor and the enterprise and a significant degree of influence by the investor on the management of the enterprise" (BPM5, paragraph 359).

58. "The benefits that direct investors expect to derive from a voice in management are different from those anticipated by portfolio investors having no significant influence over the operations of enterprise…Direct investors are thereby in a position to derive benefits in addition to the investment income that may accrue on the capital that they invest (e.g., the opportunity to earn management fees or other sorts of income). Such extra benefits are likely to be derived from the investors' associations with the enterprises over considerable periods of time. In contrast, portfolio investors will evaluate, on a separate basis, the prospects of each independent unit in which they might invest and may often shift their capital with changes in these prospects, which may be affected by short-term developments in financial markets" (BPM5, paragraph 361).

	Definitions noted in BPM5 and features of direct investment (DI)			Definitions noted in BPM5 and features of portfolio investment (PI)		Proposed treatment in balance of payments statistics
investment in ordinary or retail CIIs (e.g., retail mutual funds)[59] by investors	X	Δ It is possible to excise an influence on investment matters (i.e., the change of investment strategy or the endorsement of fund managers) through general meeting of shareholders, depending on the percentage of ownership (Feature A).	X	O	O	classify into PI, regardless of the percentage of ownership
investment in hedge funds by investors	Δ In some cases, a definite lock-up period is scheduled (Feature B).	Δ Feature A.	X	O	Δ Feature B.	classify into PI, regardless of the percentage of ownership
investment in private equity funds by investors	O	Δ Feature A.	O	O	Δ Feature B.	classify into DI, if the percentage of ownership is 10 per cent or more

59. It comprises contract-type investment trusts (open-end: mutual funds in the US, unit investment trusts in the UK, close-end: unit investment trusts in the US) and corporate-type investment trusts (open-end: mutual funds in the US, open-ended investment companies (OEIC) in the UK, close-end: corporate-type close-end investment companies in the US, investment trusts in the UK).

	Definitions noted in BPM5 and features of direct investment (DI)			Definitions noted in BPM5 and features of portfolio investment (PI)		Proposed treatment in balance of payments statistics
investment in general business companies by ordinary or retail CIIs	X	Δ It is possible to excise an influence on management matters (e.g., the change of management strategy, the endorsement of executives) through general meeting of shareholders, depending on the percentage of ownership (Feature C).	X	O	O	classify into PI, regardless of the percentage of ownership
investment in general business companies by hedge funds	X	Δ Feature C.	X	O	O	classify into PI, regardless of the percentage of ownership
investment in general business companies by private equity funds	O	O	O	X	X	classify into DI, if the percentage of ownership is 10 per cent or more

Note: “O” indicates relatively corresponded features, “Δ” indicates corresponded features in some cases, and “X” indicates relatively non-corresponded features.

ANNEX 9.
MERGERS AND ACQUISITIONS (M&A) AS A PART OF FDI STATISTICS –

[SEE DOCUMENT DAF/INV/STAT(2007)3]

ANNEX 10.
ULTIMATE INVESTING COUNTRY

1. The Case of Austria

1.1 History

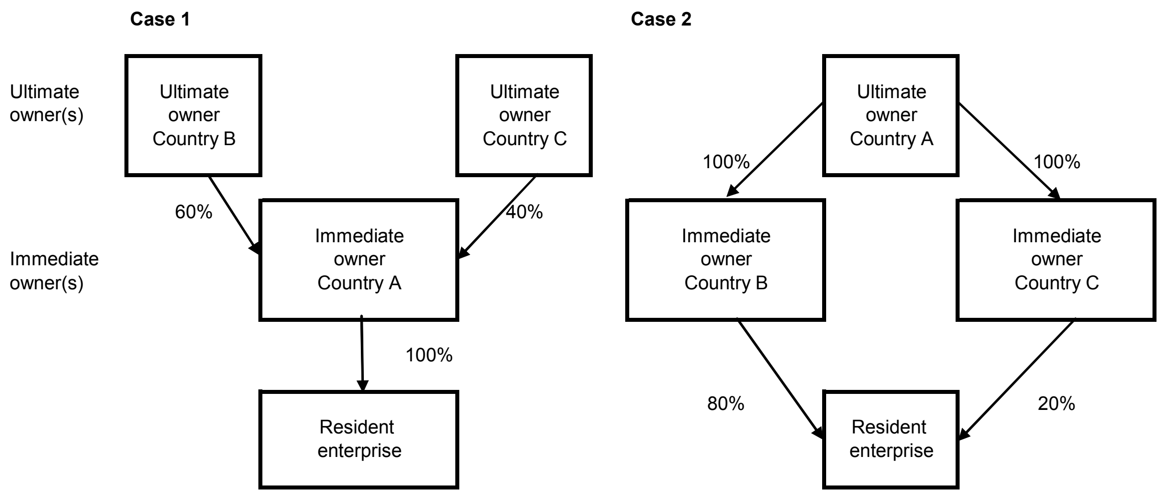
480. The Oesterreichische Nationalbank (OeNB) is in charge of compiling and disseminating the balance of payments and related statistics for Austria The OeNB applies international standards and guidelines. As a result, foreign direct investment (FDI) transactions are allocated geographically according to the "immediate" counterpart principle, as required by both the IMF's BPM and the OECD's Benchmark Definition. This is true for financial flows as well as related income flows.

