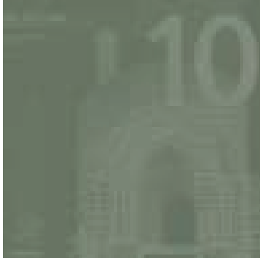
FOREIGN DIRECT INVESTMENT TASK FORCE REPORT

MARCH 2004

FOREIGN DIRECT INVESTMENT – TASK FORCE REPORT MARCH 2004

EUROPEAN CENTRAL BANK



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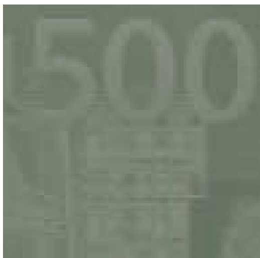

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CONTENTS

EXECUTIVE SUMMARY 5

INTRODUCTION 16
- Summary of the mandate 16
- Structure of the report 17

1 CONCEPTUAL ISSUES RELATED TO THE FULLY CONSOLIDATED SYSTEM AND THE COVERAGE OF INDIRECT FDI RELATIONSHIPS 18
- Introduction 18
- Companies with indirect links of ownership. 20
- The case of "fellow" / "sister" companies 25
- Conclusions 28

2 PRACTICAL ASPECTS RELATED TO THE COVERAGE OF INDIRECT FDI RELATIONSHIPS 31
- Introduction 31
- Statistical consolidation versus accounting consolidation 31
- Current practices: results of the questionnaire 38
- Different consolidation approaches and the geographical allocation of transactions and positions: impact on the compilation of the European aggregates 40
- Conclusions and recommendations 46
- European database on ownership structures 47

3 VALUATION OF FDI EQUITY STOCKS 51
- Introduction 51
- Related decisions adopted by the Statistics Committee and the Working Group on Balance of Payments and External Reserves 51
- Results of the questionnaire on valuation of FDI equity stocks 53
- National feasibility studies on how to compile FDI in listed companies' shares on the basis of both market values and book values 56

4 REINVESTED EARNINGS 65
- Introduction 65
- International standards concerning reinvested earnings and clarifications adopted by the TF-FDI 65
- Current collection and compilation methods for reinvested earnings in the European Union 69
- International Accounting Standards (IAS) 73
- Conclusions and recommendations 74

5 ISSUES RELATED TO OTHER CAPITAL IN FDI STATISTICS 77
- Introduction 77
- Current practices in the treatment of Other Capital in the EU Member States 77
- Conclusions 80
- The application of the directional principle: practical issues and empirical evidence 83

6 IDENTIFICATION AND TREATMENT OF SPECIAL PURPOSE ENTITIES (SPES) 87
- Introduction 87
- Reasoning for the identification of SPEs and problems in dealing with SPEs 87
- Definitions of SPEs in international guidelines 89
- Importance of SPEs and offshore countries in European statistics 91
- Overview of the impact of offshore centres on European aggregates 92
- Results of the empirical exercise on the importance of SPEs in EU Member States 95
- Summary 96
- Conclusions 97

7 ALLOCATION OF FDI INWARD STOCKS BY COUNTRY OF "ULTIMATE BENEFICIAL OWNER" (UBO) 98
Conceptual framework 98
Practical application in some EU countries 99
EU aggregates and UBO allocation 101
Conclusions and recommendations 101

8 GENERAL CONCLUSIONS AND RECOMMENDATIONS 104
Introduction 104
Conclusions and recommendations for individual items 104
Prioritisation and timing for implementation of the TF-FDI recommendations 113
Issues for follow-up work 114

LIST OF ANNEXES 115
Annex 1: Compilation of FDI stocks at t+9 months 116
Annex 2: Definitional issues related to FDI/Other capital 118
Annex 3: Summary of the answers to the questionnaire on Other Capital 125
Annex 4: Application of the directional principle in different countries 128
Annex 5: Questionnaire on importance of the main sub-items of "Other Capital" in FDI statistics 131
Annex 6: National descriptions of UBO-based FDI statistics 133
Annex 7: Reinvested earnings in national accounts and impact on GDP 137
Annex 8: List of members of the Task Force on Foreign Direct Investment 140

SUPPLEMENTARY DOCUMENT: SPECIAL PURPOSE ENTITIES 141

EXECUTIVE SUMMARY

INTRODUCTION

SUMMARY OF THE MANDATE

1. The Task Force on Foreign Direct Investment (TF-FDI) was set up by the Working Group on Balance of Payments and External Reserves Statistics (WG-BP&ER), jointly with the Eurostat Balance of Payments Working Group (BoP WG), to investigate on the matters included in the mandate, focusing particularly on the practical and consistent implementation of the various related principles/definitions.

2. The main objectives of the TF-FDI were to identify "best practices" with a view to minimising inconsistent treatments within euro area/European Union (EU) member states. In this respect, par-ticular attention was paid to the accuracy of the geographical allocation of the relevant transac-tions and positions.

3. The mandate of the TF-FDI was articulated around the five following items:

(i) *Valuation of stocks:* the TF-FDI was mandated to investigate the practicality of the conceptual agree-ments reached by the STC in this area, i.e. the problems associated with the provision of additional breakdowns required for listed and non-listed companies for the production of memoran-dum items.

(ii) *Other capital:* the TF-FDI was mandated to investigate and put forward practical solutions for the problems linked to:

   a) the application of the "directional principle";
   b) the identification and impact of trade credits, financial leasing, debt securities subscribed by associated companies;
   c) the treatment and classification of transactions/positions on "other capital" when Monetary and Financial Institutions (MFI) are involved.

(iii) *Reinvested earnings:* the TF-FDI was mandated to review the practical aspects of the compilation meth-ods for reinvested earnings (declaration by respondents, calculation by the compilers, interim estima-tions etc.).

(iv) *Identification and treatment of Special Purpose Entities (SPEs):* the TF-FDI should investi-gate practical problems associated with the identification and treatment of transactions/positions of SPEs, mainly "other financial intermediaries" or "financial auxiliaries", in the context of direct in-vestment relationships.

(v) *Treatment of indirect FDI relationships and allocation of FDI inward stocks by country of "ultimate beneficial owner" (UBO):* the TF-FDI should investigate the practical application of the "fully consolidated system" in member states. Possible solutions to the problem of obtaining information on group structures should be examined with reference also to the costs that they would entail. The possibility and implications of classifying inward FDI stocks by the country of UBO would be analysed.

4. At their respective meetings in March 2003, the ECB WG-BP&ER and the Eurostat BoPWG gave further guidance to the TF-FDI. The WG-BP&ER stressed that "departure from international statistical standards should only be proposed by the TF in case a substantial critical mass of member states were in favour and for sound practical reasons, mainly addressed to avoid distortions in the euro area/EU aggregates".

5. Both working groups stated that the Current Operating Performance Concept (COPC) should be the reference concept for the compilation of reinvested earnings. It was also stressed that for the practical application of this concept, some

simplifications could be needed so as to facilitate its practical application. Additionally, the WG-BP&ER encouraged the TF-FDI to further examine the practicalities in compiling aggregates (in particular as regards 'extraordinary profits' and any possible distinction between financial and non-financial corporations).

FEATURES OF PRESENT COLLECTION SYSTEMS AND MOST COMMON PROBLEMS

6. The TF-FDI started its work with a review of member states' current practices in order to identify possible best practices as well as problems encountered by the national compilers. The analysis of current practices showed large differences in the applica-tion / non-application of international standards as well as regarding data collection and compilation methods.

7. The collection/compilation methods are at the moment in a transitional period, where some member states have started to move from settlement-based systems to systems based on surveys and direct report-ing. In many cases the features of the collection system used is crucial for the application or non-ap-plication of international standards.

POTENTIAL BENEFITS OF HARMONISING COLLECTION SYSTEMS IN THE FIELD OF DIRECT INVESTMENT

8. The coexistence of different collection systems is to some extent at odds with the need to produce consistent European aggregates and guarantee a certain degree of homogeneity. It is obvious that sharing solutions to common problems as well as a shift towards further standardisation should be deemed positive steps which may certainly provide substantial benefits.

INDIRECT FDI RELATIONSHIPS

9. Across the analysis carried out by the TF-FDI, it became obvious that the fifth item of the mandate (mostly in relation to the coverage of indirect FDI relationships) required a higher prioritisation since it influenced how to interpret the conclusions of most other items. For that reason, item (v) was split into three parts, the first two referring to indirect FDI relationships (from the conceptual and the practical viewpoints, respectively) and the third one referring to the UBO.

I. CONCLUSIONS AND RECOMMENDATIONS

10. The most significant issues encountered in the analysis of the items of the TF-FDI mandate are briefly presented below. The TF-FDI put special emphasis on the provision of practical recommendations and proper justification for these recommendations. Additionally, appropriate prioritisation of the measures suggested is provided, highlighting the most urgent problems to be solved.

CONCEPTUAL ISSUES RELATED TO THE FULLY CONSOLIDATED SYSTEM AND THE COVERAGE OF INDIRECT FDI RELATIONS

11. Firstly, the TF-FDI agreed that indirect relationships should undoubtedly be covered by FDI statistics.[1] As a basis for evaluating and recommending "best practices" regarding the treatment of indirect FDI relationships, the TF-FDI found it necessary to first agree on a unique interpretation of the international recommendations, on a conceptual level.

12. In particular, two different types of indirect relationships were identified: (i) parent company – affiliate and (ii) sister/fellow companies[2], i.e. pertaining to the same group, but without either direct or indirect links of ownership. The TF-FDI agreed that, for the first category, flows and stocks should be classified by the parent company as outward

1 This recommendation is very relevant for all FDI items, namely equity capital, reinvested earnings and other capital. For a more detailed analysis of the conceptual treatment suggested for the different FDI components, please refer to chapter 1.

2 Both terms, i.e. "fellow" companies and "sister" companies are indistinctly used throughout the report to refer to the same kind of companies, namely those pertaining to the same multinational group but with neither direct nor indirect control over one another.

FDI and by the (indirectly owned) direct investment en-terprise as inward FDI. In the case of sister companies, flows and stocks should be classified as outward FDI by the country which provides the investment or grants the loan and as inward FDI for the country receiving the investment/loan.

13. The TF-FDI recommends that all member states agree to put into practice these main recommendations as well as the more detailed methodology described in chapter I of the report so as to avoid asymmetries and inconsistent treatments.

PRACTICAL ASPECTS RELATED TO THE COVERAGE OF INDIRECT RELATIONSHIPS

SIMPLIFICATION PROPOSALS TOWARDS THE COVERAGE OF INDIRECT FDI RELATIONSHIPS

14. The TF-FDI considers that a full application of the fully consolidated system (FCS) by all coun-tries is virtually unfeasible on practical grounds. On the other hand, restricting FDI statistics to only cover direct relationships would not be compliant`with international standards and the outcome would offer a lower analytical value. The most important difficulty was how to find practical ways for collecting the necessary information, since the longer the chain of links between companies, the more difficult it is to get access to the balance sheet of foreign subsidiaries with no direct link to the domestic mother company.

15. In order to find an alternative solution to the full application of the FCS, which at the same time could be deemed consistent with international standards and easier to apply in practice, the TF-FDI explored different alternatives. In turn, the TF-FDI suggests a sim-plification of the FCS rules as the minimum with which all countries should be compliant. Such a minimum approach would narrow down the risk of asymmetries and would reduce the impact on the European aggregates of the different methodologies applied in member states:

16. The two admissible simplifications that should constitute the bottom line for all practises at the EU level would be:

(i) The coverage of *indirect* links of ownership above 50% (direct links of ownership above 10% would still need to be covered)

(ii) The coverage of (direct and indirect) links of ownership above 10%, calculated as the simple product of the subsequent links of ownership along a chain.

GEOGRAPHICAL DISTRIBUTION OF FDI FLOWS/ STOCKS RELATED TO INDIRECT FDI LINKS

17. The use of non-fully harmonised criteria for the geographical allocation of country contributions to the European aggregates (in relation to the existence of indirect FDI ownership links) implies a high risk of double counting and/or missing information.

18. With a view to avoiding such a risk, the TF-FDI recommends that, for both reinvested earnings and FDI equity stocks, all (indirect) FDI transactions/positions should be geographically allocated to the company with which the investor/direct investment enter-prise maintains a direct link of ownership (immediate affiliate or immediate parent company).

19. It is acknowledged that this criterion may result in less valuable statistics from an analytical viewpoint. For this reason, the TF-FDI would encourage countries to collect and publish additional information on the geographical allocation of FDI flows and stocks based on the residence of the ulti-mate beneficiary owner.

EUROPEAN DATABASE ON OWNERSHIP STRUCTURES

20. The TF-FDI analysed the issue on a European database on ownership structures from two differ-ent points of view: (i) as potential data providers, and (ii) as users of the information. The TF-FDI acknowledged that the existence of a centralised database with information about the structure of multinational

groups would be seen as a very useful tool for the compilation of FDI statistics

21. From the point of view of potential data providers, the main findings of the TF-FDI pointed out that the provision of the necessary information would imply a number of significant problems related to resources, confidentiality issues, technical problems, etc.

22. From the point of view of potential users, the TF-FDI is of the opinion that a harmonised and multilat-eral solution should be highly welcome. In this regard, the TF-FDI suggests that a solution could be explored through the ongoing project on the construction of a European Business Register currently under development by Eurostat in collaboration with the ECB. It is also suggested that other bodies, for instance the ECB's WG-BP&ER and the Eurostat's BoPWG, elaborate the list of user requirements which would permit that the final product could be used for the compilation of FDI statistics.

VALUATION OF FDI EQUITY STOCKS

23. The TF-FDI considered practical problems for the implementation of the STC decisions concern-ing how to value FDI equity stocks. No alternative market valuation methods were considered in this analysis. The decisions of the STC could be summarised as follows:

(i) FDI in listed companies' shares shall be valued on the basis of stock exchange prices in the euro area i.i.p.

(ii) FDI in non-listed companies' shares shall be valued on the basis of book values in the euro area i.i.p.

(iii) Book values consist of the application of ownership percentages to the sum of selected accounts extracted from the liabilities side of the target FDI company's balance sheet (according to the common definition of OFBV).

(iv) Two (four) memorandum items will be compiled on a centralised way: inward and outward euro area FDI based on market values and book values for all types of companies, respectively (with no geographical or sector details).

(v) To this aim, inward and outward FDI equity stocks should be reported to the ECB with a split between listed and non-listed FDI companies, and FDI stocks in listed companies' shares should be reported on the basis of both market values and book values.

24. In reviewing all possible practical problems that the implementation of all these proposals could entail, the TF-FDI considered the absence of FDI surveys for the compilation of stock statistics as a major difficulty. Such a problem has implications on the ability of certain countries to implement the decisions adopted by the STC as regards valuation of FDI equity stocks.

The TF-FDI is of the opinion that the compilation of FDI stocks should be based on information collected via FDI surveys. The provision of annual FDI stocks based on accumulation of b.o.p. flows should be discontinued as soon as possible. In relation to this subject, the TF-FDI ranks this issue as the first priority for any follow-up work subsequent to the delivery of this report.

25. Concerning practical solutions to collect the necessary information to comply with the STC agreements, the TF-FDI makes the following recommendations:

DISTINCTION BETWEEN LISTED AND NON-LISTED COMPANIES

26. The TF-FDI considered the following as possible and acceptable information sources:

(i) registers of (resident) listed companies maintained by stock exchange authorities;

(ii) information provided by respondents;

(iii) manual distinction based on internal databases and/or publicly available sources (e.g. financial press, stock exchange web sites, etc.)

VALUATION OF STOCKS IN LISTED COMPANIES

27. On the basis of the results of individual national feasibility studies carried out by six countries, The TF-FDI has come to the conclusion that:

The collection of FDI equity stocks for listed companies on the basis of two different valuation methods (market values and book values on the basis of the common definition of OFBV) can be deemed feasible and not too costly for countries running FDI surveys

Good/acceptable practices

- the most feasible way to collect market values and book values is through the information pro-vided by respondents via the addition of supplementary questions to the FDI surveys.

- Additionally, individual valuation methods based on stock exchange prices combined with inter-nal databases and publicly available information have also proved to be a viable way to get information on market values, especially in the case of inward FDI.

Non-acceptable practices:

- Leaving the choice to respondents on the valuation criterion (market values or book values) they wish to use to report FDI stocks. This can neither ensure the provision of the nec-essary information to the ECB nor guarantee the compilation of consistent FDI equity stocks.

- Application of perpetual inventory methods/ accumulation of b.o.p. flows.[3] This relies on the reasons previously explained.

COMPILATION OF FDI STOCKS AT T+9 MONTHS

28. The TF-FDI concluded that, in the current situation, only four member states are already in a position to provide pure stocks data based on surveys within the required timeliness. The others can only accumulate flows to the last available stock (perpetual inventory method), usually adjusted for exchange rate changes, and in a few instances for price changes. The provision of data with the re-quired geographical breakdown (shortly on step-3 basis) does not seem to pose significant problems for most countries.

REINVESTED EARNINGS

29. A review of current practices revealed that some member states have not yet established a sys-tem to calculate/estimate reinvested earnings.

The TF-FDI deems the non-inclusion of reinvested earnings as the most crucial problem in this area. This difficulty seems to be closely connected with the lack of FDI surveys, which should be resolved promptly, in line with the proposal made for FDI equity stocks.

30. All other TF-FDI recommendations are basically determined by how reinvested earnings (RIE) are calculated. RIE are calculated as the difference between two variables: total profits from current operations and dividends payable. The first component is normally available later than the second one and, hence, RIE (or rather total profits) are often temporarily estimated from the projection of total profits as presented in the last available FDI survey.

TOTAL PROFITS

31. International standards prescribe the application of the Current Operating Performance Concept for the measurement of total profits, excluding e.g. extra-ordinary gains and losses. Only five EU countries are compliant with this so far. In considering the need to adapt systems to the application of the COPC, the TF-FDI suggests two types of

3 Exception made of the delivery of provisional estimates by end-September (where applicable) and of real-state investments.

information sources, both connected with the accounting statements of the respondents: (i) companies' public accounts and (ii) restricted information internally available to the companies.

32. Although the split between ordinary and extraordinary gains/losses in accounting statements is not necessarily consistent with statistical definitions, it was considered by the TF-FDI to be an imme-diately available proxy for the time being. The first information source (public annual accounts) on its own cannot be considered as an acceptable proxy for the COPC without additional information internally available to respondents, notably, the geographical breakdown of the information. Therefore, a combi-nation of both information sources (i.e. public accounts and internal information) would be necessary in any case.

33. The development of the new IAS will imply a more specific definition of the components which may serve as a firm basis for the harmonisation of member states' application of the COPC. However, the devel-opment of the new IAS may pose an additional difficulty for compilers to properly apply the COPC, to the extent that only very exceptional results will be excluded from the ordinary profits and losses.

34. The TF-FDI concluded that inconsistent treatments caused by different practices imply serious distortions for the euro area/EU current account. Therefore, since the data necessary for a COPC valuation of profit is available from the respondents' accounting:

(i) *The same concept for the compilation of total profits, namely the COPC, should be used by all member states and exceptional results should be appropriately excluded from the current account.*

(ii) *As current practices within the EU indicate how difficult this may be on practical grounds, the TF-FDI concluded that acceptable solutions for the application of the COPC should aim at covering at least the reduced number of companies which contribute the most to extraordinary results.*

35. Concerning the second recommendation above, the experiences of some member states is that a reduced number of companies involved in FDI relations contribute to most of the extraordinary gains/losses. For other companies, the all-inclusive approach may be applied, since it often provides similar results to the COPC.

An acceptable practice would therefore be to apply the COPC, as a minimum, only to such companies (namely the biggest ones plus holding companies) in each Member State, and to collect the rest on an all-inclusive basis.

DIVIDENDS

36. Time of recording: international standards prescribe the recording of dividends when payable rather than when they are paid. The foreseeable increase in the use of direct reporting through surveys may bring the practices closer to international standards, as they are likely to reflect accruals-based accounting data. This changeover will, however, not take place in the short term. Nevertheless, asymmetries will only occur in short time spans, since the difference between payable and paid is usually only a matter of time allocation during a fairly limited period.

37. The treatment of dividends stemming from exceptional capital gains may be a problem in so far as it affects the calculation of reinvested earnings. While exceptional results are not included in total profits (according to the COPC definition), it is questionable whether or not, once payable, they should be recorded in the current account as income on direct investment.

38. As regards the provision of funds to affiliates to cover losses, some countries record it as nega-tive dividends, while others record it in the financial account.

CONCLUSIONS

- Concerning the time of recording, the TF-FDI suggests that member states keep on with their current practices for practical reasons and due to the limited impact on the resulting statistics in longer time spans. However, member states are requested to switch from dividends paid to dividends payable when moving towards direct reporting systems.

- Concerning payment of dividends stemming from exceptional capital gains, in accordance with international standards, the TF-FDI recommends their recording in the financial account as FDI disinvestments, thus not entering in the calculation of RIE.

- As to contributions to cover losses in direct investment enterprises, in line with international recommendations, the TF-FDI proposes that these transactions should be recorded in the Financial Account, as additional investment flows and not as direct investment income.

39. Finally, as a reference to the recommendations related to the treatment of indirect FDI relation-ships, it should also be noted that the coverage of reinvested earnings generated by indirectly related direct investment enterprises should at a minimum meet one of the following simplified rules:

(i) The coverage of *indirect* links of ownership above 50% (direct links of ownership above 10% would still need to be covered)

(ii) The coverage of (direct and indirect) links of ownership above 10%, calculated as the simple product of the subsequent links of ownership along a chain.

OTHER CAPITAL

40. The TF-FDI tried to seek clearer guidance on the inclusion/exclusion of some borderline cases within FDI other capital. In particular, the TF-FDI addresses the following recommendations:

- *Preferred shares* should be excluded from other capital and recorded as Direct Investment/Equity capital unless they take the form of non-participating shares

- *Permanent debt* (e.g. subordinated loans, perpetual bonds, etc.) should be included in Direct Invest-ment/Other capital, regardless whether or not it takes the form of securities.

- *Trade credits, financial leasing, and any other type of inter-company loans* should be included in Direct Investment/Other capital, while *financial derivatives* (in accordance with final agreements between the ECB and the IMF) should be excluded from FDI statistics.

- *When both parties involved in lending activities are MFIs*, financial intermediaries or financial auxiliaries, only permanent debt should be included in Direct Investment/ Other Capital. This rec-ommendation could raise some confidentiality concerns in some member states, as the granting of permanent debt to affiliate companies in the banking sector is usually rather limited. In such cases, the contributions to the European aggregates could be flagged as confidential.

41. Additionally, the TF-FDI particularly tried to find practical solutions to collect the necessary information from reporting agents. In this framework, the TF-FDI is of the opinion that the two main problems concerning FDI other capital are:

(i) the incomplete coverage of both transactions and stocks between affiliated companies, such as securities and trade credits, lending activities between fellow companies (i.e. companies with the same ultimate parent company but not belonging to the same ownership chain), etc. and

(ii) the partial application of the directional principle by some member states.

42. The general collection methods for FDI flows and stocks can be split into two main categories: survey-based and settlement-based systems. The practical solutions acknowledged by the TF-FDI for a consistent application of the directional principle could most probably not be deemed very innovative, but no other alternatives have been found.

43. For survey-based systems, the TF-FDI is of the opinion that the most effective way to collect the necessary information would be the addition of questions to the survey form, requesting separately each element of other capital and taking into account the directional aspect of the investment. One alternative to the direct request of separate information from reporters could be to instruct the reporters on how to reclassify (from inward to outward FDI or vice versa) the funds provided by affiliates to their parent companies.

44. For settlement-based systems, the codes used to collect information from reporters should be expanded (where necessary) to include the elements of other capital required. They should also in-clude information on the direction of the investment to satisfy the requirements of the directional prin-ciple. The TF-FDI recommends that instructions to reporters should also be expanded to specify the requirements. A database on FDI relationships of resident companies, is a useful tool to ensure that any other capital transaction involving affiliated companies is effectively recorded under direct investment, although its maintenance normally requires a significant amount of resources.