481. At the time Austria started compiling inward investment positions in 1968, it appeared reasonable to apply the same principles to direct investment positions. The OeNB's statistics on inward FDI were based on a biennial survey, which collects information on individual investments, whereby it is possible to identify individual investors and investees (direct investment enterprises). In 1974 the OeNB started collecting data on outward investment positions as well, through a second biennial survey conducted in alternating years. As early as in the 1970s, the reports analyzing the survey results cautioned that "holding companies set up e.g. in Switzerland" might "distort" the true picture of the regional structure of Austrian inward FDI.

482. Attentive to growing user needs, the OeNB introduced the concept of "Stammhausbereinigung" (reallocation according to headquarters) in its 1982/83 survey on inward FDI, which is in fact identical with, or at least similar to, the "ultimate investing country"(UIC) concept. The new approach was well received by users, and thereafter all national publications on inward FDI positions rely solely on the concept of ultimate investing country (also referred to as "ultimate beneficiaries"). In parallel, the OeNB continues to compile a second set of data where the geographical breakdown is according to immediate investing country. The immediate ownership is definitely more appropriate for bilateral comparisons and to calculate regional aggregates.

1.2 Methodology

483. Given that the surveys were originally designed to compile information on individual investments, it was possible to generate UIC statistics simply by duplicating the questions for foreign ownership In the first survey question, respondents have to name up to ten immediate strategic foreign owners (≥ 10% each), giving their names, addresses and shares in the respondents' nominal capital. If "the owners listed are not the ultimate owners," respondents are asked to provide the relevant second set of names, addresses and shares. Respondents are reminded that the ultimate ownership of equity must match the total foreign equity according to the immediate ownership principle. Following this concept, the number of ultimate owners may, of course, be larger or smaller than the number of immediate owners. For example, it will be larger if the "immediate owner" is a joint venture held by two different "ultimate owners" (case 1); it will be smaller if a given ultimate owner controls the resident enterprise through two separate enterprises located in third countries (case 2).



484. While in theory the number of "ultimate owners" might quickly grow *ad infinitum*, in practice it does not. A specific owner may of course appear in both lists, as an immediate and as an ultimate owner. If all immediate owners happen to be at the same time ultimate owners, respondents may skip the second question. In order to prevent too much item-non-response, the answers are verified against easily accessible information about enterprise structures. Nevertheless, in the majority of cases one must simply trust the answers received. It should be noted, finally, that the OeNB does not require a full description of the structure of the enterprise group; no information is available about how the ultimate owners are related to the immediate owners.

1.3 Selected results

485. Using the two alternative aspects for the ownership structure of inward FDI positions, two otherwise identical datasets are generated, from which statistics can be derived based on ultimate and immediate investing country basis, respectively. It is also to note that the amounts of "other capital", which may come from completely different sources within the enterprise group, are allocated to either the immediate or the ultimate owners according to their share in equity. The 2003 survey found 2,679 direct investment enterprises (investees) to be located in Austria, of which 399 or 15 per cent provided the compiler with additional information on "ultimate investing country" The number of foreign investors was 3,212 for immediate and 3,159 for ultimate owners, respectively. The total number of individual investments (equity holdings) was 3,393 by immediate investors and 3,378 by ultimate investors. The number of equity holdings is always bigger than the number of investors, simply because some foreign owners have stakes in more than one resident enterprise.

486. Although the number of cases where ultimate owners were reported by the respondents is not very large, the impact on the regional breakdown by country is remarkable. Countries with favourable tax regimes or low regulatory burden, like Switzerland, the Netherlands or Luxemburg, have a significantly lower share compared to immediate ownership. At the same time, some "distant" countries, like the United States., Japan and Canada seem to gain a bigger share, probably because they tend to control several European direct investment enterprises via regional headquarters or a holding company. The case of Liechtenstein, which shows a similar share in both breakdowns, may indicate the limits of this approach. It seems that in some cases respondents are in fact not in a position to identify the ultimate owners with reasonable effort. In such cases immediate ownership is all one can get.

Inward Foreign Direct Investment of Austria by immediate and ultimate ownership

Stocks at year-end 2003

Home country	*by immediate investing country*			*by ultimate investing country*			*Difference*
	Nr. of investments	*Total inward position in million €*	*in %*	*Nr. of investments*	*Total inward position in million €*	*in %*	
Germany	1.578	16.505	38,7%	1.487	16.997	39,9%	=
Switzerland	479	4.156	9,7%	449	2.997	7,0%	--
Netherlands	279	5.944	13,9%	162	3.100	7,3%	--
Italy	138	363	0,9%	156	600	1,4%	+
United States	133	2.426	5,7%	220	4.377	10,3%	++
France	116	1.289	3,0%	135	1.443	3,4%	+
United Kingdom	98	3.484	8,2%	122	4.767	11,2%	+
Liechtenstein	87	409	1,0%	88	433	1,0%	=
Luxembourg	66	2.716	6,4%	40	242	0,6%	--
Sweden	50	184	0,4%	59	619	1,5%	++
Belgium	38	283	0,7%	34	500	1,2%	++
Denmark	34	986	2,3%	33	992	2,3%	=
Russia	28	574	1,3%	28	574	1,3%	=
Spain	27	232	0,5%	29	1.065	2,5%	++
Slovenia	22	50	0,1%	22	50	0,1%	=
Japan	19	109	0,3%	65	971	2,3%	++
Austria	x	x		28	172	0,4%	+++
Finland	9	121	0,3%	15	148	0,3%	+
Norway	14	109	0,3%	16	120	0,3%	+
Canada	5	135	0,3%	10	160	0,4%	+
other countries	173	2.555	6,0%	180	2.305	5,4%	-
Total	3.393	42.632	100,0%	3.378	42.632	100,0%	

Source: Oesterreichische Nationalbank

487. The reporting economy, in this case Austria, is always a special case. While in the immediate investing country approach the reporting economy, by definition, cannot be the home country, the UIC approach reveals some “round-tripping”, i.e. local investment which transits through a non-resident entity to return back to the country as foreign investment. Cases in point are physical persons who set up a holding company abroad to manage all their activities, including their home-country business. This phenomenon needs special treatment. On the one hand transactions and positions should be reported gross in order to facilitate bilateral comparisons and the compilation of regional aggregates, on the other hand the UIC approach enables the analyst to eliminate or net out these positions if required.

1.4 Further developments:

488. Apart from producing analytically meaningful information for FDI statistics, the data collected on UIC may be useful in other statistical frameworks, too. The underlying concept of “foreign control” applied in the “activities of foreign affiliates” can be based on UIC framework. Since immediate and ultimate owners and their equity holdings are identified individually, one can implement any definition of “foreign control” (e.g. “multiple minority ownership”). One can distinguish between minority and majority foreign ownership and allocate all activities recorded to the single most important ultimate foreign owner.

489. In order to reduce the reporting burden, the Oesterreichische Nationalbank recently decided to simplify the UIC question. Instead of having to indicate a complete set of "ultimate owners", respondents are now only required to name a "country of ultimate control" for each of the immediate owners. Furthermore, there are plans to identify "special purpose entities," which might be shown as an "of which" item in FDI statistics. While under this approach, the ultimate beneficiaries will not be known individually any more, the recommended geographical allocation according to the country of the ultimate beneficiaries will be available and serve the needs of many analysts. Furthermore, it should remain possible to identify the country of origin of the single most important investor (ultimate controlling unit). Although one may imagine exceptional cases where the two procedures lead to diverging conclusions concerning the country of ultimate control, users will appreciate the availability of two datasets meeting different user needs.