IDENTIFICATION AND TREATMENT OF SPECIAL PURPOSE ENTITIES (SPES)

45. Due to the increasing role of Special Purpose Entities in the provision of intra-group financing and other services, the TF-FDI examined (i) the appropriateness of collecting separate statistics for this type of companies; and (ii) whether an alternative treatment for transactions and positions in which SPEs are involved should be applied. Concerning the second point, the TF-FDI considered the possibility of "passing through" this kind of enterprises (i.e. do not record either assets or liabilities) in those cases in which SPEs do not carry out any real economic activity in the territory in which they are located.

The TF-FDI disregarded both options (i.e. a different treatment and the collection of separate statistics) on the grounds that international standards recommend treating SPEs as any other FDI enterprise (exception made for some special cases[4]) and do not require any separate statistics for this kind of institutions. Additionally, the non-existence of a single harmonised definition of SPE would hamper their identification as well as the application of different rules for the recording of transactions and positions in which these entities are involved.

At present, most countries do not distinguish transactions/positions with non-resident SPEs from those with any other foreign counterpart. Furthermore, most member states do not separately identify domestic SPEs in their regular statistics.[5] A change in the methodology applied to these companies would be confronted with the difficulty to calculate consistent historical series.

- *Against this background, the TF-FDI recommends the inclusion of transactions/ positions of/with SPEs or SPE-like companies in b.o.p./i.i.p. reporting concerning the contributions to the euro area/EU aggregates.*
- *Notwithstanding all the practical and conceptual difficulties previously stated, the TF-FDI recommends that the possibility to collect separate statistics for SPEs continue*

4 For instance, in the case of holding companies (for which a reclassification in the economic sector of activity is recommended) or SPEs with a financial nature (for which it is recommended excluding from FDI statistics intra-group lending and borrowing vis-à-vis other related corporations with a financial nature).

5 One country excludes SPEs from national statistics, since, if that were not the case, national statistics would be blurred by the volume of financial transactions between non-resident entities channelled through domestic SPE's.

being assessed by both working groups and in the framework of ad-hoc workshops in the future.[6]

– *Following the latest decisions of the IMF and the ECB, SPEs principally engaged in financial intermediation for a group of related enterprises should be included in the category of affiliated finan-cial intermediaries and, therefore, inter-company loans with any other institution included in the category of MFIs/affiliated financial intermediaries should be excluded from direct investment and should be recorded in other investment.*

ALLOCATION OF FDI INWARD STOCKS BY COUNTRY OF "ULTIMATE BENEFICIAL OWNER" (UBO)

46. Following its mandate, the TF-FDI analysed the possibility and implications of classifying in-ward FDI stocks by the country of the UBO. The compilation of FDI statistics based on the UBO prin-ciple implies allocating FDI stocks according to residence of the entity that exercise control on the capital stock considered.

47. The TF-FDI assessed the impact of applying the UBO principle on the intra/extra-EU allocation and concluded that such impact was significant in most of the cases analysed (namely on two out of the three countries for which this information was available)

DEFINITION OF UBO

48. Ultimate beneficial owners are the first persons proceeding up along the chain that are not con-trolled by any other company. This definition should be applied at least to equity capital.

PRACTICAL METHODS TO COLLECT INFORMATION BASED ON THE UBO PRINCIPLE

49. Two approaches were identified by the TF-FDI to apply the UBO through the FDI sur-veys: (i) direct collection of UBO-based FDI stocks from respondents; and (ii) calculation by the compiler on the basis of more basic information (e.g. on all intermediate owners plus percentages of ownership) collected from respondents.

CALCULATION OF EU AGGREGATES BASED ON THE UBO ALLOCATION.

50. In the case of the EU aggregates, the application of the UBO criterion may imply some double recording related to the inward FDI stocks held by non-euro area countries. For this reason, the TF-FDI recommends that the UBO should only be applied in those cases in which EU direct in-vestment companies are directly owned by an investor located in an extra-EU country. However, the value of the FDI equity stocks controlled by extra-EU countries should also reflect the con-solidated value of the group, including other affiliates (inside or outside the EU/euro area), in line with the recommendations related to the treatment of indirect FDI relationships.

51. The TF-FDI did not hold a conclusive discussion on the practical ways in which these proposals could be implemented in practice. Therefore, it is proposed that some further work in this area should be part of the follow-up to the TF-FDI.

PRIORITISATION AND TIMING FOR IMPLEMENTATION OF THE TF-FDI RECOMMENDATIONS

52. The TF-FDI was requested by the Statistics Committee to provide an appropriate prioritisation of its recommendations, with a clear emphasis on those actions which were considered more urgent for the quality of FDI statistics. Following this request, the TF-FDI has divided its recommenda-tions into three categories according to the potential distortions that departing from its recommen-dations could entail for the European aggregates: high, medium and low importance, respectively.

6 To this aim, co-ordination should be ensured with the related work currently being developed in the OECD.

53. Additionally, a second dimension refers to the effort that each individual action would require from member states and the time lag with which the application of its recommendations could be reasonably expected. On that basis, the proposed actions could also be classified in three addi-tional categories: short, medium and long-term. The TF-FDI did not intend to define (in terms of more specific timing) the deadlines corresponding to each slot, since this was considered out of its mandate.

54. By combining both dimensions (i.e. importance and timeframe), the most significant recommenda-tions of the TF-FDI have been integrated in a matrix for illustrative purposes.

Table 23 Matrix of conclusions: prioritisation and timing for implementation of the TF-FDI recommendations

	Importance		
Timeframe	**High**	**Medium**	**Low**
Short-term	• All countries should start compiling FDI equity stocks and reinvested earnings on the basis of the results of FDI surveys, at least annually. 1) • FDI equity stocks should be collected separately for listed (both book 2) and market values) and non-listed companies. • All indirect FDI relationships 3) should be conceptually treated in accordance with the interpretation of standards outlined in chapter 1. • All (indirect) FDI transactions/positions should be geographically allocated to the immediate affiliate or parent company.4)		• Contributions to cover losses of direct investment enterprises should be recorded in the financial account.
Medium-term	• The COPC should be used by all MS. 5) • The components of other capital should be identified on the basis of the recommendations provided in chapter 6.	• Contribute to the development of a European database with information about the structure of multinational groups. • Payment of dividends from exceptional capital gains should be recorded in the financial account (thus not entering in the calculation of RIE).	
Long-term	• Indirect FDI relationships 6) should cover in practice (as a minimum) either (i) indirect links of ownership above 50%; or (ii) direct and indirect links of ownership above 10%, calculated as the product of the subsequent links of ownership along a chain. • The directional principle should be (fully) applied by all member states for FDI flows and stocks.		• Dividends should be recorded when payable rather than when paid.

1) Exception made of provisional results to be provided at T+9 and real-state investments. The following non-acceptable practices should be abandoned: (i) to leave the choice to the respondents on the valuation criterion (market values or book values); and (ii) the application of a perpetual inventory method/accumulation of b.o.p. flows to compile stocks.
2) Based on the common definition of own funds at book value.
3) To the extent that they can be identified, considering the practical difficulties existing at present, as addressed in chapter 2 of this report.
4) For both reinvested earnings and FDI equity stocks.
5) MS may focus on a reduced number of companies (the biggest ones and/or holding companies) to perform the distinction between ordinary and extraordinary gains and losses.
6) For all elements of FDI statistics (namely equity capital, reinvested earnings and other capital).

I. ISSUES FOR FOLLOW-UP WORK

55. Due to its limited time horizon, the TF-FDI could not expand the topics defined in its mandate with other subjects identified in the course of its investigations. Additionally, the TF-FDI did not hold discussions on more strategic issues. Therefore, it is proposed that some work could follow the delivery of this report in the following areas:

– Elaborate an implementation calendar with specific deadlines to put the recommendations of the TF-FDI in practice.

– Monitor on a regular basis the implementation status of the TF-FDI recommendations as well as other matters related to FDI (e.g. exchange of experiences and information on FDI) through, for instance, the regular meetings of the working groups and/or ad-hoc workshops. Among the different issues to be considered in the future, the TF-FDI recommends that the possibility to collect separate statistics for SPEs continue being assessed in the future.[7]

– Develop a twofold monitoring task, which should focus on: (i) the definition of the new international accounting standards; and (ii) the update of the IMF Balance of Payments Manual. This monitoring task should aim at promoting further convergence between statistical and accounting standards, while keeping in mind that FDI statistics should always be able to serve analytical needs from the macroeconomic viewpoint.[8]

– Explore practical ways to put the proposals to compile statistics based on the UBO in practice.

– Elaborate the list of user requirements for the European Business Register project currently being developed by the Eurostat's Business Statistics Directorate. Such a contribution should ensure that the final product will have the necessary features for the compilation of FDI statistics.

7 To this aim, co-ordination should be ensured with the related work currently being developed in the OECD.

8 In particular, the TF-FDI discussed two alternatives to try to approximate statistical rules to accounting standards: (i) change the 10% rule defining all FDI relationships to a 20% criterion; (ii) consider only indirect FDI relationships over 50% (i.e. restrict the coverage of indirect relationships to cases of majority control). The TF-FDI tentatively expressed a preference for the second option, which is already a practical simplification addressed in this report.

INTRODUCTION

SUMMARY OF THE MANDATE

1. The Task Force on Foreign Direct Investment (TF-FDI) was set up by the ECB Working Group on Balance of Payments and External Reserves Statistics (WG-BP&ER), jointly with the Eurostat Balance of Payments Working Group (BoP WG), to investigate on the matters included in the mandate, focusing particularly on the practical and consistent implementation of the various principles/ definitions involved.

2. The main objectives of the TF-FDI were to identify "best practices" with a view to minimising divergence in the treatments applied by euro area/European Union (EU) Member States. In effect, any such inconsistencies may, not only have a direct impact on the calculation of the euro area/EU aggregates, but also endanger the homogeneity of the final aggregate results. In this respect, particular attention was to be paid to the accuracy of the geographical allocation of the relevant transactions and positions.

3. The mandate of the TF-FDI was articulated around the five following items:

(i) *Valuation of stocks:* the TF-FDI was to investigate the practicality of the conceptual agreements reached within the WG-BP&ER and the STC in this area[1], i.e. the problems associated with the provision of additional breakdowns required for listed and non-listed companies for the production of memorandum items. More specifically, the TF-FDI should investigate (a) the feasibility of the separate provision of stock data on listed and non-listed FDI companies and (b) whether stocks on listed (resident and non-resident) FDI companies may be valued on the basis of both market values and book values (the latter using the common definition of "own funds at book value" approved by the WG-BP&ER and the STC)[2].

(ii) *Other capital:* the TF-FDI was mandated to investigate and put forward practical solutions for the problems linked to:

a) the application of the "directional principle";

b) the identification and impact of trade credits, financial leasing, debt securities subscribed by associated companies;

c) the treatment and classification of transactions/positions on "other capital" when Monetary and Financial Institutions (MFI) are involved.

(iii) *Reinvested earnings:* the TF-FDI was to review the practical aspects of the compilation methods for reinvested earnings (declaration by respondents, calculation by the compilers, interim estimations etc.), with the participation of Eurostat Unit B1 (National Accounts).

(iv) *Identification and treatment of Special Purpose Entities (SPEs):* the TF-FDI would investigate practical problems associated with the identification and treatment of transactions/positions of SPEs, mainly "other financial intermediaries" or "financial auxiliaries", in the context of direct investment relationships.

(v) *Treatment of indirect FDI relationships and allocation of FDI inward stocks by country of "ultimate beneficial owner" (UBO):* the TF-FDI would investigate on the practical application of the "fully consolidated system" in Member States. Possible solutions to the problem of obtaining information on group structures should be examined with reference also to the costs that they would entail. The

1 Reference documents "ST/WG/BP/FDIIMPLE.DOC", dated 29 October 2001 (WG-BP&ER) and "ST/STC/BP/FDIREPORT.DOC", dated 20 November 2001 (STC).

2 According to the above-mentioned reference document "ST/WG/BP/FDIIMPLE.DOC"

possibility and implications of classifying inward FDI stocks by the country of UBO would be analysed. The results and work ongoing in other CMFB (Steering Group on Multinationals) or Eurostat groups (FATS, Business register) would be taken into account. Eurostat Unit D1 (Business register) would be invited to participate.

4. At their respective meetings in March 2003, the ECB WG-BP&ER and the Eurostat BoPWG gave further guidance to the TF-FDI. The WG-BP&ER stressed that "departure from international statistical standards should only be proposed by the TF in case a substantial critical mass of Member States were in favour and for sound practical reasons, mainly addressed to avoid asymmetries in the euro area/EU aggregates". Both WGs stated that the Current Operating Performance Concept (COPC) should be the reference concept for the compilation of reinvested earnings. It was also stressed that for the practical application of this concept, some simplification could be needed in order to avoid excessive costs. Additionally, the WG-BP&ER encouraged the TF-FDI to further examine the practicalities in compiling aggregates (in particular as regards "extraordinary profits" and any possible distinction between financial and non-financial corporations).

5. The focus of the work of the TF-FDI, as per its mandate, was on the identification of best practices with a view to minimising asymmetries by the implementation of practical and compatible solutions over a short- to medium-term horizon.

STRUCTURE OF THE REPORT

6. In February, the TF-FDI presented a first report on the first three items of the mandate. The structure of the report was based on the order in which the various items under study were listed in the mandate. The items covered by the report were valuation of equity stocks, reinvested earnings, and other capital.

7. Starting during the first phase, one issue appeared repeatedly in the discussions, namely the potential use of (non-)consolidated accounts for the compilation of FDI statistics. Since the issue on the treatment of indirect FDI relationships has proved crucial for the final conclusions of the TF-FDI, a broader analysis has been made of these aspects. Also the structure of the report has been adapted to this situation and the first two chapters deal with the theoretical and practical aspects of the Fully Consolidated System and indirect FDI relationships.

8. The following three chapters deal with the first items of the mandate, namely valuation of equity stocks, reinvested earnings and other capital. The chapter on reinvested earnings has been developed in line with the clarifications made by the two Working Groups. The chapter on other capital has been supplemented with the results of a study on the importance of the sub-components following the request of the BoPWG. Chapters VI and VII deal with the two final items of the mandate (exception made of the coverage of indirect FDI relationships, which is tackled in the first two chapters, as mentioned in the previous paragraph), namely the identification and treatment of Special Purpose entities and the allocation of stocks by country of ultimate beneficiary owner. A final chapter provides a summary of the main conclusions and recommendations of the TF-FDI.

1 CONCEPTUAL ISSUES RELATED TO THE FULLY CONSOLIDATED SYSTEM AND THE COVERAGE OF INDIRECT FDI RELATIONSHIPS

INTRODUCTION

9. This chapter is an attempt to clarify somewhat the conceptual background established by international standards. More specifically, this chapter fosters the adoption of a unique methodology applicable to some specific cases for which international standards may leave some room for interpretation.[3]

10. This chapter has an introductory nature stemming from the fact that it tackles, purely on conceptual grounds, general aspects which are relevant to the interpretation of other parts of the report. In particular, the recommendations addressed by this chapter should be considered as to how the conclusions of, for instance, chapters 2 (Practical solutions for the coverage of indirect FDI relationships), 3 (Valuation of FDI equity stocks) and 4 (Reinvested earnings) should be applied.

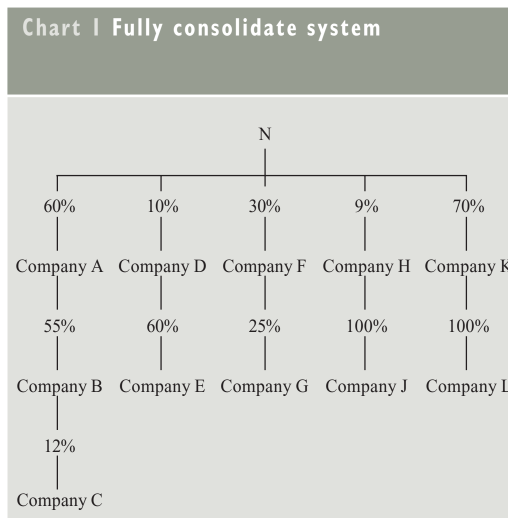
11. To be more specific, international standards prescribe that direct investment statistics should cover all directly and indirectly owned subsidiaries, associates and branches. The incorporation of indirectly related FDI affiliates to the value of the total direct investment should be done through the appropriate process of consolidation.

12. This chapter aims at clarifying further how to interpret standards with regard to the coverage of indirect FDI relationships. It is important to stress that it is restricted to the conceptual analysis of some aspects concerning the methodology applicable to the compilation of FDI statistics. The following chapter (2) will study in detail any practical problems for the application of such a methodology, current practices as well as the difficulties linked to the compilation of the European aggregates and the possible use of consolidated accounts for the compilation of FDI statistics.

13. The identification of FDI relations has been traditionally based on the methodology contained in the OECD Benchmark Definition of Foreign Direct Investment (the Benchmark) and in the IMF Balance of Payments Manual (BPM5). As part of such methodology, the so-called Fully Consolidated System (FCS) is meant to identify those enterprises in which the direct investor has directly or indirectly a direct investment interest. Thus, FDI statistics should cover transactions and positions between direct investors and all FDI enterprises which are part of the FCS.

14. The traditional presentation of the FCS is usually illustrated by the following chart:

Chart 1 Fully consolidate system



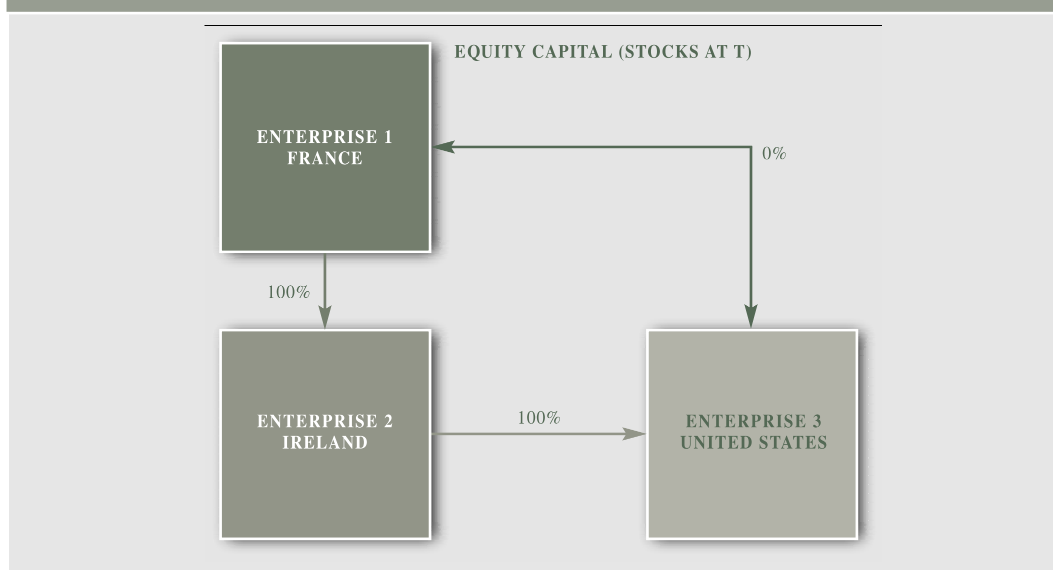
15. The FCS basically illustrates which enterprises below company N in the chain should be considered as subsidiaries, associates or branches and whether or not they should be covered by FDI statistics. According to the diagram and the FCS rules, companies A, B, C, D, E, F, K and L should be covered by FDI statistics.

16. While, as a general reference, the FCS helps to define which companies in the example should be considered in FDI statistics (leaving aside how difficult collecting such a detailed picture of the multinational groups' structure

3 It should be borne in mind that the ongoing process of updating the BPM5 could trigger significant revisions in international standards in the forthcoming years. Such revisions could help overcome some of the most significant practical difficulties currently faced by compilers and identified in this report.

might be), there are some more specific questions that may not be so clearly answered by international standards and the FCS in its traditional presentation. For instance, let us consider the following example:

Example 1 Indirect relationships grandmother – granddoughter: equity capital (stocks)



17. The (unconsolidated) balance sheet of these enterprises could initially be as follows:

Enterprise 1 (France)

Assets	Liabilities
€100 (shares of Ent. 2)	€100 (Equity capital)

Enterprise 2 (Ireland)

Assets	Liabilities
€100 (shares of Ent. 3)	€100 (Equity capital)

Enterprise 3 (United States)

Assets	Liabilities
€100 (Equipment)	€100 (Equity capital)

18. The methodology addressed by international standards (BPM5 and the Benchmark) may not suffice to determine which transactions/positions between 1 and 3 should be recorded under FDI and how. Some typical examples of transactions that may generate doubts are (i) equity transactions below 10% between companies without direct links of ownership (1 and 3); (ii) whether reinvested earnings generated by 3 should be attributed to 1; (iii) whether the valuation of the equity capital stocks based on the "own funds at book value" of 2 should include retained earnings / reserves generated by 3; etc.

19. In the next sections, these and other examples will be analysed case by case. Section one deals with stocks and section two with transactions between indirectly related companies in cases such as the one presented in Example 1. Section three considers a different

case, i.e. that of "fellow"/"sister" companies[4]. Finally, section four concludes by putting forward some general conclusions and recommendations.

COMPANIES WITH INDIRECT LINKS OF OWNERSHIP

FDI STOCKS: EQUITY CAPITAL AND OTHER CAPITAL

EQUITY CAPITAL STOCKS

20. To start with, let us focus on Example 1 as previously described: the first question could be whether or not (and how) enterprise 1 should incorporate to the value of its equity capital stocks of outward FDI part or all of the value of enterprise 3. To simplify even further the cases analysed we always focus on relationships resident/non-resident and implying 100% of ownership.

21. As regards the valuation of FDI equity stocks based on the common definition of Own Funds at Book Value (OFBV)[5], the problem could be more clearly identified by considering separately: (i) nominal capital; and (ii) undistributed reserves (i.e. reinvested earnings), including current year's profits/losses carried forward.[6]

22. Let us begin with the first component, i.e. nominal (paid-up) equity capital. If the capital of enterprise 3 was added to the nominal capital of enterprise 2, the value of the outward FDI stocks of enterprise 1 would result overestimated.

23. In our example, a company located in FR (Ent.1) invests EUR 100 in a US company (Ent. 3), through a holding company (2) located in IE. To simplify, all ownership relations entail 100% ownership.

24. If the outward FDI equity stock of FR included the share capital of all the subsequent links in the chain, it would amount to: 100 (IE) + 100 (US) = 200. However, the outward investment of FR would just be worth 100 (and would only be valued that much by the markets), which is the money that Ent. 1 has actually put in circulation.

25. With a view to further illustrating this case, we can also consider Example 2, which is based on a real group of companies. The names of the companies involved have been hidden so as to overcome confidentiality problems (see Example 2).

26. For the second calculation, the nominal capital in the balance sheet (liabilities) of the companies below *XXX Enterprises* has not been consolidated with the value of those investments in the balance sheet (assets) of *XXX Enterprises*, i.e. the funds that *XXX Enterprises* transfers to its subsidiaries. Obviously the difference between both approaches is rather substantial. *The conclusion would be that only the nominal capital of the directly-owned FDI company should be taken into account.*

27. Let us consider now the second component of equity capital, namely non-distributed reserves and profits (losses) in the current year, following the common definition of own funds at book value (OFBV) approved by the STC.