2. The case of the United States

490. The Bureau of Economic Analysis (BEA) within the U.S. Department of Commerce is responsible for compiling and disseminating the balance of payments and related statistics for the United States. Like the OeNB, BEA follows international standards and guidelines in allocating FDI transactions and positions geographically and, thus, attributes these items to the country of the immediate counterparty. In the case of inward direct investment, the transactions are attributed to the country of each member of the "foreign parent group."

491. The existence of direct investment in a U.S. business enterprise, or "U.S. affiliate," is determined solely on the basis of the voting shares (or the equivalent) held by the direct investor, or "foreign parent." To more completely describe the foreign ownership of a U.S. affiliate, however, reference must be made to two additional entities—the foreign parent group and the "ultimate beneficial owner" (UBO), the latter corresponding to this manual's concept of ultimate investor. All three concepts are necessary to identify fully the owners of U.S. affiliates. The foreign parent of a U.S. affiliate must be identified to establish that foreign direct investment does in fact exist. The UBO of each U.S. affiliate is identified to determine the person that ultimately owns or controls and, therefore, ultimately derives the benefits from owning or controlling the U.S. affiliate.[60] Members of the foreign parent group are identified to distinguish foreign persons that are affiliated with a U.S. affiliate from those that are not.

492. The affiliate's transactions with all these persons are included in the investment income, services, and financial accounts of the U.S. balance of payments accounts, and the direct investment positions in the affiliate that are held by all members of the foreign parent group, not just by its foreign parent, are included in the foreign direct investment position in the United States.

493. A given U.S. affiliate may have more than one ownership chain above it, if it is owned at least 10 per cent by more than one foreign person. In such cases, the affiliate may have more than one foreign parent, UBO, and foreign parent group.

494. A foreign parent is the first person outside the United States in a U.S. affiliate's ownership chain that has a direct investment interest in the affiliate. By this definition, the foreign parent consists only of the first person outside the United States in the affiliate's ownership chain; all other affiliated foreign persons are excluded.

495. The UBO of a U.S. affiliate is that person, proceeding up the affiliate's ownership chain beginning with and including the foreign parent, that is not owned more than 50 per cent by another person. The UBO excludes other affiliated persons. If the foreign parent is not owned more than 50 per

60. UBOs that are individuals were not required to be identified by name; however, their countries of location were required.

cent by another person, the foreign parent and the UBO are the same. Unlike the foreign parent, the UBO may be either a U.S. person or a foreign person (though most are foreign).

496. Both the foreign parent and the UBO are "persons" in the broad, legal sense. Thus, they may be business enterprises; religious, charitable, or other non-profit organizations; individuals; governments; estates or trusts; associated groups; and so forth. In the case of a foreign estate, the estate, not its beneficiary, is considered the foreign parent or UBO. For the investments of a foreign trust, either the creator or the beneficiary of the trust may be considered the foreign parent or UBO, depending on the circumstances. The creator is considered the foreign parent or UBO if the creator is a corporation or other organisation that designates its own shareholders or members as beneficiaries or if there is a reversionary interest – that is, the interest in the trust may later be returned to the creator. In all other cases, the beneficiary of the trust is considered the foreign parent or UBO.

497. A foreign parent group consists of (1) the foreign parent, (2) any foreign person, proceeding up the foreign parent's ownership chain, that owns more than 50 per cent of the person below it, up to and including the UBO, and (3) any foreign person, proceeding down the ownership chain(s) of each of these members, that is owned more than 50 per cent by the person above it.

498. The table below shows the foreign direct investment position in the United States at year-end 2004 both by country of each member of the foreign parent group and by country of UBO.

Foreign Direct Investment of the United States by Immediate and Ultimate Ownership