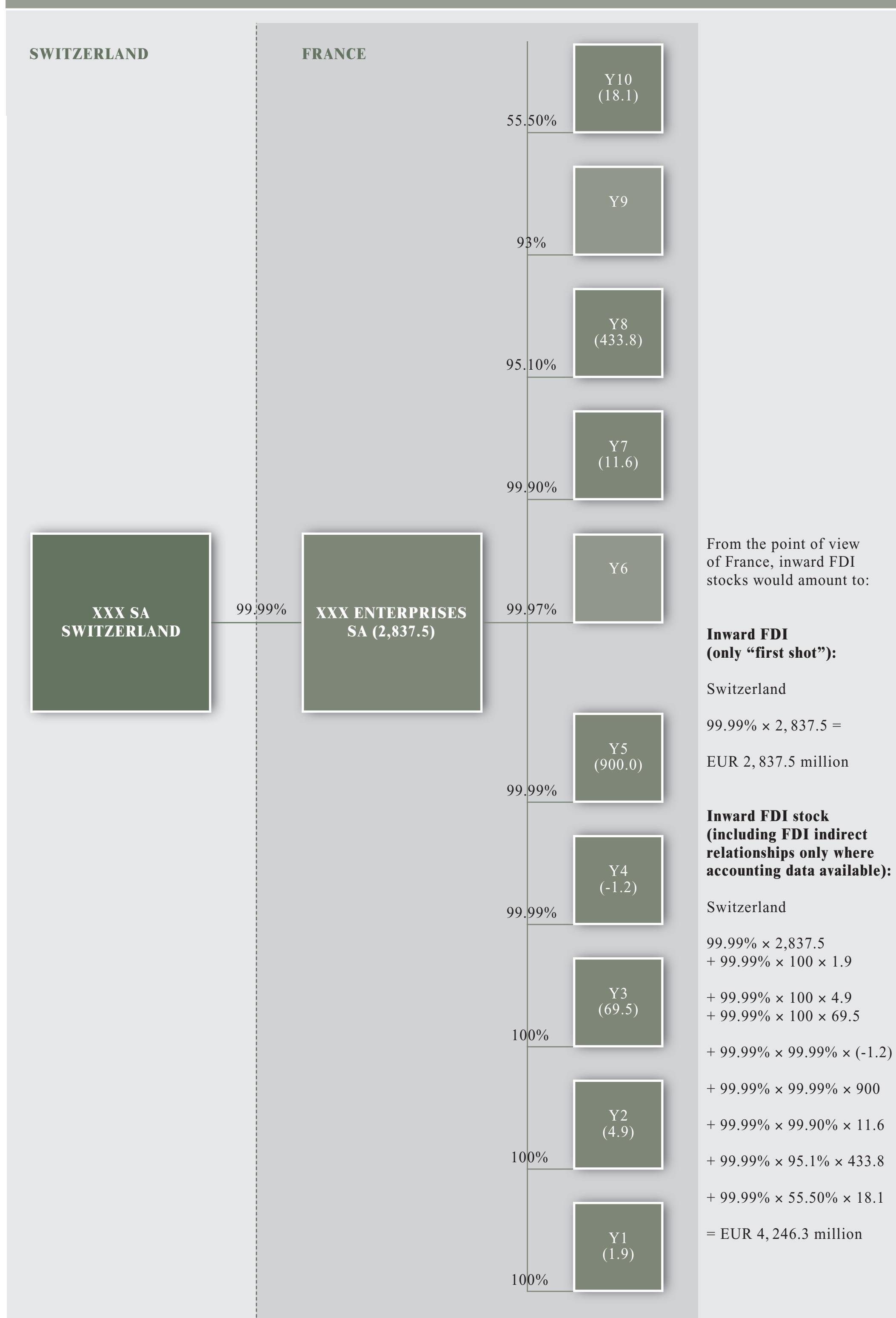
28. Coming back to the original "simplistic" example (as previously shown in Example 1), let us consider now that Enterprise 3 makes some profits, which are not distributed to its shareholders (see Chart 3).

4 Both terms, i.e. "fellow" companies and "sister" companies are indistinctly used throughout the report to refer to the same kind of companies, namely those pertaining to the same multinational group but with neither direct nor indirect control over one another.

5 The STC decided that the valuation criteria for the official euro area series should be market (stock-exchange) prices for listed companies and book values (based on the common definition of OFBV) for non-listed companies. Nevertheless, equity stocks following the book valuation based on OFBV will be requested for all types of companies.

6 The specific treatment applicable to more detailed components like premiums, non-disbursed capital, capital grants, etc. was developed by the WG-BP&ER.

Example 2 Real case of indirect relations grandmother – granddoughter



From the point of view of France, inward FDI stocks would amount to:

Inward FDI (only "first shot"):

Switzerland

99.99% × 2, 837.5 =

EUR 2, 837.5 million

Inward FDI stock (including FDI indirect relationships only where accounting data available):

Switzerland

99.99% × 2,837.5
+ 99.99% × 100 × 1.9

+ 99.99% × 100 × 4.9
+ 99.99% × 100 × 69.5

+ 99.99% × 99.99% × (-1.2)

+ 99.99% × 99.99% × 900

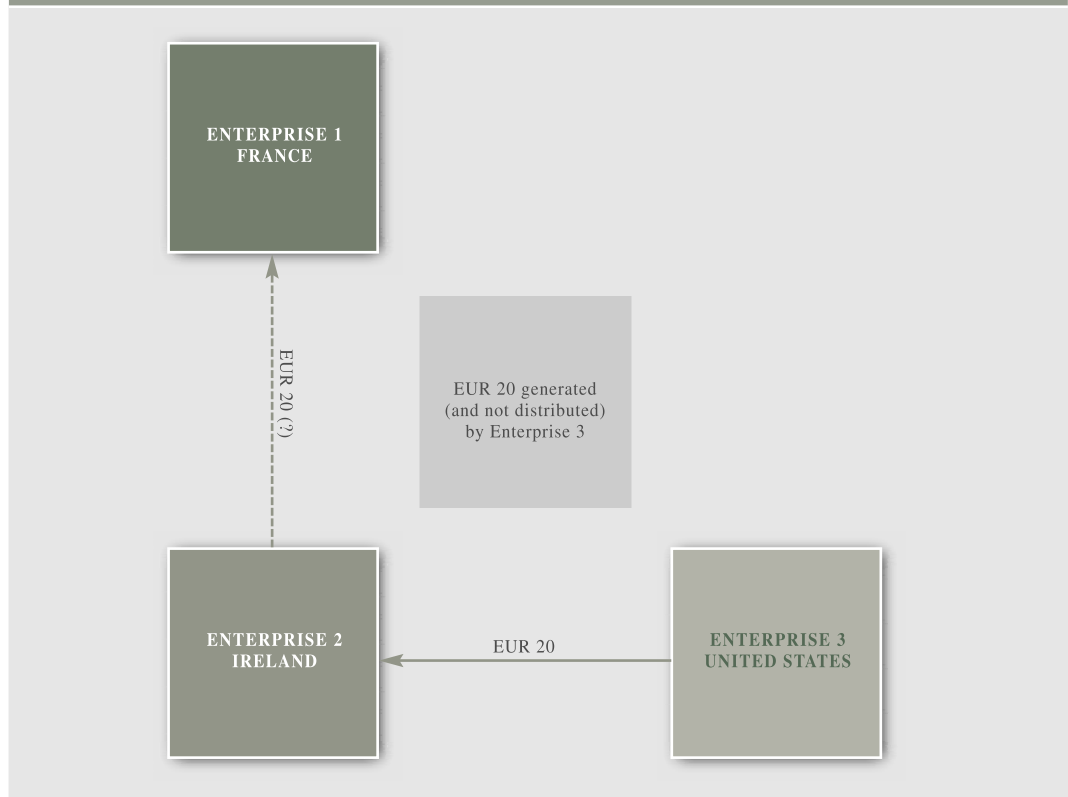
+ 99.99% × 99.90% × 11.6

+ 99.99% × 95.1% × 433.8

+ 99.99% × 55.50% × 18.1

= EUR 4, 246.3 million

Chart 3 Reinvested earnings (stocks)



29. Now the (unconsolidated) balance sheet of the three enterprises would look as follows:

Enterprise 1 (France)

Assets	Liabilities
€100 (shares of Ent. 2)	€100 (Equity capital)

Enterprise 2 (Ireland)

Assets	Liabilities
€100 (shares of Ent. 3)	€100 (Equity capital)

Enterprise 3 (United States)

Assets	Liabilities
€100 (Equipment) €20 (Cash)	€100 (Equity capital) €20 (Reserves)

30. Following the guidance provided by international standards, reinvested earnings generated by indirectly owned enterprises should also be incorporated to the total reinvested earnings corresponding to the outward FDI investments of enterprise 1.

31. Therefore, in order to be compliant with these guidelines, *these undistributed profits should also be considered within the total value of the outward FDI equity capital stocks of FR*, which should amount to EUR 100 (equity capital of ent. 2) + EUR 20 (undistributed reserves generated by ent. 3) = EUR 120. From the point of view of the enterprise located in IE, all reinvested earnings recorded as outward FDI should also be recorded as inward FDI, with a nil effect, thus, on a net basis.

32. Summing up the main conclusions of this section:

The TF-FDI is of the opinion that, on conceptual grounds, for the valuation based on book values of FDI equity stocks, the following should be considered:

Concerning the nominal capital:

(i) only that of the directly owned FDI enterprises should be included in the valuation of FDI equity stocks.

Concerning the (non-distributed) reserves, it is important to distinguish between direct investment in the reporting economy and direct investment abroad:

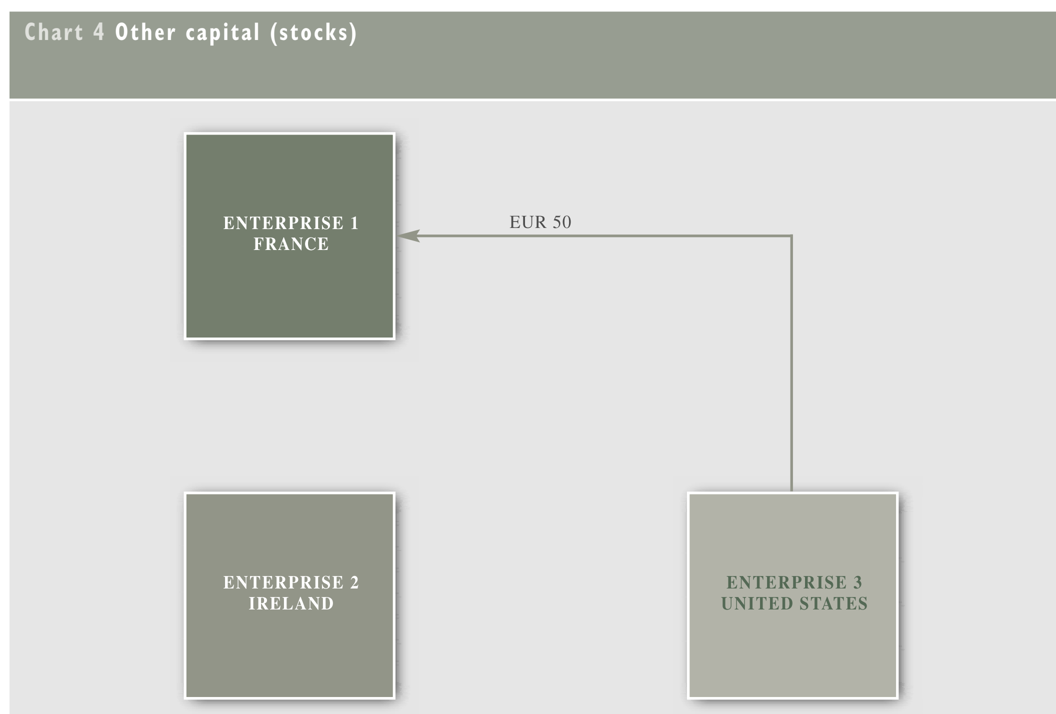
(ii) FDI abroad (outward): in addition to the reserves of the directly owned foreign FDI companies, reserves generated by the affiliates of the foreign FDI companies[7] should be incorporated to the total value of the FDI equity capital in proportion to the % of ownership across the subsequent levels of the ownership chain.

(iii) FDI in the reporting economy (inward): the FDI company should attribute to the foreign investor (i.e. the direct owner), in addition to its own reserves, all reserves generated by its directly or indirectly owned direct investment enterprises[8] in proportion to the % of ownership.

33. Therefore, as a general principle, book-value-based FDI equity stocks should cover the OFBV of the directly owned direct investment enterprise plus the (non-distributed) reserves generated by the (domestic and foreign) affiliates of the directly owned direct investment enterprise according to the rules of the FCS. Obviously, concerning valuation principles for equity capital stocks, all references to the application of the OFBV definition and whether or not reinvested earnings generated by indirectly owned FDI enterprises should be incorporated to the stocks are only applicable to the valuation based on book values. Market values based on stock exchange prices should already incorporate all relevant information and, thus, do not require any further adjustment.

7 Both resident and non-resident.
8 Both resident and non-resident.

Chart 4 Other capital (stocks)



OTHER CAPITAL STOCKS[9]

34. Coming back to our basic example, let us consider a loan granted by enterprise 3 to its (indirectly related) mother company, i.e. to enterprise 1 (see Chart 4).

35. Leaving aside some practical problems such as how to identify indirect FDI relations between lenders and borrowers, the inclusion of such a loan under FDI other capital seems uncontroversial on purely conceptual grounds. However, there might be a doubt on whether such a loan should be recorded by FR under FDI in the reporting economy following the direction of the cash flows or rather under FDI abroad as a disinvestment, i.e. following the direction of the FDI relationship.

The TF-FDI recommends that such a loan should be recorded under FDI abroad/Other capital as a disinvestment by the country of enterprise 1, i.e. the directional principle should prevail, even if such an FDI relationship is merely indirect.[10]

FDI FLOWS: EQUITY CAPITAL, REINVESTED EARNINGS AND OTHER CAPITAL

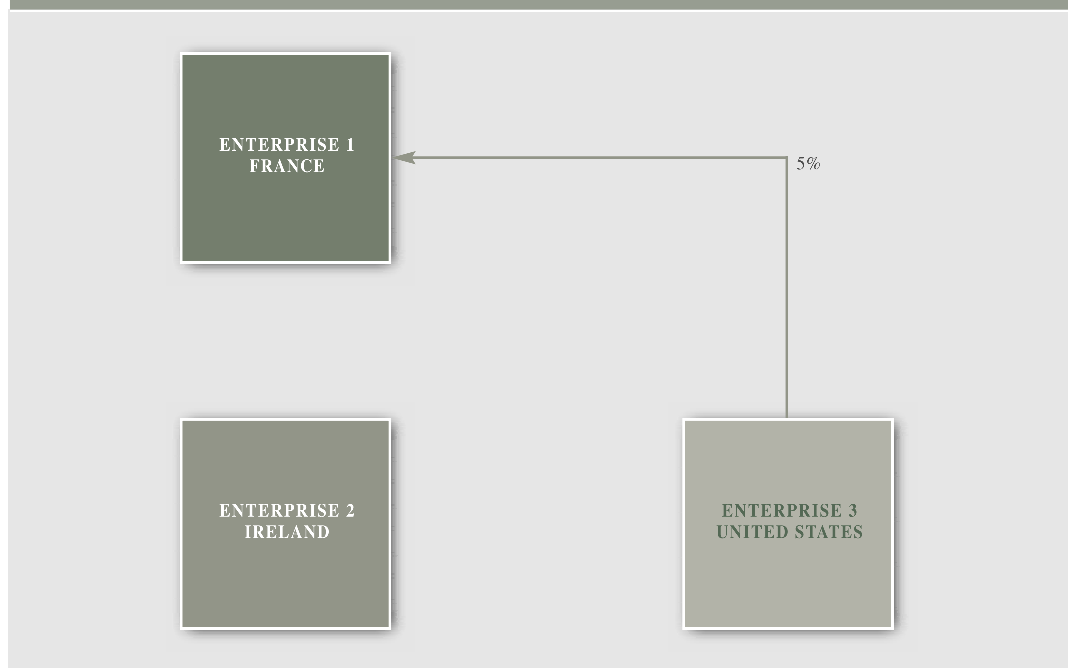
EQUITY CAPITAL TRANSACTIONS

36. The main question concerning this item is whether or not transactions between indirectly related companies below 10% of ownership should be recorded under FDI. In the example we have been analysing so far, let us consider that enterprise 3 acquires 5% of the equity capital of its (indirectly-linked) mother company located in FR (see Chart 2).

9 The loans referred to (or any transactions other than permanent debt) exclude those involving financial intermediaries.

10 Enterprise 3 should record the loan under *FDI in the recording economy/Other capital* as a disinvestment. Obviously, enterprise 2 should not record anything. Any loan in the opposite direction, i.e. granted by enterprise 1 to enterprise 3, must be recorded by FR under FDI abroad/Other capital (and by USA under *FDI in the reporting economy/Other capital*).

Chart 2 Equity capital below 10% (flows)



37. Should this transaction be recorded under *FDI/Equity*? If that is the case, should it be considered as inward or outward FDI?

The TF-FDI favours the recording of such a transaction by FR under FDI abroad/Equity/ Liabilities to affiliated enterprises as a disinvestment, for the same reasons previously explained, i.e. the directional principle should prevail. [11]

REINVESTED EARNINGS

38. A case which is equally applicable here has been already analysed under equity capital stocks in paragraphs 28 to 31. The conclusions concerning b.o.p. flows (in this case, recorded under reinvested earnings with a counter entry in the income statement) would be equivalent to the conclusions reached concerning equity stocks.

Consequently, the TF-FDI is of the opinion that:

(i) concerning direct investment abroad, reinvested earnings generated by both directly and indirectly owned enterprises[12] *should be considered in proportion to the % of ownership down the chain;*

(ii) concerning direct investment in the reporting economy, the attribution of reinvested earnings to the foreign mother company (i.e. the direct owner) in proportion to its ownership share should encompass the sum of all reinvested earnings generated by the (directly owned) domestic FDI enterprise plus all reinvested earnings generated by the (directly or indirectly owned) affiliates of the domestic FDI enterprise (also in proportion to the % of ownership)[13].

OTHER CAPITAL TRANSACTIONS

39. The example for other capital transactions could be the same as that already analysed for Other capital stocks. In short, the conclusions are basically consistent with those already provided for the consideration of stocks, namely:

It is recommended that all loans between indirectly related companies should be recorded under FDI other capital. For the consideration of those transactions as either inward or outward FDI, the directional principle should prevail, i.e. the (indirect) investor should record all transactions in FDI abroad/other capital, while the direct investment enterprise should record all transactions under FDI in the reporting economy/other capital.

THE CASE OF "FELLOW"/"SISTER" COMPANIES

40. Some of the recommendations put forward so far could slightly vary in the case of companies whose role in the group's structure is not so clearly defined. For instance, when neither company is the mother of the group nor are they clearly at the end of the chain, it might be difficult to determine how the directional principle should be applied.

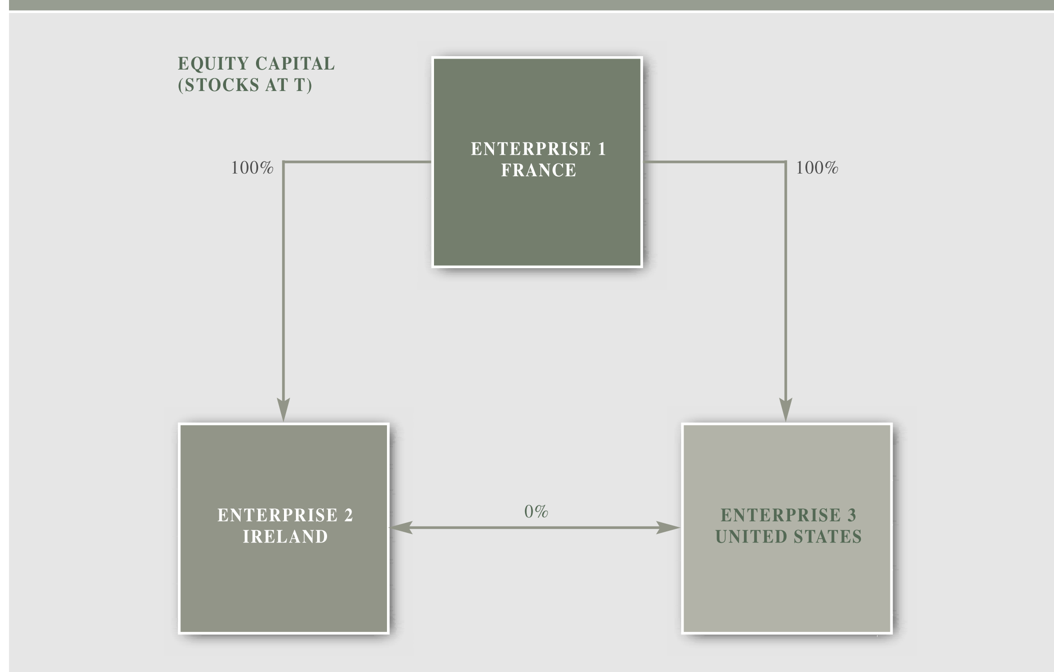
41. "Sister companies" in the context of FDI statistics could be defined as affiliates pertaining to the same multinational group which do not have a participation/interest of 10% or more in each other. Let us consider Example 2 as the basis for discussion. Enterprises 2 and 3 would be what we call "sister" companies in this section (see Example 3).

11 For the sake of consistency, the country of enterprise 3 (in the example, US), should follow the same recording rules, i.e. the transaction should be recorded under *Direct investment in the reporting economy/equity/claims to direct investors* as a disinvestment. A similar transaction in the opposite direction, i.e. an investment of 1 in the equity capital of 3 below 10% should be recorded by FR under *FDI abroad/Equity/Claims* on affiliated enterprises.

12 In the case of companies with indirect links of ownership, both foreign and domestic direct investment enterprises should be comprised (provided that the direct link of ownership is maintained with a foreign direct investment enterprise).

13 Irrespective of whether they are resident or non-resident.

Example 3 Fellow/sister companies: equity capital (stocks)



42. Then different transactions could take place between 2 and 3. Let us consider the following three independent cases, corresponding to the three FDI items. All of them are supposed to happen taking as starting point the situation in T.