Stocks at year-end 2004

	By country of each member of the foreign parent group		By country of ultimate beneficial owner	
	Millions of dollars	Per cent	Millions of dollars	Per cent
All countries	**1,526,306**	**100.0**	**1,526,306**	**100.0**
Canada	**133,761**	**8.8**	**139,904**	**9.2**
Europe	**1,078,287**	**70.6**	**977,346**	**64.0**
Austria	3,720	0.2	2,627	0.2
Belgium	11,285	0.7	11,750	0.8
Denmark	5,450	0.4	4,005	0.3
Finland	5,509	0.4	6,990	0.5
France	148,242	9.7	149,436	9.8
Germany	163,372	10.7	171,683	11.2
Ireland	21,153	1.4	9,426	0.6
Italy	7,421	0.5	15,745	1.0
Liechtenstein	310	0.0	397	0.0
Luxembourg	107,842	7.1	8,813	0.6
Netherlands	167,280	11.0	139,952	9.2
Norway	3,136	0.2	2,604	0.2
Spain	5,669	0.4	7,102	0.5
Sweden	23,853	1.6	19,389	1.3
Switzerland	122,944	8.1	58,691	3.8
United Kingdom	251,562	16.5	366,024	24.0
Other	29,539	1.9	2,710	0.2
Latin America and Other Western Hemisphere	**85,864**	**5.6**	**110,690**	**7.3**
South and Central America	26,295	1.7	21,818	1.4
Brazil	1,286	0.1	3,188	0.2
Mexico	7,880	0.5	11,451	0.8
Panama	10,707	0.7	34	0.0
Venezuela	5,548	0.4	5,662	0.4
Other	874	0.1	1,483	0.1
Other Western Hemisphere	59,569	3.9	88,872	5.8
Bahamas	1,179	0.1	74	(*)

Foreign Direct Investment of the United States by Immediate and Ultimate Ownership

Stocks at year-end 2004

	By country of each member of the foreign parent group		By country of ultimate beneficial owner	
	Millions of dollars	Per cent	Millions of dollars	Per cent
Bermuda	8,442	0.6	74,040	4.9
Netherlands Antilles	4,749	0.3	2,080	0.1
United Kingdom Islands, Caribbean	24,243	1.6	10,523	0.7
Other	20,956	1.4	2,155	0.1
Africa	**1,611**	**0.1**	**1,839**	**0.1**
South Africa	356	(*)	995	0.1
Other	1,255	0.1	845	0.1
Middle East	**8,200**	**0.5**	**17,811**	**1.2**
Israel	4,107	0.3	8,559	0.6
Kuwait	1,238	0.1	1,439	0.1
Lebanon	1	(*)	357	(*)
Saudi Arabia	(D)	(D)	4,716	0.3
United Arab Emirates	24	0.0	1,772	0.1
Other	(D)	(D)	969	0.1
Asia and Pacific	**218,583**	**14.3**	**260,459**	**17.1**
Australia	28,083	1.8	34,730	2.3
Hong Kong	1,709	0.1	29,895	2.0
Japan	176,906	11.6	180,451	11.8
Korea, Republic of	4,212	0.3	4,224	0.3
Malaysia	335	(*)	951	0.1
New Zealand	814	0.1	543	0.0
Philippines	25	(*)	101	0.0
Singapore	1,801	0.1	2,472	0.2
Taiwan	3,227	0.2	4,961	0.3
Other	1,470	0.1	2,131	0.1
United States	....	....	18,256	**1.2**

*Less than 0.05 per cent.

[D]Suppressed to avoid disclosure of data of individual companies.

ANNEX 11. SPECIFIC FEATURES OF FDI STATISTICS IN THE CONTEXT OF CURRENCY AND ECONOMIC UNIONS

1. Introduction

499. Currency Unions and Economic Unions play an increasingly important role in the world's economy. This Annex summarises the specific features of the compilation and uses of currency/economic unions' FDI statistics.

1.1 Definition of currency and economic unions and corresponding territories

500. For statistical purposes, a currency union (CU) is a union to which two or more economies belong and that has a central decision making body, commonly a currency union central bank (CUCB), endowed with the legal authority to conduct a single monetary policy and issue the single currency of the union. A CU is established by means of a formal intergovernmental legal agreement (e.g. a Treaty).[61]

501. A (CU) territory consists of the geographical territory of the CU economies that comprise the CU, plus the CUCB, where appropriate. Any other regional organizations that comprise the same or a subset of the same economies are included in the CU.

502. For statistical purposes, an Economic Union (EcUn) is a union to which two or more economies belong. EcUns are established by means of a formal intergovernmental legal agreement among sovereign countries/jurisdictions with the intention of fostering greater economic integration. In an economic union some of the elements associated with a national economic territory are shared among the different countries/jurisdictions. These elements include (1) the free movement of goods and services within the EcUn and a common tax regime for imports from non-EcUn countries (free trade zone); (2) the free movement of capital within the EcUn; (3) the free movement of (individual and legal) persons within the EcUn. Also in an EcUn, specific regional organizations are created to support the functioning of the EcUn under points (1) to (3). Some form of cooperation/coordination in fiscal and monetary policy usually exists within an EcUn.