Chart 5 Transactions between fellow/sister companies

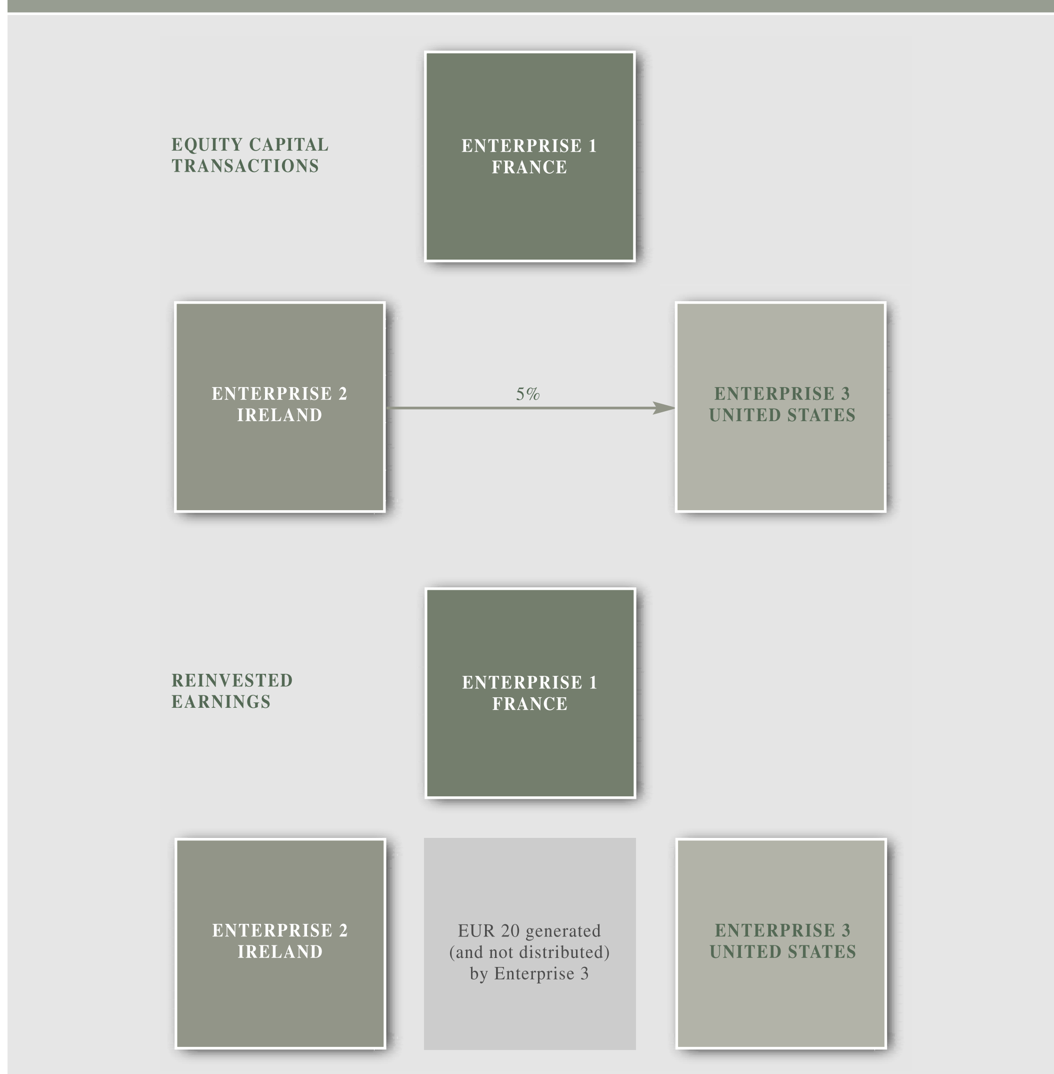
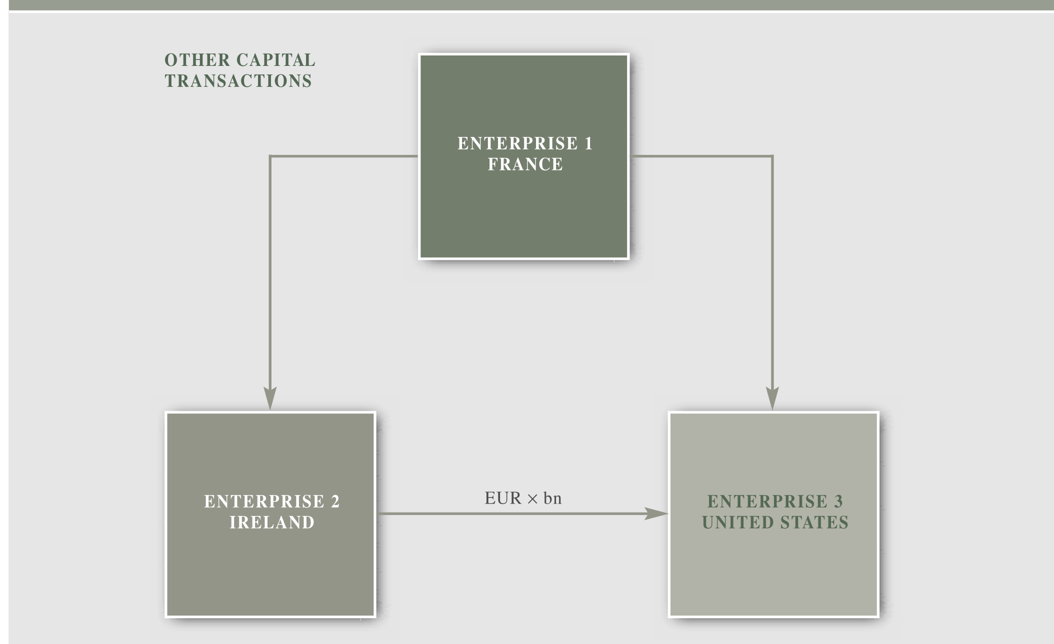


Chart 5 cont'd



43. According to the IMF Text Book, paragraph 529, "When a direct investment enterprise invests in an enterprise related to its direct investor, this investment is recorded, by the economy providing the investment, as resident *direct investment*-abroad and by the enterprise receiving the investment, as *direct investment*-reporting economy".

44. Therefore, concerning the case of fellow/sister companies, the following recommendations are proposed by the TF-FDI on conceptual grounds:

- *Equity capital transactions/positions between sister companies not exceeding 10% of ownership should be recorded under FDI (by 2 and 3; not by 1), either as inward or outward FDI depending on the direction of the investment.*

- *Reinvested earnings generated by sister companies with no direct equity links should not be recorded under FDI by those companies, i.e. 2 should not record any reinvested earnings generated by 3.*[14] *If the starting point was the situation after the acquisition of 5% of 3 by 2, 2 should record 5% of the reinvested earnings generated by 3 (and 3 should attribute 5% of its reinvested earnings to 2).*

- *Loans granted to/borrowed from sister companies should be recorded under FDI other capital (by 2 and 3; not by 1), either as inward or outward FDI depending on the direction of the loan.*

CONCLUSIONS

45. This section summarises the agreements reached by the TF-FDI towards a common conceptual understanding of international guidelines. In short, this chapter is articulated around the distinction between two types of companies with indirect links: (i) those for which one of the concerned companies exerts (indirect) control over the other; and (ii) those with neither direct nor indirect control over one another (i.e. the so-called "fellow"/"sister" companies).

14 Obviously, the mother company (1) should record the reinvested earnings generated by both companies 2 and 3.

46. For companies with an indirect link of ownership when one of them exerts indirect control over the other, the conceptual agreements of the TF-FDI could be summarised as follows:

Stocks

(i) *Equity capital*: concerning the nominal capital, only that of the directly owned FDI enterprises should be included in the valuation of FDI equity stocks based on book values. Concerning non-distributed) reserves, the value of equity stocks should include, in addition to those corresponding to the directly owned FDI companies, (i) for *FDI abroad*, reserves generated by indirectly owned[15] direct investment enterprises in proportion to the % of ownership; (ii) for *FDI in the reporting economy*, reserves generated by the domestic FDI company's affiliates[16] in proportion to the % of ownership. Equity capital stocks should be classified as inward or outward according to the directional principle (see below)

(ii) *Other capital:* loans between this type of companies should be recorded under inward or outward FDI according to the directional principle (see below).

Flows

(i) *Equity capital*: transactions below 10% *should* be recorded under inward or outward FDI equity capital according to the directional principle (see below).

(ii) *Reinvested earnings:* In line with the recommendations provided for equity capital stocks, the total reinvested earnings should include, in addition to the reinvested earnings corresponding to the directly owned FDI companies, (i) for *FDI abroad*, reinvested earnings generated by indirectly owned foreign direct investment enterprises in proportion to the % of ownership; (ii) for *FDI in the reporting economy*, reinvested earnings generated by the domestic FDI company's affiliates[17] in proportion to the % of ownership.

(iii) *Other capital:* loans between indirectly related companies should be recorded under FDI other capital. For the consideration of those transactions as either inward or outward FDI, the directional principle should prevail (see below).

Applicability of the directional principle

All stocks and flows between these types of companies should be classified by the investor (i.e. the indirect owner) as *FDI abroad* and by the (indirectly owned) direct investment enterprise as *FDI in the reporting economy*, under the relevant FDI items.

47. For the second group of FDI companies with indirect links, namely „sister" companies, the recommendations of the TF-FDI would be as follows:[18]

Stocks

(i) *Equity capital*: equity stocks held by sister companies not exceeding 10% of ownership should be recorded under FDI. The direction of the investment should determine whether stocks should be classified under inward or outward FDI.

15 In the case of companies with indirect links of ownership, both foreign and domestic direct investment enterprises should be comprised, provided that the direct link of ownership is maintained with a foreign direct investment enterprise.

16 Either directly or indirectly owned, irrespective of whether they are resident or non-resident.

17 Either directly or indirectly owned, irrespective of whether they are resident or non-resident.

18 We mostly refer hereafter to the recording by the sister companies involved. The entries that, where relevant, should be recorded by the parent company (e.g. for reinvested earnings) are not considered here.

(ii) *Other capital:* Loans granted to/ borrowed from sister companies should be recorded under *FDI/other capital* by the lender/borrower, either as inward or outward FDI depending on the direction of loan.

Flows

(i) *Equity capital*: transactions between sister companies not exceeding 10% of ownership should be recorded under FDI. The character of inward/outward FDI should be determined by the direction of the investment (i.e. outward FDI for the shareholder and inward FDI for the issuer).

(ii) *Reinvested earnings:* Reinvested earnings generated by these companies should not be recorded under FDI by the other (sister) company, as long as neither company indirectly exerts control over the other, nor direct ownership links exist between both companies.

(iii) *Other capital:* Loans granted to/borrowed from sister companies should be recorded under FDI other capital by both lender and borrower, either as inward or outward FDI depending on the direction of the loan

Applicability of the directional principle

In the case of sister companies, flows and stocks should be classified as outward FDI by the country which provides the investment or grants the loan and as inward FDI for the country receiving the investment/loan.

2 PRACTICAL ASPECTS RELATED TO THE COVERAGE OF INDIRECT FDI RELATIONSHIPS

INTRODUCTION

48. The previous chapter of this report has established common rules as to how international standards should be interpreted concerning the coverage of indirect FDI relationships in the compilation of FDI statistics. Once a common conceptual understanding has been already defined, the present chapter aims at investigating the most important difficulties currently existing for the application of such rules in practice.

49. Besides this introduction, this chapter is structured in five sections. The first section has an introductory nature and analyses the differences between the accounting rules applied to elaborate consolidated balance sheets (accounting consolidation hereafter) and statistical rules as contained in the so-called fully consolidated system (FCS) plus related methodology for the compilation of FDI statistics (henceforth referred to as statistical consolidation). The second section describes current practices in member states for the coverage of indirect relationships as well as some other connected features revealed by a questionnaire circulated within the TF-FDI.

50. Section 3 explores the consequences for the compilation of the European aggregates of the treatment applied to indirect FDI relationships through an illustrative example. Section 4 extracts some conclusions from the analysis carried out throughout the chapter and proposes some practical simplifications to the rules for the coverage of indirect FDI relationships prescribed by international standards. This section also includes some criteria that should be applied for the geographical allocation of FDI transactions and positions in which indirect FDI relationships play a role. Finally, in connection with the coverage of indirect FDI relationships and following the instructions of the mandate section 5 considers possible solutions to the problem of obtaining information on group structures and, in particular, the possibility to develop a European database/business register.

STATISTICAL CONSOLIDATION VERSUS ACCOUNTING CONSOLIDATION

INTRODUCTION

51. The inclusion of indirect links of ownership in FDI statistics is a major challenge due to the numerous practical difficulties that compilers usually encounter in accessing to the relevant information.

52. Such practical difficulties are largely acknowledged in the manuals containing international statistical standards, such as the BPM5 and the Benchmark. Therefore, these manuals normally adopt a rather practical approach for the application of the FCS and the methodology brought forward for the compilation of FDI statistics and admit the use of consolidated accounts of the companies involved in FDI deals as an acceptable way to capture indirect FDI relationships.

53. The sole use of consolidated accounts in the compilation of FDI statistics without any other supplementary information does not allow getting the results that the FCS prescribes. For instance, accounting statements normally lack vital information for the compilation of external statistics such as the geographical dimension or information on the economic sector of activity of the affiliates. Additionally, the rules to define the consolidation perimeter in accounting normally differ from those linked to the so-called fully consolidated system (FCS), which are basically defined by the 10% rule and the notion of “majority control” (so as to identify which companies should be covered in FDI statistics).

54. In particular, the connection between both approaches (the statistical rules applicable to the compilation of FDI statistics and the accounting rules applied to the elaboration of consolidated accounts) may be illustrated by splitting statistics into two dimensions: (i) input, or how the basic information is collected by the b.o.p./i.i.p. compiler, and (ii) output, or the statistic which is finally produced. The first dimension relies to a great extent on the

information sources from which the information is collected. Since FDI stocks are normally compiled via direct contact with reporters through FDI surveys, it might be logical to assume that reporters use a single set of (accounting) rules to elaborate both their balance sheet and to fill in statistical reports. Such accounting rules are aimed at assessing the micro situation of each individual company. On the other hand, the output dimension is normally ruled by the needs of the users, which normally entail a macro economic approach. Such a framework requires the application of a different methodology concerning aspects such as valuation criteria, time of recording, etc.

55. In conclusion, some confusion may come out when the notion of "consolidation" is used with no further specification, i.e. it might refer to either the output or the input dimension. On the input side, the concept of consolidation is normally associated to the notion of accounting consolidation, i.e. the rules applied by the companies to elaborate consolidated accounts. On the output side, the concept of consolidation normally refers to the FCS (as defined in the BPM5 and the Benchmark), which is meant to establish the rules governing the coverage of all relationships to be considered as direct investment. Both notions are not totally coincident even if they attach some similarities.

56. This section explores the differences between the notions of statistical consolidation and accounting consolidation. More specifically, it tries to identify the main differences between the statistical guidelines contained in the FCS plus related FDI methodology and the rules governing the elaboration of the companies' consolidated accounts.

57. As it has been recognised before, the direct use of consolidated accounts for the compilation of FDI statistics is not possible without some additional information. Therefore, the comparisons in this chapter are mainly intended for illustrative purposes. The identification of the differences between statistical and accounting rules concerning the scope for consolidation is meant to highlight the difficulties that compilers may encounter at the time of collecting information and providing instructions to respondents. Additionally, it is also intended to identify what kind of supplementary information would be necessary.

ACCOUNTING CONSOLIDATION

58. The request for consolidated accounts is meant to evaluate the true situation of a company with a participating interest in some other affiliates (subsidiaries and branches). The process of consolidation basically consists of attributing to the consolidated enterprise all assets and liabilities of its subsidiaries and branches, thus cancelling out all reciprocal assets and liabilities. In the profit and loss account, the consolidated enterprise is also attributed all credits and debits of the consolidated subsidiaries and branches' profit and loss statements.

59. In the balance sheet the most significant results are:

- all reciprocal participations in equity capital between consolidated enterprises (recorded in the assets side of their balance sheet) disappear after the consolidation process;
- the equity capital + reserves[19] of the consolidated enterprises (recorded in the liabilities side of their balance sheet) also disappear in the consolidation process;
- all loans and deposits between all enterprises involved in the process of consolidation also cancel out in the consolidated balance sheet;
- finally, a minority ownership item is created in the liabilities side of the consolidated balance sheet (accounting for the non-consolidated shareholders' interest). Additionally, minority (non-consolidated)

19 The profits/losses generated after the consolidated enterprises become members of the group do no longer disappear in the consolidation process.

interests in the assets side of the companies remain in the assets side of the consolidated balance sheet.

60. All other assets and liabilities of the consolidated enterprises are fully attributed to the consolidated company, even if the links of ownership between the companies do not reach 100%. In addition, the consolidation perimeter is limited to subsidiaries controlled or owned at 50% as a minimum (all branches are consolidated since, by definition, they are 100% owned by their mother companies).

61. One other aspect that may be worth mentioning is that the consolidation process may be applied at different levels of the chain of subsidiaries. Therefore, the same assets/ liabilities may be accounted for by enterprises pertaining to the same group in their respective consolidated accounts and, from a macro-economic point of view, gross figures may result magnified.

IMPACT OF THE NEW INTERNATIONAL ACCOUNTING STANDARDS (IAS) IN THE ACCOUNTING CONSOLIDATION RULES

62. The introduction new IAS may trigger some changes to the present practices:

- A major impact is that the proportional consolidation method[20] will be restricted to the cases of joint ventures.
- For subsidiaries, the 100%-consolidation method[21] will be the overall rule.
- For associates, no consolidation rules are proposed. The consolidated balance sheet just registers the value of the participation(s) ("equity method") and financial assets/liabilities directly transacted with those associates (e.g. loans), as with any other counterpart. The results are equal to those on non-consolidated balance sheets.
- The ownership threshold to define associated enterprises is 20%, i.e. differing from the 10% rule followed in FDI statistics.
- A set of supplementary tables will be added to the balance sheet containing information related to the subsidiaries and associates (limited information).

63. In the consolidated data there is still no distinction required between domestic and foreign consolidated enterprises.

STATISTICAL CONSOLIDATION: THE FULLY CONSOLIDATED SYSTEM (FCS)

64. The notion of consolidation in FDI statistics is meant to produce statistics with full coverage of all direct and indirect FDI relationships through a detailed specification of the affiliates that should be considered as subsidiaries, associates and branches, respectively. In particular, the FCS states that FDI statistics should cover all enterprises in which the direct investor has directly or indirectly a direct investment interest.

65. However, as we have seen in the first section of this chapter, the practical application of the rules established by the FCS is not an easy task. In particular, it requires a perfect knowledge of the ownership structure of the group, including the % of participation and the location (residence) of each entity as well as the availability of detailed information on assets and liabilities of each company pertaining to the group. In particular, concerning the latter point, intra-group assets and liabilities should not be consolidated so as to allow the production of gross figures, which are required in FDI statistics for analytical purposes.

20 Proportional consolidation means that assets and liabilities of the consolidated subsidiaries are incorporated to the consolidated balance sheet of the parent company only in proportion to its % of ownership.

21 The 100%-consolidation method means that 100% of the consolidated subsidiaries' assets and liabilities are incorporated to the consolidated balance sheet of the parent company, irrespective of the % of ownership.

66. The application of the FCS implies that reinvested earnings generated by directly or indirectly controlled affiliated enterprises are attributed to the parent company in proportion to its percentage of ownership, calculated throughout the ownership chain following the rules of the FCS.

DIFFERENCES BETWEEN ACCOUNTING AND STATISTICAL RULES FOR CONSOLIDATION

67. Following what has been described so far, some major differences between the two concepts can be established. This comparison is further illustrated in Table 1. The comparison of these two sets of rules is just meant for illustrative purposes and refers to the strict basic concepts used in both domains. It does not cover those cases in which compilers request supplementary information from respondents to complement information extracted from their accounting statements since, in such cases, all differences could potentially be overcome.

68. On the basis of the above analysis and the differences between both approaches, it becomes evident that the direct use of consolidated accounts (balance sheets) to compile FDI stocks without any other supplementary information is not possible. Due to the different criteria used to determine the consolidated perimeter and the different consolidation approaches (100% or proportional consolidation, respectively), it could produce either an overestimation or an underestimation of the resulting figures.

69. The geographical dimension implicit in the concept of FDI and the FCS constitutes an additional problem. The elaboration of consolidated accounts does not distinguish between domestic and foreign affiliates. Furthermore, the need to compile aggregate statistics for a group of countries integrated in a monetary union implies an additional difficulty, since international standards are mostly designed to provide methodological consistency from a purely national viewpoint (this point is further developed in the next section).

70. Therefore, although the use of consolidated accounts (or balance sheets) is accepted by international standards and offers some advantages as it offers information on more than one level of ownership, this procedure alone does not provide the necessary information to comply with statistical requirements. The use of consolidated accounts to produce FDI statistics always requires some supplementary information (e.g. on gross relationships, geographical breakdown of the counterparts, economic activity, etc), which is necessary to perform some adjustments.

71. Nevertheless, despite the evident deficiencies of directly using consolidated accounts in compiling FDI statistics, they might be a good proxy for compiling FDI equity stocks and reinvested earnings when the domestic respondent is in charge of compiling consolidated accounts for the group. In those cases, links of ownership above 50% are well covered. For compiling other FDI items, the use

Table 1 Differences between accounting and statistical rules for consolidation [1]

	Accounting rules	Statistical rules
Consolidation perimeter	≥ 50 % ownership	≥ 10 % ownership
Attribution of consolidated elements	100% [2]	In proportion to % of ownership
Breakdown by item	no	yes
Geographical breakdown	no	yes
Breakdown by counterpart	no	yes
Measurement basis	net	gross

1) This exercise is based on the accounting rules in place in a majority of countries. Such accounting rules may be different in some other countries such as, for instance, the UK and IE.
2) Exception made of minority interests.

of consolidated accounts as such is more problematic. In any case, the obligation to elaborate consolidated accounts demands a lot of information on intra-group assets and liabilities, which may be readily available to respondents and may become suitable for statistical purposes. Special care should be taken to avoid double recording.

FULL STATISTICAL CONSOLIDATION (FCS) VERSUS THE COVERAGE OF ONLY DIRECT LINKS OF OWNERSHIP

72. The complexity of a full compliance with the rules established by the FCS has been extensively mentioned throughout the report. Many countries cannot go beyond the first level of the ownership chain in their FDI statistics (see results of the questionnaire on current practices in the next section). By restricting themselves to only cover direct ("first-shot") links of FDI, those countries also try to minimise the reporting burden for respondents.

73. Such an approach implies, concerning equity stocks (above 10%) and reinvested earnings, the recording of: (i) as regards direct investment in the reporting economy, only stocks/flows vis-à-vis the foreign investor(s) that directly owns shares of the domestic DI enterprise; and (ii) concerning direct investment abroad, only stocks/flows vis-à-vis the foreign DI enterprise(s) directly owned by the domestic investor. Other capital stocks/flows and equity capital flows/stocks below 10% are attributed to the direct counterpart.

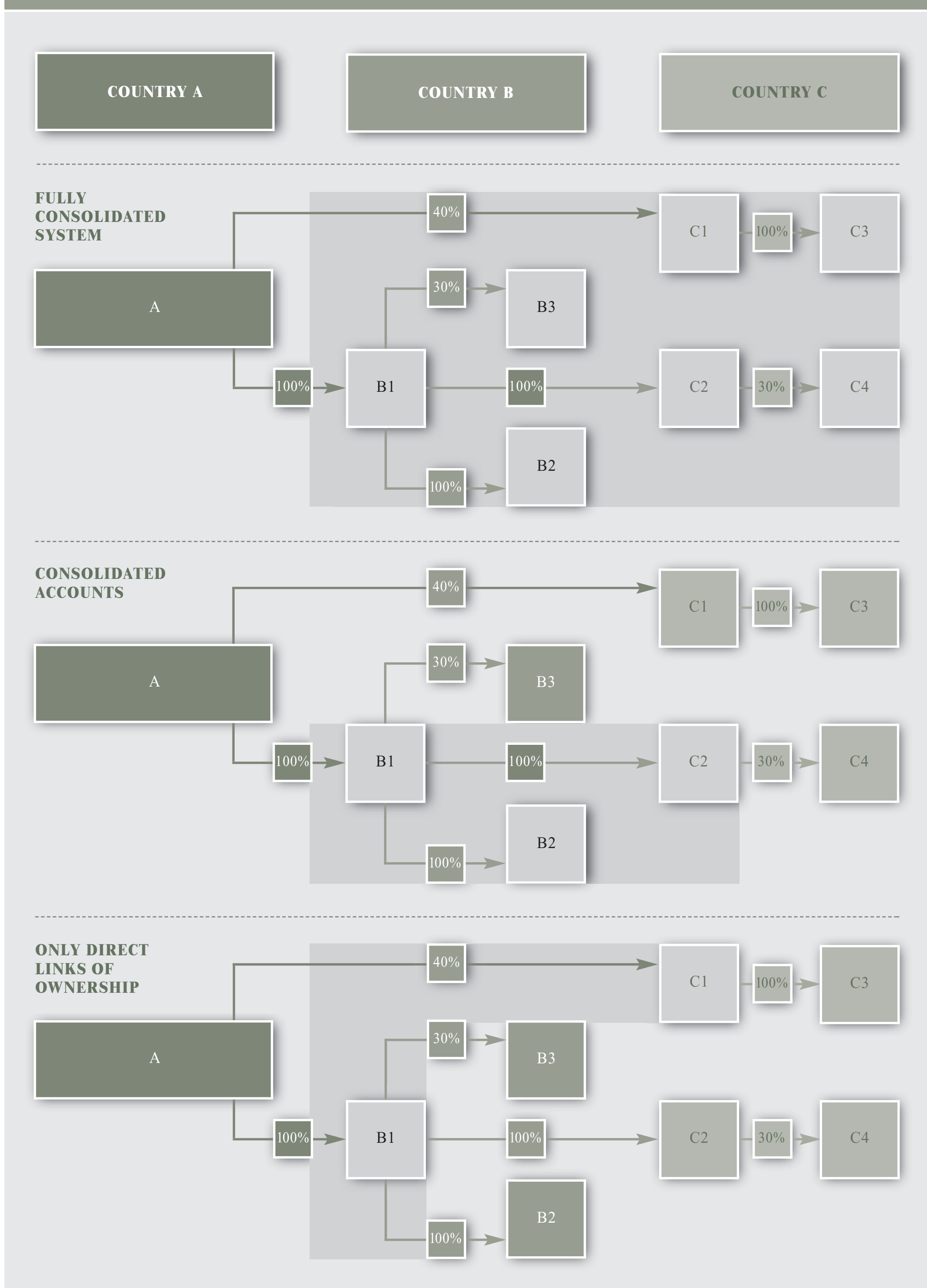
74. While this procedure is efficient, less complicated and less costly than a complete application of the FCS, it does not fully meet international standards.

COMPARISON BETWEEN (I) COVERAGE OF ONLY DIRECT LINKS OF OWNERSHIP; (II) THE "STATISTICAL CONSOLIDATION" (FCS) AND (III) THE "ACCOUNTING CONSOLIDATION" APPROACHES

75. As we have seen in the previous paragraph, the comparison between the coverage of only direct ownership links and the FCS approach reveals that both have advantages and disadvantages. This section ends with a comparative analysis of the three approaches considered so far. This comparison is purely meant for illustrative purposes, since, as previously said, while the concepts underlying the direct-ownership and the FCS/statistical consolidation approaches are meant to produce statistics, the rules governing the elaboration of consolidated accounts and its final product, i.e. the consolidated balance sheet, cannot be used to that purpose without making use of supplementary information.

76. The most important difference between the three approaches is their respective coverage, which is illustrated in Chart 6. A more exhaustive description of the pro's and con's of the three approaches is shown in Table 2. Once more, it might be convenient to underline that this comparison is made for illustrative purposes and that it does not contemplate mixed systems such as, for instance, the use of accounting data supplemented by additional information provided by respondents.

Chart 6 Diagram showing the difference in the scope of the three approaches [1]



[1] The comparison is based on the accounting rules in place in a mjority of countries. Such accounting rules may be significantly different in some other countries such as, for instance, the UK and IE.

Table 2 Comparison between: (i) direct-ownership approach; (ii) accounting consolidation; and (iii) statistical consolidation (FCS)

	1. Direct-ownership approach	2. Accounting/enterprise consolidation	3. Statistical consolidation (FCS)
Coverage	• First level of the chain of affiliates (immediate level of ownership)	• Enterprise consolidation (usually only affiliates owned at more than 50 per cent)	• Data collected for all levels of the investment chain following the rules of the FCS
		Pro's	
1. Concept	• Simplicity (> 10%)	• Simplicity (> 50%) • Acceptable approximation to international standards	• Fully compliant with international standards – FCS
2. Availability of data	• Data available and more accessible than for the other two options	• Data to some extent available (> 50 per cent ownership)	
3. Reporting burden	• Lower reporting burden for respondents • Lower costs for compiler		
4. Breakdowns	• Geographical breakdown • Activity breakdown		• Geographical breakdown • Activity breakdown
5. Data quality	• Easier to avoid asymmetries • Reliability of the available data	• Good estimate of stocks and profits • Good analytical value	• If perfectly applied, no asymmetries [1] • Best estimate of stocks, profits and income • Offers the highest analytical value
6. Feasibility	• The most feasible to implement in the short – medium term		
		Con's	
1. Concept	• Deviation from international standards	• Not fully consistent with FCS (50% consolidation perimeter, 100%-consolidation approach, etc.) • More complex for reporters than 1 • Risk of inconsistency between flows and stocks, since flows are consistent with approach 1	• Complex for reporters • Risk of inconsistency between flows and stocks, since flows are consistent with approach 1
2. Availability of the data		• Availability (problematic due to EU Regulation) [2]	• The longer the chain the more difficult to access to the data • In some cases, can even not be available
3. Reporting burden		• Reporting burden for respondents higher than alt. 1 • More costly for compiler than alt. 1	• Highest reporting burden • Highest costs for compiler
4. Breakdowns		• Difficulties to distinguish between domestic and foreign subsidiaries • No geographical break down • No activity breakdown	
5. Data quality	• Likely underestimation of equity stocks and profits • Low analytical value	• Cannot ensure a symmetric treatment (the same assets/ liabilities can be accounted for by several companies along the chain) • The 50% consolidation perimeter may underestimate results, while the application of the 100%-consolidation method may over estimate them	• Higher risk of asymmetries (as the rules are more complex)
6. Feasibility			• The least feasible to implement in the short – medium term

1) Though, as it is more complex, the risk of asymmetries is much higher than in the case of the direct-ownership approach.
2) Not all countries may have access to the consolidated accounts of their reporters, due to the specific accounting guidelines and national legislation in place in each country. In particular, some countries do not require consolidated accounts from resident enterprises if their annual accounts are consolidated into the accounts of an enterprise governed by the law of a European Economic Area (with certain exceptions).

CURRENT PRACTICES: RESULTS OF THE QUESTIONNAIRE

INTRODUCTION

77. During the constant review of current developments carried out by the TF-FDI, it became evident that there was a significant distance between theory and practice for the coverage of indirect FDI relationships. For this reason, the TF-FDI designed a questionnaire with a view to investigating current practices and the most significant problems that countries encounter to comply with international standards.

78. This section is a schematic overview of the answers provided by the TF-FDI members to the questionnaire and is structured in three parts: (i) current practices; (ii) most significant problems to cover indirect FDI relationships; and (iii) feasibility and costs of switching to an alternative system. Some other results of this questionnaire are shown in the last section of this chapter (in connection with the possible development of a European database on ownership structures as a potential information source to cover indirect FDI relationships) and in chapter 7 (statistics based on the UBO principle).

CURRENT PRACTICES

79. Countries were asked about which principle they follow to compile FDI statistics as regards the coverage of indirect FDI relationships. Four possible replies were suggested:

(i) Just cover direct links of ownership.

(ii) Use consolidated accounts as an approximation to the coverage of indirect FDI relations, without any other supplementary information. The rules applied to elaborate consolidated accounts are normally based on the national accounting regulation, which varies from country to country (specially concerning the scope for consolidation, i.e. normally 10, 20 or 50%). Normally data can not be used directly, since the geographical dimension (and breakdowns by sector of activity) is necessary. Some extra information is normally required and, thus, most (if not all) of the replies classifying their methodology under this category should rather be moved to the fourth (residual) block.

(iii) Application of the FCS as prescribed by international standards, by means of, for instance, direct information requested from respondents, calculations made by the compiler based on feedback from reporters, ITRS and other public information sources (such as annual reports, financial press and websites, Dunn&Bradstreet, etc.) From the feedback obtained from the respondents to the questionnaire, it turned out that most countries included in this category always have to admit exceptions to the full application of the FCS due to practical problems, and should thus be more properly considered under the residual category.[22]

(iv) Other methods (basically a mixture of the previous options).

80. Bearing in mind the above-mentioned reservations concerning the replies to the questionnaire, the total results of the questionnaire have been summarised in Table 3, which distinguishes between inward and outward FDI, between stocks and flows and with a split by FDI components.

22 For instance, Belgium includes associates of associates and Germany only includes indirectly related data when the direct link is above 50%.

Table 3 Coverage of indirect FDI relationships in FDI statistics (number of countries included in each option[1])

			Direct relations	Accounting consolidation	FCS	Other methods
Inward FDI	Flows	Equity capital	8	3	2	1
		Reinvested earnings[2]	6	4	2	1
		Other capital	4	3	2	5
	Stocks	Equity capital	6	4	3	1
		Other capital	4	3	2	5
Outward FDI	Flows	Equity capital	8	2	2	2
		Reinvested earnings[2]	6	2	2	3
		Other capital	4	2	2	6
	Stocks	Equity capital	6	2	3	3
		Other capital	5	2	2	5

1) All EU member states except LU, i.e. 14 responses.
2) Just 13 countries as RE are not available in the Spanish b.o.p.

81. Another issue that was investigated was the extent to which countries could distinguish between direct and indirect FDI relationships in their FDI data. The intention was to figure out how easy it could be to countries to exclude (include) indirect FDI relationships from FDI figures if a common approach was decided at the euro area/EU level. The outcome was that, for most FDI items and countries, separate figures for indirect relations are not available.

82. Additional information: only 3 countries have more information available than what is finally published: AT, BE and DE compile some data on indirect links of ownership which is not added to their publications or only at the national level (DE and AT).

– Though from the replies to the questionnaire it appeared that there is no visible difference between inward and outward FDI statistics as to whether countries do or do not incorporate indirect FDI relationships to their FDI statistics, some countries revealed later that they have more difficulties in the case of outward FDI.
– Although a majority of countries incorporate some data on indirect FDI relations to their FDI statistics, most of them cannot distinguish indirect from direct links of ownership, since these data are often derived from enterprises' consolidated accounts, in which there is no such a distinction (and it's not a current output requirement).
– Therefore, the achievement of a unique and homogeneous methodology across the EU countries concerning whether or not (and how) indirect FDI relationships should be incorporated to FDI statistics seems a difficult task in the current circumstances. Those countries which currently only consider direct relations have practical difficulties to extend their coverage so as to cover indirect FDI links. On the other hand, countries currently including such indirect links in their statistics would have serious difficulties to exclude them, since they are not separately distinguished (and would not be willing to do so, as it would be considered as a "backward" step in their methodology).

MOST SIGNIFICANT PROBLEMS TO COVER INDIRECT FDI RELATIONSHIPS

83. The most important problems identified by the questionnaire are as follows:

– Access to the relevant information: the systems to collect data on indirect relations are normally very costly and an appropriate coverage is difficult to guarantee.

– Identification of the target population, specially in the case of indirect relations below 50%.
– Timing problems, e.g. changes in ownership structures are normally not available in time.
– Difficulties to check the data collected.
– Difficulties to get more detailed data, since domestic respondents may not have access to the accounts of such indirectly related foreign affiliates.

FEASIBILITY AND COSTS OF SWITCHING TO THE ALTERNATIVE APPROACH

84. Mostly for the sake of ensuring a consistent and homogeneous way of compiling the European aggregates, it became clear that countries would need to agree on a common approach towards the coverage of indirect FDI relations. The information included in Table 3 showed that European countries are basically split into two groups: those that stick to the coverage of only direct links of ownership and those that incorporate indirect FDI relations to their FDI statistics.

85. Therefore, the respondents to the questionnaire were asked about the feasibility of changing their current system to the alternative solution. More than half of the countries declared that costs associated to such a change would be difficult to assume.

86. Another alternative that was explored was the possibility to keep on with current practices in the compilation of national statistics and just change the methodology and coverage for the contribution to the European aggregates (so that all countries applied a common methodology at the extra euro area/EU level.) That solution would imply, *de facto*, the existence of two parallel methodologies in some countries. Most countries rejected such a possibility as it was deemed not cost-effective, implied an increase in the burden on respondents and required a complete change in the legal framework.

Nevertheless, the replies to the questionnaire expressed some consensus on two points:

- *Changes could only be acceptable to the extent that (i) all countries accepted any change in parallel; and (ii) the final outcome implied a closer alignment to international standards.*

- *Any such change should be implemented within a long-time perspective, since the adptation of systems and legislation would require sufficient time lag.*

DIFFERENT CONSOLIDATION APPROACHES AND THE GEOGRAPHICAL ALLOCATION OF TRANSACTIONS AND POSITIONS: IMPACT ON THE COMPILATION OF THE EUROPEAN AGGREGATES

87. One key issue in the compilation process for the European aggregates is the need for consistency in the methodologies applied by all member states. Therefore, the existence of dissimilar consolidation approaches for the compilation of FDI statistics is a potential risk whose distortions should be carefully analysed. In addition, and in connection with the treatment of indirect FDI relationships, the geographical attribution of related flows/stocks could also trigger serious distortions in the compilation of the euro area aggregates. In particular, the existence of transactions and positions that could be recognised in the statements of several enterprises (located in different countries) pertaining to the same group could imply some risk of omissions or double recording in the European aggregates.

88. To analyse in more detail the consequences that any decision concerning the treatment of indirect FDI relationships could imply concerning the European aggregates, a more detailed example is presented in the next sub-section. Some conclusions concerning the need for a homogeneous approach and some recommendations concerning the geographical allocation of transactions and positions are presented immediately after.

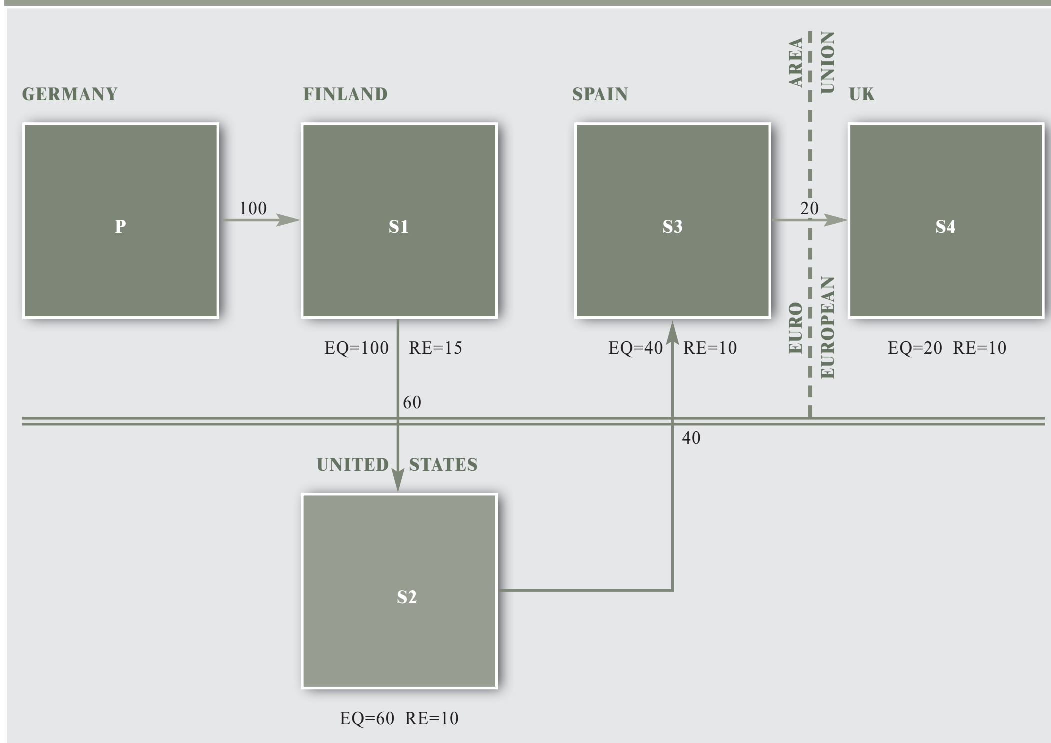
ILLUSTRATIVE EXAMPLE: DISTORTIONS THAT DIFFERENT APPROACHES TO THE COVERAGE OF INDIRECT FDI RELATIONSHIPS MAY EXERT ON THE EUROPEAN AGGREGATES

89. This example relies on the assumption that, for the sake of simplicity, two basic variants exist for the compilation of FDI statistics: (i) first shot approach (i.e. only direct FDI relationships are considered); or (ii) application of the FCS. Concerning the second alternative, for the production of FDI equity stocks and reinvested earnings the following applies:

- in the assets side (direct investment abroad), the domestic direct investor have to consider, in addition to the equity capital of the directly owned (non-resident) FDI companies, all reinvested earnings generated by such directly owned foreign companies as well as those generated by indirectly owned enterprises;
- in the liabilities side, in addition to the equity capital of the domestic FDI company, the (non-resident) direct investor is also attributed the reinvested earnings of both the domestic FDI company and its directly and indirectly owned resident and non-resident affiliates.

90. Along these lines, let us consider a multinational group, whose mother company is located in DE. The subsequent investments of the group are placed inside the euro area (FI and ES), inside the EU (UK) and outside the EU (USA) respectively, according to the diagram entitled Example 1. The figures in Example 1 reflect the situation at the end of 2001 in terms of equity capital and reinvested earnings (reserves) of the companies. The arrows represent funds flowing from the parent companies to their respective affiliates. With a view to simplifying the example, all direct investment relationships imply 100% of ownership (see Chart 7).

Chart 7 Example: multinational group with direct and indirect FDI links



- For the compilation of both national statistics and European aggregates, there might be three possible scenarios:

(ii) Scenario 1. FI applies the FCS for the compilation of FDI statistics, while DE, ES and the UK compile inward and outward FDI statistics according to the "first-shot" approach.

(iii) Scenario 2. All European countries, both inside and outside the EU, apply the FCS for the compilation of FDI statistics.

(iv) Scenario 3. All European countries compile FDI statistics according to the "first-shot" approach.

- The first scenario may resemble the current situation in the EU, while the other two scenarios may represent the two alternative solutions that could be proposed to avoid dissimilar practices in the EU, i.e. either promoting the application of the FCS across all EU countries or imposing that all countries compile FDI stocks on the basis of the first-shot approach, alternatively.

(i) According to Scenario 1 (in which only FI applies the rules of the FCS as previously described), the following entries would be recorded in national and European statistics (the details in brackets reflect whether the figures come from either equity capital or reinvested earnings and the country of location of the company originating each entry):

National statistics

– Germany
Outward FDI equity stocks *vis-à-vis FI*:
100 (EQ FI) + 15 (RE FI) = 115
Total RE *vis-à-vis FI*: 15
Inward FDI equity stocks = 0

– Finland
Outward FDI equity stocks *vis-à-vis USA*:
60 (EQ USA) + 10 (RE USA) + 10 (RE ES) + 10 (RE UK) = 90
Total RE *vis-à-vis USA*: 30
Inward FDI equity stocks *vis-à-vis DE*:
100 (EQ FI) + 15 (RE FI) + 10 (RE USA) + 10 (RE ES) + 10 (RE UK) = 145
Total RE *vis-à-vis DE*: 45

– Spain
Outward FDI equity stocks *vis-à-vis UK*:
20 (EQ UK) + 10 (RE UK) = 30
Total RE *vis-à-vis UK*: 10
Inward FDI equity stocks *vis-à-vis USA*:
40 (EQ ES) + 10 (RE ES) = 50
Total RE *vis-à-vis USA*: 10

– United Kingdom
Outward FDI equity stocks: 0
Inward FDI equity stocks *vis-à-vis ES*:
20 (EQ UK) + 10 (RE UK) = 30
Total RE *vis-à-vis ES*: 10

Euro area aggregates (only ES and FI would report transactions and positions vis-à-vis non-euro area countries):
Outward FDI equity stocks *vis-à-vis USA + UK*: 60 (EQ USA) + 10 (RE USA) + 10 (RE ES) + 10 (RE UK) + 20 (EQ UK) + 10 (RE UK) = 120
Total RE *vis-à-vis USA + UK*: 40
Inward FDI equity stocks *vis-à-vis USA*:
40 (EQ ES) + 10 (RE ES) = 50
Total RE *vis-à-vis USA*: 10

European Union aggregates:
Outward FDI equity stocks *vis-à-vis USA*:
60 (EQ USA) + 10 (RE USA) + 10 (RE ES) + 10 (RE UK) = 90
Total RE *vis-à-vis USA*: 30
Inward FDI equity stocks *vis-à-vis USA*:
40 (EQ ES) + 10 (RE ES) = 50
Total RE *vis-à-vis USA*: 10

(ii) According to Scenario 2 (in which all countries compile FDI statistics in compliance with the FCS), the following entries would be recorded in national and European statistics:

National statistics

– Germany
Outward FDI equity stocks *vis-à-vis FI*:
100 (EQ FI) + 15 (RE FI) + 10 (RE USA) + 10 (RE ES) + 10 (RE UK) = 145
Total RE *vis-à-vis FI*: 45
Inward FDI equity stocks = 0

– Finland
Outward FDI equity stocks *vis-à-vis USA*: 60 (EQ USA) + 10 (RE USA) + 10 (RE ES) + 10 (RE UK) = 90
Total RE *vis-à-vis USA*: 30
Inward FDI equity stocks *vis-à-vis DE:*
100 (EQ FI) + 15 (RE FI) + 10 (RE USA) + 10 (RE ES) + 10 (RE UK)=145
Total RE *vis-à-vis DE*: 45

– Spain
Outward FDI equity stocks *vis-à-vis UK*:
20 (EQ UK) + 10 (RE UK) = 30
Total RE *vis-à-vis UK*: 10
Inward FDI equity stocks *vis-à-vis USA* = 40 (EQ ES) + 10 (RE ES) + 10 (RE UK) = 60
Total RE *vis-à-vis USA*: 20

– United Kingdom
Outward FDI equity stocks: 0
Inward FDI equity stocks *vis-à-vis ES:*
20 (EQ UK) + 10 (RE UK) = 30
Total RE *vis-à-vis ES*: 10

Euro area aggregates:
Outward FDI equity stocks *vis-à-vis USA and UK*: 60 (EQ USA) + 10 (RE USA) + 10 (RE ES) + 10 (RE UK) + 20 (EQ UK) + 10 (RE UK) = 120
Total RE *vis-à-vis USA + UK*: 40
Inward FDI equity stocks *vis-à-vis USA*:
40 (EQ ES) + 10 (RE ES) + 10 (RE UK) = 60
Total RE *vis-à-vis USA*: 20

European Union aggregates:
Outward FDI equity stocks *vis-à-vis USA*: 60 (EQ USA) + 10 (RE USA) + 10 (RE ES) + 10 (RE UK) = 90
Total RE *vis-à-vis USA*: 30
Inward FDI equity stocks *vis-à-vis USA* = 40 (EQ ES) + 10 (RE ES) + 10 (RE UK) = 60
Total RE *vis-à-vis USA*: 20

(iii) According to Scenario 3 (in which all countries compile FDI statistics according to the first-shot principle), the following entries would be recorded in national and European statistics:

National statistics

– Germany
Outward FDI equity stocks *vis-à-vis FI*:
100 (EQ FI) + 15 (RE FI) = 115
Total RE *vis-à-vis FI*: 15
Inward FDI equity stocks = 0

– Finland
Outward FDI equity stocks *vis-à-vis USA*:
60 (EQ USA) + 10 (RE USA) = 70
Total RE *vis-à-vis USA*: 10
Inward FDI equity stocks *vis-à-vis DE* = 100 (EQ FI) + 15 (RE FI) = 115
Total RE *vis-à-vis DE*: 15

– Spain
Outward FDI equity stocks *vis-à-vis UK*:
20 (EQ UK) + 10 (RE UK) = 30
Total RE *vis-à-vis UK*: 10
Inward FDI equity stocks *vis-à-vis USA* = 40 (EQ ES) + 10 (RE ES) =50
Total RE *vis-à-vis USA*: 10

– United Kingdom
Outward FDI equity stocks: 0
Inward FDI equity stocks *vis-à-vis ES:*
20 (EQ UK) + 10 (RE UK) = 30
Total RE *vis-à-vis ES*: 10

Euro area aggregates:
Outward FDI equity stocks *vis-à-vis USA + UK*: 60 (EQ USA) + 10 (RE USA) + 20 (EQ UK) + 10 (RE UK) = 100
Total RE *vis-à-vis USA + UK*: 20
Inward FDI equity stocks *vis-à-vis USA:*
40 (EQ ES) + 10 (RE ES) = 50
Total RE *vis-à-vis USA:* 10

European Union aggregates:
Outward FDI equity stocks *vis-à-vis USA*:
60 (EQ USA) + 10 (RE USA) = 70
Total RE *vis-à-vis USA*: 10
Inward FDI equity stocks *vis-à-vis USA*:
40 (EQ ES) + 10 (RE ES) = 50
Total RE *vis-à-vis USA*: 10

CONCLUSIONS FROM THE EXAMPLE

91. It is evident that the results obtained following the three approaches are remarkably different, from the point of view of both national statistics and European aggregates. The example is not necessarily overly realistic, specially concerning the proportion of earnings generated by each affiliate, which has been exaggerated for illustrative purposes.

92. Bearing this in mind, the results obtained are presented in Table 4. The net FDI position (outward – inward FDI equity stocks) of the euro area would be 70, 60 and 50 according to the three scenarios. For the EU, the results of the three scenarios would be 40, 30 and 20. As regards the net flows (i.e. credits minus debits) of annual reinvested earnings in the euro area b.o.p. the three scenarios would register 30, 20 and 10, respectively, while for the EU, they would be 20, 10 and 0 (see Table 4).

93. The main conclusions that can be extracted from these results are summarised as follows:

(i) Scenario 1 (dissimilar approaches across countries)

National statistics

- Global results cannot be deemed consistent across countries due to heterogeneous practices.

- Net results (outward – inward FDI) are not comparable across countries.

- There is no symmetry between counterpart countries recording the same FDI stocks/flows.

- The risk of double attribution of reinvested earnings generated by indirectly owned FDI companies in assets (outward FDI) by more than one country without a counter entry in liabilities (inward FDI) exists.