503. An EcUn territory consists of the geographical territory of the economies that comprise the EcUn, and the regional organizations that comprise the same or a subset of the same economies and are set up to manage the functioning of the EcUn.

1.3 Specific issues arising for the FDI statistics of the currency/economic union

504. The concept of FDI statistics does not differ per se for currency or economic unions, taken as a single economic entity, from that of individual countries. As other subscriptions to the capital of international organizations, the subscription to the CUCB, or to regional organizations is not recorded under direct investment even though these contributions may exceed 10% of the voting shares of these

61. See BPM6, paragraph XXX.

institutions.[62] Furthermore, specific legal status may exist for groups of companies in CUs or EcUns, as illustrated by the "European Company Status". Such arrangements may have consequences on national FDI statistics, e.g. by facilitating the transfer of assets and activities across countries, but the involved FDI cross-border[63] transactions and positions would be recorded according to the standard methodology as described in this Manual.

505. The compilation of FDI statistics could be similar to that of individual countries, if a specific data collection were performed on the basis of the residency within the union. However, such an approach may duplicate the data collection with the national statistics, still necessary in such situations (if only because various key national policies, e.g. tax policies, are under the national responsibility, within such unions). In this context, currency and economic unions FDI statistics are usually based on the sources used for the compilation of national FDI statistics. This raises a number of specific compilation issues, which this Annex intends to briefly describe.

2. The contributions to the currency/economic union FDI statistics cannot be identical to national data

2.1 Need to compile "extra currency/economic union" stocks and flows in each participating country

506. In principle net direct investment stocks and flows (i.e. assets minus liabilities) for the currency/economic union could be compiled as the aggregation of the national data of the members of the union, plus those of the institutions of the union. However, this approach would not allow the compilation of assets and liabilities for the currency/economic union because transactions between countries belonging to the union would be included on both sides. Furthermore, it would be subject to distortions in case of asymmetric recording of positions/transactions within the currency/economic union. In this context, currency/economic union FDI has to be compiled as the sum of its residents' positions/transactions *vis-à-vis* non-residents of the union (thereafter: "extra" positions/transactions), plus those of the institutions of the union.

2.2 Need for specific treatments

2.2.1 Identification of ancillary entities

[TREATMENT OF ANCILLARY UNITS TO BE CHECKED WITH LATEST BPM AND SNA RELEVANT SECTIONS]

507. While entities having no production and created mainly for tax purposes would be treated as ancillary to their parent company if the latter were located on the same territory, they are treated as separate institutional units, resident in their country of incorporation, if they are on a different territory from that of their parent company. They are in the latter case included in the financial corporations sector, as "miscellaneous financial institutions", in national statistics.

508. However, when compiling FDI statistics for the currency/economic union as a whole, such entities having their parent company in another country of the union would in principle be treated as

62. According to paragraph 39 of the draft IASM Appendix on currency unions, subscriptions to CUCBs should be recorded under other investment.

63. It is worth noting that cross-border refers to the CU as a whole. Intra-CU transactions and positions are not relevant for the FDI statistics of the CU, although they still are for the FDI statistics of CU member countries.

resident of the same economy (i.e. the CU or EcUn) and, thus, become ancillary to their parent. As such, they would be allocated to the institutional sector and activity of their parent company. In practice, it is recognised that such a reclassification may raise significant practical difficulties, and would need a close cooperation between compilers concerned with the parent and ancillary corporation units.

2.2.2 Determination of the Ultimate Investing Country and of the Ultimate Host Country [SUB-SECTION TO BE CHECKED DEPENDING ON FINAL DECISIONS ON UIC/UHC]

509. The identification of the Ultimate Investing Country and of the Ultimate Host Country has to be performed only with respect to positions held with immediate counterparts outside the currency/economic union, in order to avoid duplications.

510. As an example, an investment from a country A to a country Z may be performed via entities resident in countries B and C, both in the same CU/EcUn. It may be expected that national statistics in country B and C would both identify the UIC as country A and the UHC as country Z. However, for the CU/EcUn FDI statistics, the position *vis-à-vis* A should be reported only once, and that *vis-à-vis* Z should also be reported once. One approach to ensure this outcome is that UIC or UHC positions would only be reported in union statistics if they refer to extra positions from the point of view of the immediate counterpart; in the example, B would report the UIC as country A and C would report the UHC as Z.