European aggregates

- Reinvested earnings of indirectly owned enterprises could be recorded several times or missing in the European aggregates without appropriate counter entries in liabilities (inward FDI), depending on whether the contributing countries apply or not the FCS for the compilation of FDI statistics.

Table 4 Summary of the results

		Euro area			EU		
		Scenario 1	Scenario 2	Scenario 3	Scenario 1	Scenario 2	Scenario 3
Equity stocks	Outward	120	120	100	90	90	70
	Inward	50	60	50	50	60	50
	Net	70	60	50	40	30	20
Reinvested earnings	Outward	40	40	20	30	30	10
	Inward	10	20	10	10	20	10
	Net	30	20	10	20	10	0

– Net results (outward – inward FDI) will, thus, be distorted[23]

94. Obviously, the first scenario (which could be rather close to reality) implies many worrying consequences on both national and, specially, on European statistics. Additionally, the lack of a common methodology does not enable a transparent approach vis-à-vis users, as practices differ among countries. A logical conclusion would be that a common solution should be promoted and applied by all EU countries. Such a common solution could be coincident with either scenario 2 or scenario 3. Let us analyse the consequences of each scenario, without entering into how feasible each one could be on practical grounds.

(ii) Scenario 2 (all countries compile FDI statistics according to the FCS)

National statistics

– Global results are comparable due to homogeneous practices

– Net results (outward – inward FDI) are also comparable across countries.

– Counterpart countries record the same FDI transactions/positions in a symmetric way.

– Reinvested earnings generated by indirectly owned FDI enterprises are recorded by more than one country, thus implying larger gross figures (i.e. inward and outward FDI).

– Since companies in the middle of a chain will record the same amounts in assets and liabilities, there will be no impact on the net.

European aggregates

– Reinvested earnings of indirectly owned enterprises would be recorded several times in the gross FDI figures of the European aggregates. Therefore, inward and outward FDI will register larger figures than in scenario 3.

– Net results (outward – inward FDI) are not distorted, since reinvested earnings of indirectly owned companies are recorded more than once in the assets side, but are also recorded in liabilities by companies in the middle of a chain, so that the net FDI just registers reinvested earnings once.

(iii) Scenario 3 (all countries compile FDI equity stocks on the basis of non-consolidated accounts)

National statistics

– Global results can be deemed consistent across countries, since all of them follow homogeneous practices

– Counterpart countries record the same FDI transactions/positions in a symmetric way.

– Net results (outward - inward FDI) are comparable across countries.

– However, the net results are not correct according to international standards and are different than in scenario 2 due to the non-recording of reinvested earnings generated by indirectly owned FDI enterprises. Whether the impact on the net results is positive or negative (compared with scenario 2) cannot be ascertained a priori.

European aggregates

– Reinvested earnings of indirectly owned enterprises are not recorded. Therefore, gross (inward and outward) FDI figures are lower than in scenario 2.

– Net results (outward – inward FDI) are not conceptually correct and different than in scenario 2. Whether the impact on the net results is positive or negative (compared with scenario 2) cannot be ascertained a priori.

23 In the example, the reinvested earnings generated by the UK company are recorded twice in outward FDI (accounted for by both ES and FI), while they are omitted in inward FDI, since ES does not follow the FCS.

THE GEOGRAPHICAL ALLOCATION OF RELATED FLOWS/STOCKS

95. In addition to the above-mentioned problems, the way in which these transactions/ positions are broken down geographically may even imply further distortions for the European aggregates.

96. For instance, according to scenario 3, let us assume that all countries attribute all entries to the ultimate counterpart. In that case, the b.o.p./ i.i.p. of both Finland and Germany would record extra-euro area entries under FDI abroad (assets) accounting for the reinvested earnings generated by the company located in the USA. Since the b.o.p./i.i.p. in Finland would record those reinvested earnings in liabilities against Germany (i.e. as an intra euro area flow/stock), only the (extra euro area) asset entries would be recorded in the euro area aggregates, thus implying a distortion in both gross and net euro area figures. Similar distortions would occur in the case of the reinvested earnings generated in UK or ES.

97. These distortions could be avoided if all countries attributed all FDI flows and stocks to the "first shot" counterpart, i.e. according to the location of the directly related affiliates, in the case of outward FDI, and according to the location of the non-resident investor, in the case of inward FDI.

CONCLUSIONS AND RECOMMENDATIONS

SIMPLIFICATION PROPOSALS TOWARDS THE COVERAGE OF INDIRECT FDI RELATIONSHIPS

98. Chapter 1 established that compliance with international standards implies that indirect FDI relationships should be effectively incorporated to FDI statistics. The review of current practices has revealed how difficult this is on practical grounds. EU member states do not currently follow a homogeneous approach, since they are basically split into the group of countries that only cover direct FDI relationships and those other that also cover indirect relationships (to different extents).

99. The illustrative example analysed in this chapter proved that the current situation (similar to scenario 1 considered in the example) is very harmful for the quality of the European aggregates. Therefore, a common solution should be agreed concerning whether or not (and to which extent) indirect FDI relationships should be part of FDI statistics.

100. Given the numerous practical difficulties revealed, the TF-FDI considers that a full application of the FCS by all countries is unfeasible on practical grounds. Therefore, the only two possible alternatives for a common approach at the EU level seem to be: (i) that all countries cover just direct (first-shot) FDI relationships; or (ii) to fix a bottom line concerning the minimum indirect FDI relationships that all countries should be in a position to cover in the medium term.

101. The first alternative (only cover direct FDI relationships) has the advantage of simplicity and a lower burden on respondents (which are obliged to report less information) and, in same cases, also on compilers. In addition, and mainly from the point of view of the compilation of supranational aggregates, this approach would suffer from fewer problems concerning the geographical allocation of flows and stocks. Conversely, the main problem of this approach is that the results obtained would not be fully compliant with international standards and the outcome would offer a somewhat lower analytical value, specially considering the increasing role of special financial vehicles, clearing centres, etc. in the investment strategy of multinational groups.

102. The second alternative would consist of establishing a bottom line for the coverage of indirect FDI relationships that all countries should be in a position to surpass. Such a minimum common approach would narrow down the risk of asymmetries and would reduce the impact on the European aggregates of the different methodologies applied in member states. The most important difficulty would be

the exploration of practical ways for collecting the necessary information, since the longer the chain of links between companies, the more difficult it is to get access to the balance sheet of foreign subsidiaries with no direct link to the domestic mother company. For this reason, a simplification of the rules described in the FCS could reduce the obstacles existing to apply the "statistical consolidation" approach.

103. Some testimonies in the TF-FDI pointed towards the significant proportion represented by FDI relationships above 50% over the total FDI figures. Additionally, this information is more easily available to domestic respondents in those cases in which there is an obligation to compile consolidated accounts. Therefore, it was concluded that efforts should aim at appropriately covering at least this kind of links.

104. Against this background, the TF-FDI considered that two simplification approaches should be deemed acceptable minimum common standards for the coverage of indirect FDI relationships and could, thus, constitute the bottom line that all countries should reach in the medium term:

(i) The coverage of indirect links of ownership above 50%.[24]

(ii) The coverage of direct and indirect links of ownership above 10%, calculated as the product of the subsequent links of ownership along a chain.

GEOGRAPHICAL DISTRIBUTION OF FDI FLOWS/STOCKS RELATED TO INDIRECT FDI LINKS

105. The illustrative example analysed in this chapter revealed some problems that non-fully harmonised criteria for the geographical allocation of transactions and positions related to indirect FDI links of ownership could entail for the quality of the European aggregates. In order to avoid such possible distortions, the following recommendations should apply:

– Reinvested earnings should be geographically allocated to the immediate affiliate (direct investment abroad) or immediate mother company (direct investment in the reporting economy), i.e. the one with which the investor/direct investment enterprise maintains a direct link of ownership. This criterion should apply irrespective of whether the retained profits are actually generated by a different counterpart along the chain of ownership.

– Likewise, FDI equity stocks should be attributed to the immediate affiliate (DI abroad) direct investor (DI in the reporting economy) even if, in some cases, a substantial part of the total value may be generated by indirectly linked enterprises further down in the ownership chain.

106. It is acknowledged that these criteria may result in less valuable statistics from the analytical viewpoint. For this reason, the TF-FDI would encourage countries to collect and publish additional information on the geographical allocation of FDI flows and stocks based on the residence of the ultimate beneficial owner, whenever such information were not too difficult to obtain (see chapter 7).

EUROPEAN DATABASE ON OWNERSHIP STRUCTURES

INTRODUCTION

107. In connection with the coverage of indirect FDI relationships, the TF-FDI mandate stated that possible solutions to the problem of obtaining information on group structures should be examined with reference also to the costs that they would entail.

108. Some relevant information is often publicly available in annual reports, media, commercial data providers, etc. Besides these information sources, the idea of sharing information through a common platform, such

24 All direct links of ownership above 10% would still need to be covered.

as a centralised database to be used by European compilers, has been suggested in several occasions. To some extent this initiative could resemble for direct investment the envisaged role of the Centralised Securities Database in the area of portfolio investment.

109. The TF-FDI analysed the issue from two different points of view: (1) from the point of view of potential data providers; and (2) from the point of view of users of the information. The first aspect is further developed in the first section, in connection with a number of national studies carried out by the TF-FDI on the basis of the information currently available to NCBs. The second aspect has been considered in the framework of the information received by the TF-FDI right before its last meeting concerning an ongoing project to develop a European Business register, which, at that time, was under consideration by Eurostat and the ECB.

(1) NCBS AS POTENTIAL DATA PROVIDERS

RESULTS OF THE SURVEY ON INDIRECT RELATIONSHIPS

110. The questionnaire on indirect FDI relationships mentioned at the beginning of this chapter sought the TF-FDI members' views with regard to the willingness of MS to participate in a European register of multinational ownership structures as potential data providers, from a fairly general perspective. All countries but 3 would agree to provide the data. Most of them would only be willing to update the data provided to such a European database on an annual basis.

111. Finally, some problems were identified, basically linked to confidentiality constrains, need to adapt national legislation, requirement for additional resources, and need to develop a common platform with international identification codes as a necessary prerequisite.

112. To sum up, most countries could deliver the data on an annual basis on certain conditions, namely:

– if its usefulness is studied before any product is launched;

– if confidentiality is ensured;

– if an appropriate legal framework is foreseen.

RESULTS OF THE SUB-GROUP ASSESSING THE FEASIBILITY OF FEEDING A EUROPEAN DATABASE ON OWNERSHIP STRUCTURES

113. With a view to further exploring the feasibility of such a centralised database containing information on ownership structures within multinational groups, four countries (FR, ES, DE and IT) studied whether or not and how they could contribute to the project. In particular, the four countries studied at which frequency and with which information they could contribute to the feeding of the database, how costly it could be and which main obstacles would require a way out.

114. The main findings of the countries participating in the study can be summarised in the following blocks:

Type of information available

– DE: 2 databases for trade statistics. 130.000 resident/60.000 non-resident enterprises covered respectively

– ES: external loans register. Cover all non-banks receiving/granting a loan from/to abroad.

– FR: FDI register of FR companies including their links with non-resident entities.

– IT: no such register is currently available. The UIC is currently running a research project to study the feasibility of maintaining a business register for the compilation of FDI statistics in IT. Some of the sources under investigation are Istat, Dun & Bradstreet, CERVED, CONSOB and Foreign Trade Institute/R&P.

Specific problems to each country

- DE: the two main problems are (i) the lack of ownership information in the data currently available in the trade databases; and (ii) confidentiality rules for the treatment of the information.

- ES: the main problem would be the additional costs that ensuring quality would entail, since the use of ownership information is fairly limited at present and, therefore, is not exhaustively checked.

- FR: the two main concerns would be: (i) how to ensure confidentiality; and (ii) the additional costs that it could entail.

- IT: difficult to answer at the current stage, since no such information is currently available.

General problems of the project

- Problems previously mentioned by some of the countries (non-availability of the data, how to ensure confidentiality, need for additional resources, costs, etc.)

- Technical problems to adapt the information that should be available in the database to the structure of multiple and different national collection systems.

- Most public sources only cover listed enterprises. How to obtain information for non-listed enterprises would require a much harder and deeper investigation.

- History dimension would be required, i.e. the specific situation of each individual group at different time periods should be maintained in the database so as to allow the compilation of statistics across time.

- The existence of individual identification codes (e.g. ISIN) for each enterprise is an absolute must to permit the development of such a database.

Overall conclusions

- The existence of a centralised database with information about the structure of multinational groups would be seen as a very useful tool for the compilation of FDI statistics.

- However, a number of significant problems have been identified. Some of these problems are deemed difficult to overcome.

- A very preliminary estimation of the costs has revealed that they could be high.

(2) NCBS AS POTENTIAL USERS OF THE INFORMATION

115. As stated in the introduction, at its last meeting the TF-FDI received information on a project of the Eurostat's Business Statistics Directorate which, at that time, was under consideration. The project basically consisted of the development of a pan-European business register including information on the multinational groups' ownership structure for statistical purposes. The project would be based on an update of Regulation (EC) No 2186/93 of 22 July 1993 on Community co-ordination in drawing up (national) business registers for statistical purposes.

116. Due to the late notice at which the TF-FDI received information on this project, it was not possible to consider in more detail its potential usefulness for the purposes of the compilation of FDI statistics. However, as stated in the previous subsection, the TF-FDI recognised the numerous practical difficulties that the collection of this type of information may entail from the individual country perspective.

117. For this reason, The TF-FDI is of the opinion that a harmonised and multilateral solution should be highly welcome from the point of view of users of the possible products that such a database could put at the disposal of FDI compilers. Given the above-mentioned time constrains, it was not possible to further

consider how the TF-FDI could contribute to such a project.

For this reason, as a follow-up work to the TF-FDI, it is suggested that other bodies, for instance, the ECB's WG-BP&ER and the Eurostat's Balance of Payments WG, elaborate the list of user requirements which would permit that the final product could be used for the compilation of FDI statistics.

3 VALUATION OF FDI EQUITY STOCKS[25]

INTRODUCTION

118. In the recent years, different issues related to the valuation of foreign direct investment (FDI) equity stocks have been considered in several fora. Following thorough investigation, in 2001 the ESCB Statistics Committee (STC) and the Working Group on Balance of Payments and External Reserves Statistics (WG-BP&ER) reached some conceptual agreements related to the general rules that should guide the valuation of these stocks in the euro area international investment position (i.i.p.). Some practical difficulties to implement these decisions were recognised, inter alia, the time schedule for putting these agreements into practice.

Following its mandate, the TF-FDI exclusively considered the valuation criteria approved by the STC and, thus, solely focused on how to apply the agreements reached by the STC on practical grounds. Other valuation methods, such as macroeconomic revaluation indexes or current-cost methods as presented by the USA in the November 2002 IMF BOP Committee, are not considered in this chapter.

119. Within the above-described framework, the TF-FDI carried out an analysis of the current state of play. Based on this analysis, at the end of this chapter the TF-FDI addresses some conclusions and recommendations, putting special emphasis on their applicability. All issues related to the use of consolidated accounts for the valuation of FDI equity stocks (in particular, whether the common definition of OFBV should be applied on consolidated or on non-consolidated accounts of the direct investment enterprises) have been already tackled in the previous two chapters. In particular, the TF-FDI addressed recommendations on how to incorporate indirect links of ownership to the total book-value-based FDI equity stocks.

120. This chapter is in three sections. The first one contains a brief summary of the main related decisions adopted by the STC and the WG-BP&ER. The second section summarises the answers of the countries to the questionnaire on current practices and future prospects related to the valuation of FDI equity stocks (Table 5 further illustrates the answers received from all countries). Finally, section three presents an overview of the results of the national feasibility studies carried out within the TF-FDI concerning the viability of producing separate figures for listed and non-listed companies and of collecting two different valuations (book values and market values) for FDI in listed companies. The compilation of FDI stocks at T+9 months is separately covered in Annex 1.

RELATED DECISIONS ADOPTED BY THE STATISTICS COMMITTEE AND THE WORKING GROUP ON BALANCE OF PAYMENTS AND EXTERNAL RESERVES

121. In the course of 2000, the STC considered the distortions exerted by the wide range of valuation criteria applied by European Union Member States for the compilation of FDI equity stocks. The lack of a single set of valuation rules was acknowledged as an important source for inconsistencies in the construction of the euro area aggregate. For this reason, the STC considered the provision of clearer guidance as a high priority, with a view to identifying common rules for the valuation of FDI equity stocks to which all Member States should converge in their contributions to the euro area aggregate.

122. At the time of deciding on the most appropriate valuation rules, the analysis of international standards was not fully conclusive. While both the IMF Balance of Payments Manual (5th edition) and the OECD Benchmark Definition of Foreign Direct

25 The analysis in this chapter did not cover the valuation of FDI equity stocks arising from real-state investments. Due to the impossibility to send FDI surveys to the non-resident owners of real state in the country (nor to domestic households acquiring properties abroad), it was concluded that the accumulation of flows could be a reasonable solution for this specific case.

Investment generally recommend the use of market (i.e. stock exchange) prices, in the absence of such market prices (i.e. for non-listed DI companies), other alternatives are admitted. Even the use of book values for the valuation of FDI in listed companies is not conclusively ruled out in either manual.[26]

123. Considering that most difficulties are linked to the valuation of FDI companies when their shares are not quoted on the stock exchange, the STC decided that the following criteria would be the basis for the valuation of the euro area inward and outward FDI equity stocks in the future:

- *FDI in listed companies' shares shall be valued on the basis of stock exchange prices;*

- *FDI in non-listed companies' shares shall be valued on the basis of book values, assuming the lack of any appropriate market reference for these companies.*

124. In defining these criteria, the STC felt that, whereas the concept of "stock exchange price" was straightforward, a common definition of "book values" was needed, notably to avoid asymmetries between assets and liabilities. Indeed, book values for outward DI could often be interpreted as accounting values in the investors' books (in many cases coinciding with "historical prices"), while for inward DI, stocks are usually valued on the basis of the domestic FDI company's own funds.

125. Therefore, the STC decided that the common definition would exclusively be based on the value of the FDI company's own funds. It was considered that the price recorded in the balance sheet of the direct investor (i.e. the acquisition/historical price) hardly reflects the evolution of the price of the company through time due to the strict valuation rules usually in place in accounting.

126. The subsequent work consisted in finding out which accounts *on the liabilities side of the direct investment enterprise's balance sheet* should be considered when assessing the total value of the company based on its volume of own funds, i.e. its own funds at book value (OFBV). Then, the calculation of FDI equity stocks would consist of applying the percentage of ownership of each direct investor to the company's worth calculated this way. Following this approach, the valuation of DI stocks should show some consistency with the evolution of the true value of the company.

Book values should be understood as the % of ownership of the direct investor times the value of the DI company based on its volume of own funds, which should be calculated according to the following definition of OFBV:

- *Paid-up capital (net of own shares).*

- *All types of reserves (including shares premium accounts and investment grants).*

- *Net value of non-distributed profits and losses (including results for the current year).*

127. Moreover, in order to further improve euro area FDI statistics, the STC envisaged producing two memorandum items for the total (i.e. without sector or geographical breakdowns) inward and outward FDI equity stocks:

(i) FDI equity stocks on the basis of book values (for all types of FDI companies), mostly to ensure continuity in the time series; and

(ii) FDI equity stocks marked-to-market (for all types of FDI companies), mostly to provide users with some complementary information

26 Paragraph 377 of the BPM5 reads: "Although this Manual, in concordance with the SNA, affirms the principle of using market price as the basis for valuation, it is recognized that, in practice, book values from the balance sheets of direct investment enterprises (or investors) often are used to determine the value of the stock of direct investment." This paragraph seems to implicitly admit this valuation and does not make any distinction between listed and non-listed companies.

for analytical purposes and as a proxy for the reconciliation with financial accounts statistics (shares and other equities item).

128. For the practical implementation of all these proposals, euro area Member States should take the following steps: (i) split the reporting of the equities item within FDI in the euro area and FDI abroad between listed and non-listed companies; and (ii) report to the ECB FDI in equities of listed companies on the basis of both market and book values (following the agreed common definition of OFBV).[27] The valuation of FDI in listed companies on the basis of book values should be twofold: as direct input for the first memorandum item and for the calculation of ratios market value divided by book value, which could form the basis for the production of the second memorandum item.

129. After in-depth discussion, Member States identified several practical difficulties in carrying out these principles. Indeed, it was recognised that practical problems may already be affecting the compilation of FDI stocks at present. Some countries may have difficulties to apply the common definition of OFBV especially in the case of FDI abroad due to the difficult access to the details required about non-resident FDI companies. The next section provides some indications on how other countries have managed to (or plan to) overcome such practical problems to implement these agreements.

RESULTS OF THE QUESTIONNAIRE ON VALUATION OF FDI EQUITY STOCKS

130. Following the fact-finding exercise on the collection of direct investment stocks (September 2000)[28], the sub-group designed a new questionnaire to investigate current practices of Member States and possible plans concerning the applicability of the STC decisions on valuation of FDI equity stocks. Twelve out of the thirteen participating countries sent the completed questionnaire. Ireland and Luxembourg, which did not participate in the work of the TF-FDI from its inception, were not questioned.

131. The main answers to the questionnaire are summarised in Table 5 (see next page).

DISTINCTION BETWEEN LISTED AND NON-LISTED COMPANIES

132. Nine countries (DK, ES, FR, IT, AT, PT, FI and GR) are able to (directly) distinguish between listed and non-listed companies for inward stocks and five countries (DK, FR, IT, PT, FI) for outward stocks. One country (DE) plans to make this distinction for both inward and outward stocks beginning with figures at end-2002. Three countries (NL, SE, UK) do not have any plans. One country (BE) uses a ratio based on the market capitalisation of listed companies compared to the total capitalisation of both listed and non-listed companies to provide inward stocks broken down between listed and non-listed companies.

Practical solutions

(i) Five countries, namely DK, IT, FI as well as FR and PT (for outward stocks) rely on information provided by respondents to make this distinction.

(ii) In the case of inward stocks, four countries (AT, PT, FI and GR) use registers of resident listed companies maintained by stock exchange authorities, at least for cross-checking purposes (FI).

(iii) Only two countries (IT, FR for inward stocks) use internal security databases to know about companies' status.

(iv) When the information is not provided by respondents and no register exists or is

27 These requests only apply to step-2 aggregates. Step-3 breakdowns should only be provided using market values for listed companies and book values for non-listed companies. No rules have been specified for step-1 figures (i.e. national data).

28 See document ST/WG/BP/DISQUEST.DOC "Collection of direct investment stocks: outcome of the questionnaire", 30 October 2000.

Table 5 Questionnaire on the valuation of direct investment stocks – summary table

	Distinction between listed and non-listed companies		Application of some form of consolidation	Possibilty to provide stocks on a non-consolidated basis	Valuation of DI stocks in non-listed at book value	Application of the WG-BP&ER agreed definition of OFBV	Valuation of DI stocks in listed companies at market value	Source of information to compile marked-to market stocks
	Inward stock	Outward stock						
Belgium	yes	no	yes	yes	yes	yes	yes	Adjusted cumulated flows
Denmark	yes	yes	yes	yes	yes	yes	yes	Respondents
Germany	yes (beginning with figures at end 2002)	yes (beginning with figures at end 2002)	yes	yes	yes	yes	yes (beginning with figures at end 2002)	Respondents (beginning with figures at end 2002)
Spain	yes	no	yes	no	Partially (inward stock in the MFI's sector)	Partially	Partially (inward stocks in the MFI's sector)	Stock exchange prices
France	yes	yes	no	-	yes	yes	yes	Security database + other publicly available information
Italy	yes	yes	yes	no	no (perpetual inventory method) yes (FDI survey)	no (perpetual inventory method) yes (FDI survey)	yes/no (respondents can report book values if market values not available)	Perpetual inventory method + respondents
Ireland	yes	yes	yes	no	no	yes	yes	Stock exchange prices
The Netherlands	no	no	yes	no	yes	yes	yes/no (respondents can decide for themselves wether they use book or market value)	Respondents
Austria	yes	no	no	-	yes	yes	yes (inward stock only)	Stock exchange prices
Portugal	yes	yes	no	-	yes	yes	no	-
Finland	yes	yes	yes	no	yes	yes	yes	Respondents
Sweden	no	no	yes	no	yes	yes	no	-
United Kingdom	no	no	no	-	yes	yes	no	-
Greece	yes	no	yes	yes	yes	yes	yes	Stock exchange prices

available (case of outward stocks), the distinction is made manually (e.g. AT) by means of internal security databases and publicly available sources (mostly financial press and stock exchange web sites) to identify listed companies.