2.3 Need for enhanced cooperation between the members of the currency/economic union

2.3.1 Need to coordinate compilation practices

511. International statistical standards intentionally provide only a set of core definitions and concepts, and leave some flexibility to national compilers to define their compilation methods and detailed compilation practices, and adapt them to their specific environment. For instance, this Manual allows for several approaches regarding the valuation of non-quoted shares. While countries not belonging to a CU/EcUn may define their compilation practices independently from other countries, although still taking on board the interest of international comparability of the data, those belonging to a EU/EcUn have to coordinate closely in order to produce meaningful FDI data for the Union as a whole.

512. Similarly, supplemental data on “SPEs” may be meaningful only if based on a common definition of SPEs for all members of the Union. [*THE TREATMENT OF SPES IS STILL UNDER REVIEW; THIS SENTENCE WILL BE REVIEWED IN THE LIGHT OF THE OUTCOME OF THIS PROCEDURE*]

2.3.2 Need to coordinate the recording of large transactions/positions

513. As explained above, aggregated FDI statistics are usually compiled from the data collected by national compilers. Beyond the close coordination of compilation practices, the data quality of the union’s FDI requires to coordinate the recording of some large transactions (and resulting positions) involving several countries. For example, a company in a country A may disinvest from a country B, belonging to a CU/EcUn, to invest in another country C of the same CU/EcUn. While such a development should have no impact on the FDI statistics of the CU/EcUn, it may be important in practice to coordinate the recording of the corresponding transactions/positions of countries B and C, in order to ensure that they are compiled in exactly the same way (especially in terms of timing).

514. This coordination may be delicate as national confidentiality rules usually do not allow national compilers to share confidential information with statistical bodies outside their national borders. To facilitate the maintenance and improvement of data quality through data checking, the establishment of an appropriate statistical data confidentiality regime is likely to be desirable and necessary. Such a regime

would ideally address the sharing and protection of confidential data both between national compilers and between national compilers and the CU/EcUn to enable the compilation of consistent and reliable aggregated Union's statistics.

2.4 Usefulness of FDI data regarding currency/economic unions

515. While national FDI statistics still play a prominent role for policy-makers in the countries participating to such unions, where tax and other policies are still defined at national level, FDI statistics for such CU/EcUns are important to contribute to the overall assessment of the benefits of the Union and the conduct of its policy, in particular the decisions made e.g. with respect to trade, competition or labour rules. The analysis of the developments of globalisation within and outside the Union, or the determinants to GDP growth for the Union as a whole may also strongly benefit from information on inward FDI.

ANNEX 12. REPORTING METHODS, DATA CONFIDENTIALITY, DATA TRANSMISSION AND OTHER RELATED ISSUES – DRAFT OUTLINE

[WILL BE COMPLETED LATER]

516. This annex discusses the foundation needed for data sources, compilation practices, the need for legislation and the dissemination practices. Major points are listed below for further developments.

(1) ***Data sources***:

- (a) Surveys (annual, quarterly…)
  - ➢ Survey design
  - ➢ Respondents' relations
- (b) Administrative data,
- (c) Published sources,
- (d) Bilateral sources,
- (e) Press reports

(2) ***Business Register (BR)***: a frame of enterprises is needed to incorporate and maintain the list of respondents to surveys

- (a) Designed specifically for Foreign direct Investment (FDI) requirements
- (b) FDI flag incorporated in an existing BR.

(3) ***Periodicity:***

- (a) Annual as a minimum requirement
- (b) Quarterly detail for specific variables

(4) ***Data coverage***

- (a) Minimum detail required Geographic and industry

(5) ***Timeliness and revision practices***

(a) Need to assess the time lag between the survey process and the data dissemination

(b) Need to assess revision practices.

(6) ***Data transmission***

(a) Established according to data sources (mail, electronic, direct access, fax, etc…)

(7) ***Legislation***

(a) Need for a legal structure that will protect the respondent and ensure reasonable response rate.

(b) Confidentiality

(8) ***Dissemination***

(a) Requirements needed by national Authorities

(b) Requirements needed by International Organisations (OECD, IMF, UNCTAD,…)

ANNEX 13.
RESEARCH AGENDA

[WILL BE COMPLETED AFTER WIIS DISCUSSION]

ANNEX 15.
OECD COUNCIL RECOMMENDATION

[TO BE COMPLETED FOLLOWING THE COUNCIL APPROVAL]

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GLOSSARY

INDEX