The TF-FDI considers that all these solutions may be deemed valid to obtain the split between listed and non-listed companies and, thus, no prioritisation among them is provided in this report.

133. As regards the proportion of listed companies out of the total direct investment stocks, few countries were able to provide data. The ratio of the number of listed direct investment companies to the total number of DI companies varies widely, from 0,7% to 12,2% at the end of 2000 (inward FDI stocks). In proportion of the total amount of the stock, the variance is even greater (from 0,8% to 25%). Similar results were found concerning the stock of outward FDI.

APPLICATION OF THE "CONSOLIDATED SYSTEM"

134. The possible use of consolidated accounts for the compilation of FDI statistics was extensively covered in the previous chapter. The questionnaire only raised the question of the application of the "fully consolidated system" or of any other form of consolidation by Member States.

135. Eight countries (BE, DK, DE, ES, IT, FI, NL, SE) say they apply, at least partially, the "consolidated system" as described in the OECD FDI Benchmark Definition of Foreign Direct Investment, but few give precise answers regarding their methodology. GR does not fully apply the FCS but, whenever indirect FDI relations are identified, they are taken into consideration in the FDI figures.

136. In some cases, consolidated data are compiled on the basis of accounting consolidation (e.g. for inward FDI in Finland). However, the extent to which this is the case, the principles underlying the concept of "consolidation" in each country and whether all these facts may constitute a problem of consistency in the European aggregates could not be investigated sufficiently in detail on the basis of the answers to the questionnaire.

VALUATION OF STOCKS IN NON-LISTED COMPANIES

137. All but three countries, namely IT, GR and ES (partially), say they are able to compile direct investment stocks in non-listed companies at book value, applying the WG-BP&ER agreed definition of own funds at book value. It was not clear to the countries though whether such a definition should apply to consolidated or to non-consolidated balance sheets. Hence different applications by countries may be a source of asymmetries. The clarifications provided through the previous two chapters should help overcome such asymmetries in the future.

VALUATION OF STOCKS IN LISTED COMPANIES

138. Nine countries (BE, DK, ES, FR, IT, NL, AT, FI and GR) declare being able to compile, at least partially, direct investment stocks in listed companies at market value.

Practical solutions

(i) *Four countries (ES for inward FDI stock in the banking sector, FR, AT and GR) use an individual valuation method based on stock exchange prices and, in the case of FR, the combination of an internal securities database + other publicly available information.*

(ii) *Four countries (DK, IT, NL and FI) rely on information provided by respondents to compile marked-to-market stocks, while one country (DE) plans to do so in the future.*

(iii) *In two cases though (IT, NL), it seems that respondents may report stocks at either book or market value depending on the available information, which could impede the compilation of consistent stocks using one or the other valuation method.*

(iv) In three cases (BE, IT and ES partially), this valuation is made using a perpetual inventory method ().

The TF-FDI considers than (i) and (ii) can be deemed valid solutions, while (iii) and (iv) are not recommended.

139. The two main obstacles for compiling marked-to-market stocks for listed companies are, first, the difficulty to identify listed companies among foreign direct investment companies and, second, the difficulty to gain access to stock exchange prices for these companies. The future Centralised Securities Database – CSDB – may however help to solve this problem, allowing an individual valuation of FDI stocks in listed companies.

140. Among countries that do not apply the STC decision to compile marked-to-market direct investment stocks for listed companies yet, three (BE, DE, ES) plan to change their collection systems. One country (PT) says it will rely on available sources and on new assessment exercises to comply. Other countries (NL, SE, UK) do not have any plans as regards this issue.

141. Six countries (IT, BE, ES, NL, SE, UK) would have difficulties in providing FDI stocks on the basis of two different valuation principles, i.e. book value and market value, for listed companies. All of them stressed the additional costs such a requirement would imply. The next section presents a more detailed analysis on the feasibility of combining these two calculations for FDI in listed companies' shares.

NATIONAL FEASIBILITY STUDIES ON HOW TO COMPILE FDI IN LISTED COMPANIES' SHARES ON THE BASIS OF BOTH MARKET VALUES AND BOOK VALUES

INTRODUCTION

142. One of the most significant difficulties declared by EU countries at the time of implementing the STC agreements on the valuation of FDI equity stocks was related to the collection of FDI in listed companies. The implementation of the STC agreements required that FDI in listed companies' shares should be valued twice, on the basis of both book values (based on the common definition of OFBV) and market values. For this reason, the TF-FDI investigated, on the one hand, how some countries may currently collect this information and, on the other hand, how the other countries would plan to change their collection systems to accommodate this request.

143. Some countries participating in the TF-FDI decided to carry out individual national feasibility studies (NFS) in order to determine whether collecting two valuations for FDI in listed companies was feasible and outline a tentative assessment of costs, if possible. For countries already collecting this information, the intention was to seek ideas on how this can be done and how costly/feasible it is.

144. Against this background, the countries which volunteered to carry out these feasibility studies were classified into three different categories, on the basis of their current state of play:

(i) Countries currently compiling FDI data for listed companies on the basis of both market values and book values. FI, DK, FR and GR (the latter for inward FDI) pertained to this group.

(ii) Countries not currently compiling both valuations, but with solid plans to do so in the near future. PT declared to be in this situation.

(iii) Countries neither compiling both values at present nor with concrete plans yet, but able to evaluate how feasible and costly it would be. BE and ES volunteered to prepare a joint assessment from this starting point.

145. The next subsections introduce the results of these NFS. At the end, a global assessment addresses some overall conclusions on the basis of the feedback reported by the participating countries.

(I) COUNTRIES CURRENTLY COMPILING FDI DATA FOR LISTED COMPANIES ON THE BASIS OF BOTH MARKET VALUES AND BOOK VALUES

DENMARK

Implementation

146. When we began compiling book value as well as stock-exchange value (market value) for listed companies we only had to make a few changes in our procedures:

– add two fields in our database, one for direct investments in DK and one for Danish direct investments abroad

– add two fields in our questionnaire and our corresponding excel-file

– adapt the changes in guidelines concerning the questionnaire

147. In fact very small changes were necessary. The costs were small, because we produce an updated questionnaire, an updated excel-file and updated guidelines for the survey every year.

Practice

148. We ask the companies to provide us with information on the book value of FDI equities in all types of companies as well as on the market value of FDI equities if the company is listed. Information on ownership share, name of the stock exchange where the company is listed or the ISIN-code is not requested.

149. The questionnaire is sent to respondents in March every year.

Problems

150. We do not have very detailed information about the listed companies and where the company is listed. We rely on the respondents' information.

Future plans

151. We plan to change our collection system from reference year 2003 or 2004. Our plans include more detailed information about listed companies.

FINLAND

152. In the annual direct investment surveys, the data on both the book value and the market value of listed direct investment enterprises are collected. The published time series for FDI position data are still based on book values.

153. The data request for the market value was added to the inward and outward FDI surveys from the reference year 2000. The evaluation of the costs, related to the addition of market value data to the surveys, is not possible.

Inward investment

154. In the annual inward FDI survey, the resident listed direct investment enterprises report the total book value and the market value of equity capital and the direct investor's ownership percentage.

155. The survey is addressed only to the directly foreign-owned enterprises.[30] The equity capital at book value is based on the

30 Therefore, it does not cover market value data of any possible foreign indirectly-owned listed enterprise. Such possible subsequent investments are supposed to be considered by the markets at the time of assessing the stock exchange price of the first-shot FDI company.

consolidated accounts of the directly foreign owned enterprise and the indirectly foreign owned enterprises are supposed to be covered this way. [31]

156. The register of resident listed companies maintained by the resident stock exchange authorities is used to check the quality of the survey data. Both the information publicly available on market prices of listed enterprises and their annual reports are used to check the quality of the survey replies. With a few years' experience, respondents seem to report the market value data with high quality.

157. As to inward investment for 2000, there were 23 resident direct investment listed companies which represented 8.3 per cent of the total inward equity stock at book value.

Outward investment

158. In the annual outward FDI survey, the resident direct investors report the total book value and the market value of the foreign listed direct investment enterprises and the direct investor's ownership percentage.

159. The survey covers both directly and indirectly owned direct investment enterprises and the data collection method gives us the opportunity to get data on the market value of both directly and indirectly owned listed direct investment enterprises.

160. The respondents can provide data on equity capital by individual foreign direct investment enterprise. They are also allowed to give consolidated sub-group replies, where one foreign direct investment enterprise is the parent enterprise of the sub-group. If the direct investment enterprise is listed, we insist on getting the sub-group reply with this listed enterprise as the parent company.

161. Within these few years, the respondents have not reported market value data with care. For the moment no appropriate quality control methods are available. We are dependent on how carefully the respondents want to reply. Only the quality of the data on very large investments mentioned in the financial press can be checked.

162. As to outward investment for 2000, there were 17 foreign direct investment listed companies which represented 7.9 per cent of the total outward equity stock at book value.

FRANCE

163. FR currently collects just book values from reporters. The compiler subsequently calculates market values using other publicly available sources. This method enables to compile two different values for FDI equity stocks without increasing the reporting burden weighing on respondents. It however entails some shortcomings.

Current practices

164. The current process for compiling marked-to-market FDI stocks is not fully automated yet, but should be in the future. Methods differ for inward and outward FDI stocks.

– Inward stocks

165. Data on inward stocks are compiled using various databases, first to identify direct investment companies and then to get their accounting data. There is no specific stock survey.

166. The population of resident direct investment companies at the end of a given year is defined as the population at the end of the previous year, plus resident companies that have been acquired by non-resident direct investors during the year, minus direct investment companies that have been sold by their non-resident direct investors. A database of resident direct investment companies, including data on shares of ownership, is

31 See previous chapter on consolidation.

maintained by the Balance of Payments Directorate of the Banque de France.

167. Once the whole population of resident direct investment companies has been identified, balance sheet data are mostly downloaded from an internal database on French companies maintained by another Directorate of the Banque de France. These data are used to compile inward direct investment stocks at book value.

168. The distinction between listed and non-listed companies is currently made manually, by using a security database and other publicly available sources (mostly financial press). The possibility to use the national identification number of each French company ("SIREN") in an automated way to search for the ISIN code of the company's shares (when it exists) has been investigated and will be implemented in the data processing system in order to be operational at the end of 2004. When a company has been identified as listed, its market value is retrieved from the above-mentioned security database.

– Outward stocks

169. Outward direct investment stocks are collected via an annual survey conducted by Banque de France branches, which gather information on companies located within their respective areas. Respondents are asked to provide us with the book value of their foreign affiliates, following the common definition of OFBV agreed by the WG-BOPER.

170. The distinction between listed and non-listed companies is here again made manually, on the basis of the names of the foreign direct investment companies and using various sources (security database, financial press or stock exchange web sites). Since this method is both time-consuming and imperfect, the possibility to collect information on the status (listed/non listed) of the direct investment companies is currently under consideration.

171. When a company has been identified as listed, its market value may be obtained from the above-mentioned sources.

Advantages / shortcomings of these methods

– Advantages

(vi) The system enables to compile both book and market values for listed companies.

(vii) Very limited information is required from respondents. In fact, nothing is directly collected from resident companies to compile inward direct investment equity stocks.

– Shortcomings

(viii) The distinction between listed and non-listed companies is both time-consuming and imperfect. Because it is made manually, thresholds are applied.

Future plans: possible ways of improvement

– Inward stocks

172. The process of distinguishing between listed and non-listed companies will be automated in 2004, using the link between the identification number of French companies ("SIREN") and the ISIN code in the securities database.

– Outward stocks

173. The new survey (which will be operational as of 2004) will contain a question on whether or not the foreign direct investment company is listed. Moreover, the survey will ask directly two values.

GREECE

174. In the annual direct investment survey (as of data corresponding to end-1997) the respondent enterprises provided information only on the basis of book values. GR started compiling both book and market values for

inward FDI on listed companies from end-2001 positions.

175. The whole process is fully automated and consists of, firstly, the identification of listed FDI companies and, subsequently, a special computer program is applied taking into account the end of period stock exchange prices and the equity capital information provided by respondents.

176. The set-up cost and the operational cost for calculating market values were small since these changes were part of a general project of computerising the process of collecting and processing the i.i.p. data. So far there no special problems have been encountered in the whole process.

177. As far as outward FDI data is concerned, such information is also collected through an annual survey using a business register. The respondent enterprises report only book values and there is no distinction made between listed and non-listed companies but there are plans to manually identify listed companies.

COUNTRIES NOT CURRENTLY COMPILING BOTH VALUATIONS, BUT WITH SOLID PLANS TO DO SO IN THE NEAR FUTURE

PORTUGAL

178. Annual information on both book and market values is collected through the FDI stocks surveys. Concerning the series available for market valuation, no stability can be found for the outputs obtained since the type of information requested has varied along the years. For the time being, no control has been made to the answers provided.

179. Recently, in the context of the joint-work developed within the Banco de Portugal for the Working Group on Unquoted Shares (WG-US), and with a view to obtaining a first assessment regarding the practical implementation of the STC recommendation the TF-FDI is dealing with, we have tried to develop a test exercise on the answers provided under the last surveys and some additional sources of information were evaluated as well.

180. Assets and liabilities were assessed differently, provided their specifications, namely by ranking in a different way the sources of information.

Inward direct investment

181. Information on the market value and the percentage of participation was asked in 2001, under the last inward stocks survey. Only banks and insurance companies were approached with this aim, for data concerning 1999 and 2000. Replies to these questions were never checked before, and therefore, for the time being, no use was made of them.

182. Recently, under the test exercise made for the WG-US, a new source of information was additionally tested for gathering the market value of direct investment enterprises: information on quotations made available by the Euronext Lisbon (Stock Exchange).

183. As a result of the comparison exercise made the last month, we can say that answers provided in the survey by banks and insurance companies for their market value are of quite good quality, when compared with information provided by the Stock Exchange.

Future plans:

- This issue was only tested once;
- Quality control on the replies to this type of questions in the FDI survey must be improved;
- A methodology of production needs to be defined;
- This type of questions still need to be extended for non-financial enterprises and re-defined for banks and insurance companies;

– It requires the definition of new procedures in terms of regular production;

– Supplementary sources of information should be taken into account, namely news, annual reports of companies and publicly available information on market prices.

Outward direct investment

184. Through the outward stocks survey, the resident direct investors report information on the market value of their direct participation abroad, quotations, number of owned shares and percentage of participation. This information is supplied to the Banco de Portugal since 1998. For the time being, replies to these questions were not carefully checked, provided no supplementary information was available to this end.

185. Regarding the market valuation of direct investment enterprises located abroad, use was also made recently of the information available for some European Indexes, namely for the Stoxx 600 companies and the Stoxx 50 index companies, which were disseminated under the test exercise of the WG-US. Additionally, some further investigation was made on the information available for some stock exchange markets of countries where there is a significant stock of Portuguese direct investment.

Future plans:

– Further investigation is needed on the way how to proceed;

– Accessibility to additional stocks exchange markets should be studied. However, efforts will be concentrated on the most important markets evaluated in terms of Portuguese FDI;

– Quality control and check procedures have to be defined;

– Supplementary sources of information should be taken into account, namely news, annual reports of companies and publicly available information on market prices.

Additional comments (for both Inward and Outward)

186. The test exercise was performed on the direct participation in equity. According to the directional principle, there are reverse relationships on equity, which were, in the exercise, excluded. Being however insignificant, further definition is needed on this issue.

187. The information collected through the FDI stocks surveys is based on the accounts of the resident direct investment company, for inward FDI, and the non-resident direct investment company, for outward FDI, the last being reported by the resident direct investor.

188. The book value of either inward or outward FDI is calculated from the direct participation, as collected through FDI stocks surveys. No indirect relationship is covered. Consolidated accounts are also requested in the surveys for both outward and inward FDI, but no use is made of them.

(III) COUNTRIES NEITHER COMPILING BOTH VALUES AT PRESENT NOR WITH CONCRETE PLANS YET

BELGIUM

Possibilities for the collection of the necessary information

– Direct Investment in BE

In the survey it could be questioned whether an enterprise is listed and if so, where it is listed, for instance:

– Is the resident company listed?
  Yes No
– On which stock exchange
  Euronext
  Nasdaq Europe
  Elsewhere namely

The market value can be calculated based on the number of shares (cf. CD-ROM "Data on standardised annual accounts") and the stock exchange value (financial papers).

– Direct Investment abroad

– Is the non-resident company listed?
  Yes No
– On which stock exchange?
– Number of shares?
– Stock exchange value on the last day of the reference year ?

Timing

189. In April 2003, the survey is sent to collect data related to the reference year 2002.

Problems

190. It will be difficult to check whether or not a company is listed in the case of direct investment abroad.

Double reporting by listed companies

191. As mentioned before, the market value of listed companies can be calculated based on the extra data that will be asked in the future. In fact, listed companies do not really have to double report but report as in the past (just book values) and deliver some extra information so that we can calculate the market value ourselves.

SPAIN

– Direct Investment in ES

192. In the absence of an FDI survey, FDI stocks in ES for non-financial sectors are currently being compiled by accumulating b.o.p. flows.

Split between listed and non-listed companies:

"Other Sectors". We plan to use the information provided by our future new data collection system on tradable securities.

"MFIs". We already have this information available from accounting statements.

Double valuation:

"Other Sectors". Only the market value would be available.

"MFIs". Market value and book value would be available.

– Direct Investment abroad

Split between listed and non-listed companies:

"Other Sectors". We plan to use the information provided by our future new data collection system on tradable securities.

"MFIs". Information available from accounting statements.

Double valuation:

"Other Sectors". Only the market value would be available.

"MFIs". Market value and book value would be available.

Timing

193. For the MFI sector, the new sources of information will be available next year. The processing, checking and analysis of the new data would require additional time and effort. In the case of the new data collection system for tradable securities, the data will not be available before January 2004.

Problems

194. The new system for tradable securities will only provide information on market values. We have no survey implemented. This makes almost impossible to have information on book values related to the non-financial sector of the economy. The evaluation of the costs and

timing of implementing an FDI survey is, at the moment, not possible.

CONCLUSIONS

195. The six countries which conducted the NFS may fairly represent the situation of all euro area countries concerning the eventual collection of data on FDI in listed companies on the basis of two different valuation methods. Some of them already collect this information, while some others will have to introduce some changes in their collection systems in order to cope with the need to produce the necessary data.

196. The main lessons from the countries currently compiling this information can be summarised as follows:

– FR is currently the only country trying to compile FDI stocks both at book value and market value without requesting two values from respondents and by using other available information (security database and financial press). This process of compiling FDI stocks at market value is however imperfect and time-consuming, as it is not fully automated. For that reason, FR will modify its collection system for outward FDI in order to collect directly the necessary information. For inward FDI, the treatment will be automated. Both systems will be available at the end of 2004.

– Two countries directly collect the information on both book and market values from reporters, by including additional questions in their FDI surveys. The cost of introducing such additional questions was not deemed too high (although FI could not provide a precise assessment).

– For inward FDI, information collected from reporters can be cross-checked with data gathered from the domestic stock exchange.

– Most difficulties are linked to the implementation of plausibility checks to the stock exchange prices collected from reporters for non-resident direct investment companies (i.e. for outward FDI in listed companies), due to the lack of direct access to information on foreign markets' quotations.

197. As regards the country not currently collecting this information but with plans to do so in the near future (namely PT), the main conclusions could be the following:

– Annual information on both book and market values can be collected through the FDI stock surveys.

– For inward direct investment, information on the market value and the percentage of participation can be collected as part of the surveys.

– The results can be checked with information on quotations in the domestic stock exchange. Such checkings have revealed that the answers provided in the survey are of good quality.

– For outward direct investment, the survey may get information on the market value of direct participation abroad, quotations, number of owned shares and percentage of participation.

– Answers are not so easy to check due to the lack of supplementary information. The use of European Indexes as well as information from additional stock exchange markets could be considered to this aim.

– Supplementary sources of information should be taken into account, namely news, annual reports of companies and publicly available information on market prices.

– Reverse relationships on equity could constitute a problem

198. Concerning countries neither currently collecting this information nor with concrete plans, the following conclusions may summarise the outcome of the NFS conducted by the participating countries:

- The use of current information sources should be promoted to the extent possible.

- The most feasible way of compiling the additional information required could be the introduction of additional questions to the FDI surveys. For inward FDI, this additional information could be combined with data gathered from the domestic stock exchange.

- In the absence of FDI surveys, the use of MFIs' balance sheets may be an alternative solution for the MFI sector's FDI. Direct investment by the "other sectors" would still require an alternative solution, which does not seem straightforward without pure FDI surveys.

From the outcome of the NFS conducted by the three groups of countries, the TF-FDI adopted the following conclusions and recommendations:

- *The collection of FDI equity stocks for listed companies on the basis of two different valuation methods (market values and book values on the basis of the common definition of OFBV) can be deemed feasible for countries running FDI surveys.*

- *For those countries, it does not imply adding too much to costs.*

- *The most feasible way to collect this information would be the addition of supplementary questions to the FDI surveys.*

- *For outward FDI, where no access to quotations in foreign stock exchanges may be possible, resident reporters should be directly questioned through the FDI survey.*

- *For those countries that, in the absence of FDI surveys, would require collecting additional information, the use of current information sources could be promoted to the extent possible as a temporary solution until FDI surveys may be introduced and produce alternative results.*

- *For inward FDI, the availability of stock exchange quotations could be used as either an additional information source aimed at reducing respondents' burden or to double-check the accuracy of the information gathered from respondents.*

4 REINVESTED EARNINGS

INTRODUCTION

199. The TF-FDI was mandated to "…review the practical aspects of the compilation methods for reinvested earnings (declaration by respondents, calculation by the compilers, interim estimations etc.)."

200. The core objective, as stated in the mandate, is to identify "best practices" and recommend their implementation in order to minimise dissimilar treatments within EU Member States for balance of payments flows as well as international investment position stocks. Particular attention should be paid to the accuracy of the geographical allocation.

201. As a further guidance, the ECB WG-BP&ER and the Eurostat BoPWG, at their respective meetings in March 2003, stated that "the Current Operating Performance Concept (COPC) should be the reference concept for the compilation of reinvested earnings. It was also stressed that for the practical application of this concept, some simplification may be needed in order to avoid excessive costs. Additionally, the WG-BP&ER encouraged the TF-FDI to further examine the practicalities in compiling aggregates (in particular as regards 'extraordinary profits' and any possible distinction between financial and non financial corporations).

202. Reinvested earnings (RIE) is often referred to as a transaction category *per se*. It is, however, a function of two variables: profit from current operations and dividends payable. What should be recorded in the current account and which affects the GNI is the amount of total profits (both distributed and undistributed) from current operations. The calculation of RIE serves mainly one purpose for the b.o.p., namely to estimate an offsetting entry in the financial account, FDI, which is necessary firstly to avoid net errors and omissions effects and secondly to contribute to the reconciliation of stocks and flows. (There is of course also an analytical interest to study the reinvested part of the profit in relation to the total profit.)

203. Any study of RIE will, as a consequence, focus on the two components rather than on the RIE residual. This is also the case for the work carried out by this TF-FDI.

204. The chapter is structured as follows: it starts by presenting international standards as regards reinvested earnings, total profits and payable dividends as well as some clarifications provided by the TF-FDI to the contents of some of these concepts. The second section reviews current practices so as to monitor to which extent international standards are applied as well as the main deviations observed. This review of current practices is carried out through the findings of a questionnaire circulated to the members of the TF-FDI on the characteristics of their current collection systems. Thereafter, an additional section analyses the impact that the introduction of new international accounting standards (IAS) will most likely have in the compilation of FDI statistics. The final section recapitulates the main problems and causes of asymmetries and presents some proposals based on best practices.

205. Issues connected to the international recommendations regarding consolidation have been treated in the first two chapters of the report and are, thus, no further developed in this chapter.

INTERNATIONAL STANDARDS CONCERNING REINVESTED EARNINGS AND CLARIFICATIONS ADOPTED BY THE TF-FDI

206. The definition of reinvested earnings can be found in the OECD Benchmark Definition of Foreign Direct Investment (paragraph 28):
– For subsidiary and associate companies: "the direct investor's share of the total consolidated profits earned by the company and its subsidiaries and associates in the period covered, after allowing for tax, interest and depreciation, less dividends due for payment to the direct investor in the period even if these dividends relate to profits earned in earlier periods".

– For branches: "[…] total profits earned by the branch in the period covered, after allowing for tax, interest and depreciation, less earnings remitted in the period even if these relate to profits earned in earlier periods".

207. The Balance of Payments Manual (5th edition) of the IMF also provides a definition (§ 278):"Reinvested earnings comprise direct investors' shares – in proportion to equity held – of (i) earnings that foreign subsidiaries and associated enterprises do not distribute as dividends and (ii) earnings that branches and other unincorporated enterprises do not remit to direct investors. (If that part of earnings is not identified, all branch earnings are considered, by convention, to be distributed.) Thus, reinvested earnings may be calculated as the entrepreneurial income (net operating surplus) of the direct investment enterprise, plus any income or current transfers receivable, minus any income or current transfers payable. The latter include any current taxes payable on income, wealth, etc."

208. These definitions are consistent with ESA95/SNA93. Appendix 1 contains a summary of the treatment of reinvested earnings in national accounts and data about the impact of net reinvested earnings on Member States GNI[32].

209. Thus, for subsidiaries and associates, reinvested earnings are calculated as the difference between total profits of the direct investment enterprise and dividends distributed by the direct investment enterprise. The treatment of profits and dividends in FDI statistics is developed hereafter.

210. Profits: the BPM5 and the Benchmark recommend the use of the Current Operating Performance Concept (COPC) to measure the earnings of direct investment enterprises. According to the BPM5, the COPC includes income from normal operations of the enterprise (net of depreciation allowances and of other transfers) and does not include any realised or unrealised holding gains or losses arising from valuation changes and write-offs[33].

211. Counter to the COPC, the so-called all-inclusive concept includes in the calculation of income all items (therefore also capital gains/losses and write-offs) causing any increase or decrease in the shareholders' or investors' interests during the period, other than dividends and any other transactions between the enterprise and its shareholders or investor (BD, §31).

32 Neither BPM5 nor SNA 93 provide guidance on the application/non-application of the accruals concept with respect to direct investment income. In particular, if a direct investment enterprise is sold at the beginning of the year (or acquired at the end of the year), this is normally not taken into account in the calculation of total reinvested earnings, which are based on annual results and do not take into account how many months the enterprise was part of the total FDI stock. This may be a source of asymmetries, in particular vis-à-vis the United States which does apply this principle for income associated with acquisitions/disposals recorded during the period under review.

33 See BPM5 §285 for a long list of examples: "Direct investment earnings are measured on the basis of current operating performance. Operational earnings represent income from normal operations of the enterprise and do not include any realized or unrealized holding (capital) gains or losses arising from valuation changes, such as inventory write-offs; gains or losses on plant and equipment from the closure of part or all of a business; write-offs of intangibles, including goodwill, because of unusual events or developments during the period; write-offs of research and development expenditures; losses on the write-offs of bad debts or on expropriation without compensation; abnormal provisions for losses on long-term contracts; and exchange-rate-related gains and losses. Unrealized gains or losses resulting from the revaluation of fixed assets, investments, and liabilities and any realized gains or losses resulting from the disposal of assets or liabilities should be excluded from direct investment earnings; that is, gains should not be added in and losses should not be deducted. In addition, valuation changes resulting from unforeseen obsolescence, catastrophes, and depletion of natural resources are treated as holding losses at the times that the decreases in values actually occur. Because data for many countries are available only on an all-inclusive basis, when holding gains and losses and other extraordinary income are included in reported earnings, those countries that report earnings on either an operating basis or all-inclusive basis should collect and publish supplementary information on holding gains and losses and other extraordinary items. This practice would enhance international comparability for both flows and stock positions."

212. Turning to the COPC, whereas the exclusion of holding gains and losses is clearly stated in the methodology[34], the reference to „income from normal operations“ made in §285 of the BPM5 may lead to ask the question if it is possible to identify categories of income (as distinct from holding gains) that should be excluded from the COPC because they do not refer to the normal operations of the enterprise.

213. The TF-FDI discussed the case of financial income (interest and dividends being the main categories) for a manufacturing firm. The BoP textbook clarifies this point in §411, where it states that reinvested earnings equal Operating profits (operating revenue minus operating expenses) plus current transfer receivable, interest receivable, dividends receivable and the enterprise's share of reinvested earnings of any subsidiary or associated enterprises, minus taxes due for payment, other current transfer payable, interest payable and dividends payable[35]. Therefore financial income is included as a component of the COPC and the concept of "income from normal operations" should not be equated with concepts such as "operating profits" or "operating surplus".

214. The case of financial institutions was also discussed. In particular, it was asked whether it is possible to isolate holding gains and losses on financial assets. Most of the members of the TF-FDI considered that when these gains and losses are regarded as normal activity by the reporting financial company it is very difficult in practice to obtain separate information from the respondent. In addition, in the case of MFIs, the separate distinction of holding gains and losses may prove extremely difficult in practice.

215. The TF-FDI also discussed the treatment of goodwill, particularly as concerns write-off and depreciation of existing goodwill. In §285, the BPM5 explicitly lists "write-offs of intangibles, including goodwill, because of unusual events or developments during the period" among the cases that should be excluded from the COPC because they represent holding losses. Concerning the yearly allowances for depreciation of goodwill, §286 of the BPM5 refers to depreciation, without distinction between tangibles and intangibles assets, as an element that should be included in the calculation of the COPC.

216. Dividends: according to BPM5 (paragraph 287) dividends payable to the non-resident shareholders (direct investors and portfolio investors) must be recorded gross of any withholding taxes. In practice, it is often the company itself that pays the taxes to the tax authorities of the country in which it operates and, subsequently, distributes the dividends to the non-resident shareholders net of tax. In such cases a correction should be ideally made so that dividends be considered as being paid in full to the non-resident shareholders by imputing a counter-entry (for the amount of tax) as a current transfer (credit). Likewise, a correction should be made for dividends receivable.

217. Time of recording: dividends should be recorded as of the date they are declared payable. According to BPM5, dividends are to be recorded "as of the date they are payable." This recommendation could be misunderstood to mean the dates on which dividends are "due for payment." This issue is addressed in the

34 Besides the paragraph quoted in the previous footnote, see also §409 of the BoP Textbook: "Capital gains and losses do not constitute income and therefore are not included in the calculation of enterprise earnings. Examples of capital gains are the sudden discovery of natural resources; the revaluation of fixed assets; and increases, which are due to changes in exchange rates or to higher stock exchange quotations for these assets, in the market value of financial assets. (…)". The general definition of holding gains can be found in the SNA93 (3.62) "Positive or negative nominal holding gains may accrue during the accounting period to the owners of financial and non-financial assets and liabilities as a result of a change in their prices. (…) Holding gains may accrue on assets held for any length of time during the accounting period, not only on assets held at the beginning or end of the period". The BD also specifies that the exclusion of all classes of realised and unrealised gains/losses applies also to banks and financial intermediaries (§33).

35 It is understood that interest paid and received from affiliated enterprises (direct investor or direct investment enterprise according to the direction) are recorded separately in the balance of payments and should not be double counted when measuring reinvested earnings (see also § 410 of the BoP Textbook)

IMF Balance of Payments Textbook which uses the terms "declared payable"[36], in accordance with the accrual principle for the time of recording dividends. However, the BD (§28) recommends that dividends should be recorded as they are "due for payment". The issue of differing recommendations of the BPM5 and BD on the time of recording dividends was addressed in earlier discussions of the OECD WPFS where it was agreed to align the concepts with the recommendations of BPM5, and therefore that dividends should be recorded on the date they are declared payable by the company distributing them.

218. However, in practice many countries deviate from this standard and record dividends at the time they are paid. Point 16 of the last release of the summary results of the IMF/OECD SIMSDI can be quoted here: "The SIMSDI survey questionnaire focused on determining the number of countries that were using a paid (cash) basis for measuring dividends, as compared with the 'payable' basis. The results indicate that the majority of OECD countries record dividends as of the date they are paid. This departure from the accrual principle is largely a result of the primary data source used for recording FDI income data – a large number of these OECD countries rely on an international transactions reporting system for recording dividends flows and, as this is basically a settlement-based reporting system, it mostly provides information on a cash basis. Largely for this same reason, about half of the OECD countries record interest on a paid basis, instead of as it is accrued".

219. Provision of funds to cover losses: Another aspect discussed by the TF-FDI in relation with dividends was the treatment of funds provided by parent companies to their affiliates to cover losses that some countries record as negative dividends. The prevalent opinion was that these transactions should be treated in the financial account (under FDI/equity capital) rather than in the current account (either as negative dividends or in a separate item). Losses are supposed to have had an earlier impact in the current account (as well as in the financial account and in the value of equity stocks) as long as reinvested earnings (on a COPC basis) are calculated as a net figure between total ordinary profits (net of losses) and dividends paid. The provision of money to cover those losses makes the value of the direct investment company return to its original magnitude, thus offsetting the temporary loss of value resulting from the losses registered by the company. Therefore, the recording as a new direct investment transaction seems appropriate. The reference here is §374 of the BPM5.

220. Exceptional dividends: the TF-FDI also discussed the treatment of dividends paid by multinationals as a consequence of exceptional capital gains. Reference was made to the case of *liquidating dividends*. According to BPM5 §290, "liquidating dividends are excluded from *investment income* because such dividends represent returns of capital contributions rather than remittance (distribution) of earnings. Therefore, liquidating dividends should be recorded in the financial account as withdrawals of capital."

221. In some countries, the treatment adopted for liquidating dividends is extended to some cases of dividends received and paid by large multinationals. Such dividends are paid out as an extra bonus to shareholders and stem from immense capital gains after the sale or liquidation of an affiliate. These dividends are not related to any form of operational income and are therefore not included in FDI income. Since the capital gain at the origin of the dividend is not recorded under total profit because of the application of the COPC, there is no impact on reinvested earnings.

36 Refer to paragraphs 397 and 406 of the IMF *Balance of Payments Textbook*, 1996.

222. Support for the treatment of dividends as described above can be found in IMF's Government Finance Statistics Manual (GFS), §5.87:

When payments are received from public corporations, it can be difficult to decide whether they are dividends or withdrawals of equity. Dividends are payments a corporation makes out of its ongoing productive activities. A corporation may, however, smooth the dividends it pays from one period to the next so that in some periods it pays more in dividends than it earns from its productive activities. Such payments are still dividends. Distributions by corporations to shareholders of proceeds from privatization receipts and other sales of assets and large and exceptional one-off payments based on accumulated reserves or holding gains are withdrawals of equity rather than dividends.

223. Further support for this treatment is also found in ESA 95 Manual on Government Deficit and Debt (4.b The Notion of Dividend).

224. Other participants in the TF-FDI mentioned some counter-arguments to this treatment. In the first place, the identification of exceptional dividends in the sense defined above may not be easy and may contain some elements of arbitrariness. Secondly, for countries in which these dividends are received rather than paid, it is likely to be impossible to distinguish the various cases and so these dividends would be recorded in the current account. This would give rise to an asymmetrical treatment of this type of dividends between the two countries involved.

CURRENT COLLECTION AND COMPILATION METHODS FOR REINVESTED EARNINGS IN THE EUROPEAN UNION

225. The sub-group on reinvested earnings designed a questionnaire circulated to the members of the TF-FDI as part of a fact-finding exercise on methods and practices used, problems encountered and plans for the future. The main answers to the questionnaire are summarised in the *summary table* next page.

226. The replies to the TF questionnaire on reinvested earnings indicated the following situation: FI, IE, the NL, SE and the UK apply the COPC, while AT, DK, FR, DE, IT and PT apply the all-inclusive concept. MS applying the COPC reported to base their calculation on surveys conducted on the enterprise and on possible contacts with the respondent aiming at clarifying the nature of particular entries. MS applying this approach mainly concentrate on the most important reporters. These companies have the largest effect on extraordinary items and are, therefore, mostly approached individually. Smaller companies can also be approached though.

227. BE and ES do not publish reinvested earnings from collected data and therefore the questions on the concept used for total profits at the enterprise level did not apply. RIE for BE (BLEU up to 2002) have been estimated for 2000 and 2001. ES covers RIE only for MFIs and is planning to estimate the remaining part.

Table 6 Questionnaire on reinvested earnings – summary table

			Concept	Relations	Collection of profits	Collection of dividends	Geo break-down	Revisions	
	Include RIE	Different calculations inward/ outward	Opera-tional (O) All-inclusive (A)	Direct Indirect	Census Sample Full estimation	ITRS Surveys, direct reporting Estimation	Available Estimated according to stocks Limited	Final data for 2002 ready in:	Plans
Austria	yes	no	A	Direct	Census	ITRS	Available	2004 June	Improve timeliness
Belgium	yes	yes	O (inward) A (outward)	Direct	Estimate	Estimate	Limited	2003 Sep.	Enlargement survey
Denmark	yes	no	A	Direct	Census	Survey/DR	Available	2004	More detailed data on profits/losses and paid dividends
Finland	yes	no	O	Direct, indirect	Sample	Survey/DR	Available	2003 Sep.	
France	yes	no	A	Direct	Census	ITRS	Estimated	2004	
Germany	yes	no	A	Direct	Census	ITRS	Available	2004 Feb. 2005 Feb.	
Italy	yes	no	A	Direct	Sample	ITRS	Estimated	2003 May	
Netherlands	yes	no	O	Direct, indirect	Census	Survey/DR	Available	2004	April 2003 direct reporting system
Portugal	yes	no	A	Direct	Sample/cen	ITRS	Estimated	2004	Improve timeliness and reduce frequency of surveys
Spain	no								
Sweden	yes	no	O	Direct, indirect	Sample	Survey/DR	Estimated	2004	Jan. Dividends asked in annual survey
United Kingdom	yes	no	O	Direct	Sample	Survey/DR	Estimated	2004 Jan.	
Greece	no (until 2002)	no	A	Direct	Census	ITRS	Available	Q1 2004	Calculate data for 2002 and use of COPC for 2003 data

Total profit

228. Most of the MS including RIE in the Balance of Payments calculate these data on the basis of annual surveys on the (annual) total profit combined with short-periodic data collection of (e.g. monthly) dividends. BE, however, uses estimation techniques without the support of data collected.

229. The annual surveys are carried out either with a census approach (with a cut-off threshold applied) or as sample surveys.

Table 7 Census/cut-off

Country	Cut-off	Direct/indirect relations
Austria	EUR 72,000 – shareholding	Direct
Denmark		Direct
Germany	mEUR 3 – balance sheet total	Direct
France		Direct
Netherlands		Direct and indirect
Portugal	For non-financial enterprises, 90% of previous stock has to be covered, new investments since then are added	Direct

Table 8 Sample surveys

Country	Sampling basis	Direct/indirect relations
Finland	Size inward/outward stock, main economic activity	Direct and indirect
Italy	Volume of assets, geographical area, economic sector	Direct
Sweden	Size inward/outward stock, main economic activity	Direct and indirect
United Kingdom		Direct

230. BE bases the estimation of profits on balance sheet data and structural business survey for inward FDI and applies a ratio for the estimation of outward.

231. FDI by individuals are included – at least partially/in principle – by AT, DE, IT, the NL, PT and SE.

DIVIDENDS

232. Most countries collect the data on dividends on a monthly/quarterly basis, mostly when paid as a result of the settlement systems used.

233. The SIMSDI summary table (Table 7) below shows that all EU MS record dividends at the time they are paid, except SE and IE. In the TF questionnaire, FI specified that in the case of “huge dividends” these are recorded at the time they are declared payable.

Table 9 Time of recording of FDI income transactions

Countries that record:	Dividends as of the date they are: Payable	Paid	Other
Austria	no	yes	no
Belgium	no	yes	no
Denmark	no	yes	no
Finland	no	yes	no
France	no	yes	no
Germany	no	yes	no
Greece	no	yes	no
Ireland	yes	no	no
Italy	no	yes	no
Luxembourg [2]	no	yes	no
Netherlands	no	yes	no
Portugal	no	yes	no
Spain	no	yes	no
Sweden	yes	no	no
United Kingdom	no [1]	yes	no
Total EU15	***2yes***	***13yes***	***-***
Total OECD (30)			
Yes	***6***	***24***	***1***
No	***24***	***6***	***29***
Response not available	***0***	***0***	***0***

1) "Yes" for distributed branch profits of unincorporated enterprises.
2) Separate annual transaction data on LU can be derived from the survey on FDI positions. Monthly transactions statistics are common for BE and LU.

234. Two countries, AT and DE, include in FDI Income contributions from parent companies to cover losses in their subsidiaries. AT records these transactions as negative dividends, whereas DE regards them as a separate sub-item of FDI Income. The majority of the MS treat such contributions as financial transactions similar to shareholders' contributions.

THE CURRENT OPERATING PERFORMANCE (COPC) AND THE ALL-INCLUSIVE CONCEPT

235. In compliance with the international standards, FI, The NL, IE, SE, and the UK apply the COPC, whereas the other MS use the all-inclusive valuation of total profit. The reason why the majority of the MS use the all-inclusive concept is partly that it is easy to collect, simply asking for the net result of the financial year. In order to calculate the profit according to COPC, adjustments will have to be made for write-offs, capital gains and losses, etc. Even though respondents may have these data available, most MS have chosen not to collect them, mainly in order to limit the data collection.

236. Furthermore, as a result of a request of the BoP WG, the TF-FDI discussed in more depth some practical aspects linked to the problem of identifying items for holding gains and losses (as defined in the statistical methodology) within the accounts of the enterprises included in the surveys. Some of the Member States that adopt the COPC explained that this identification often requires a supplement of work with the respondent through direct contact. As a result, it is often the case that this deeper analysis is limited to the most important respondents.

237. The NL supplied more information on the concepts used for obtaining the COPC from the survey used for data collection. In the explanatory notes to the survey there is the indication that companies should report their profits excluding extraordinary items and

before profit appropriation. Extraordinary items in the Dutch guidelines for the annual reports are profits/gains or losses which do not arise from normal operations. This means that, for instance, what is regarded by the reporter as "normal" write-offs of fixed assets such as machinery or plants is included as a deduction in the COPC. In some practical cases the distinction between amortisation of fixed assets and "normal" write-offs of these assets may become blurred.

Forecasts

238. In order to calculate RIE for the current year, most countries use forecasting methods to estimate the total profit (the other component of RIE, dividends, is collected on a current basis), extending from rough estimates to modelling based on different indicators.

239. AT, for example, uses profits extrapolated company by company combined with information on GDP and exchange rate development. FR applies an exogenous growth rates hypothesis, whereas FI and SE base their estimates on figures for the previous year, development of the economy, and (SE) exchange rates. DK applies an average ratio for inward/outward FDI, respectively, between profit/loss and total equity. PT uses GDP trends in PT for inward FDI and in the most important recipient countries for outward FDI.

Geographical breakdown

240. Depending on data collection methods, the geographical breakdown is either collected or estimated on the basis of stock data.

241. Countries *collecting* geographically distributed data are AT, DE, DK, FI, and the NL. *Estimations* on the basis of stock data are made by FR, IT, SE, PT and UK. BE has only a limited breakdown (intra/extra Eurozone).

242. The data on total profit (and RIE) is collected on a consolidated basis by the UK, FI, IE, the NL, and SE. All countries except SE allocate the data to the first directly owned company, whereas SE makes a distribution on all levels of the chain of indirectly owned enterprises.

Timeliness

243. Final RIE data are available only after completion of the annual surveys, the time for which differs considerably between MS. The present situation is seen below:

Table 10 Availability of final data on reinvested earnings (to end-2002)

Country	Date
Austria	June 2004
Belgium	September 2003
Denmark	2004
Germany	February 2004, revision in February 2005
Finland	September 2003
France	2004
Italy	May 2003
Netherlands	2004
Portugal	2004
Sweden	January 2004
United Kingdom	January 2004

INTERNATIONAL ACCOUNTING STANDARDS (IAS)

244. A preliminary discussion of the principles contained in the new International Accounting Standards on the notion and recording of income was also held.

245. The main result was that the new IAS refers to a broader concept of income than the one adopted in the statistical manuals discussed above. In particular, the IASB Framework[37] clarifies that income encompasses "revenue and gains" (expenses and losses) and that the two components are not distinguished in the IAS general framework. The relevant paragraphs from the Framework (§§74-76) are quoted below:

37 References were taken from the publication "International Financial Reporting Standards – incorporating International Accounting Standards and Interpretations", International Accounting Standards Board, January 2003.

74 *The definition of income encompasses both revenue and gains. Revenue arises in the course of the ordinary activities of an enterprise and is referred to by a variety of different names including sales, fees, interest, dividends, royalties and rent.*

75 *Gains represent other items that meet the definition of income and may, or may not, arise in the course of the ordinary activities of an enterprise. Gains represent increases in economic benefits and as such are no different in nature from revenue. Hence, they are not regarded as constituting a separate element in this Framework.*

76 *Gains include, for example, those arising on the disposal of non-current assets. The definition of income also includes unrealised gains; for example, those arising on the revaluation of marketable securities and those resulting from increases in the carrying amount of long term assets. When gains are recognised in the income statement, they are usually displayed separately because knowledge of them is useful for the purpose of making economic decisions. Gains are often reported net of related expenses.*

246. Therefore the application of the new IAS by companies, even on a compulsory basis, would not imply that holding gains and losses be isolated in the standard presentation. The analysis of IAS n° 8 (on Profit and Losses) confirmed this conclusion. The TF-FDI also examined an "improvement project"[38] being developed in the framework of IAS and aiming at distinguishing various standard components of income. The TF-FDI considered that it would be very useful for data compilers to implement the reporting of these components by companies in a harmonised way. The project is however still at a preliminary stage of discussion in the IAS framework. The subject could be usefully studied further in the framework of the Eurostat/ECB "Accounting and statistics" TF-FDI.

CONCLUSIONS AND RECOMMENDATIONS

247. It appears that a significant part of MS find it difficult to adapt to the international definitions as stated in BPM5 and OECD's Benchmark Definition and consider a full adherence to these principles to be hard to attain, at least in the short run. MS' different practices naturally lead to inconsistencies on an EU/Euro area level. The problems of applying the standards in practice depend partly on difficulties to obtain the necessary data, partly on the data collection methods used and partly on the information internally available to respondents.

PROFITS

248. A significant part of MS do not apply the Current Operating Performance Concept; only five countries have so far implemented the COPC, namely FI, The NL, IE, SE, and the UK. Asymmetries caused by different practices will mainly affect the total Income on FDI Equity in the Current Account. The different practices used affect the total Income in the Current Account and thus the calculation of the GNI for the MS, causing asymmetries on the EU/euro area aggregates.

249. In order not to deviate from international standards, the same concept for the calculation of profits, namely the COPC, should be used by all MS. The TF discussed the problems connected with a change from the all-inclusive to the COPC and the practices applied by the MS whose compilation practices already comply with the standards.

250. According to the experiences of some countries like the UK and DE, a reduced number of domestic companies (in some cases, holding companies[39]) involved in FDI transactions/

38 See http://www.iasc.org.uk/cmt/0001.asp?s=9198007&sc={61FA8D2B-B229-4738-95E6-B3FEE9D05804}&n=66. The project examined by the TF-FDI is "The Income Statement (Reporting Performance)".

39 Such holding companies normally present very high profits/losses in the financial year compared with a relatively low volume of equity capital.

positions contribute to most of the total extraordinary gains/losses in their countries. For the other companies, the all-inclusive approach often provides similar results to the COPC.

251. The TF-FDI concluded that acceptable solutions for the application of the COPC should aim at covering at least the reduced number of companies which contribute the most to extraordinary results (namely the biggest respondents and holding companies).

252. Two information sources were considered for the application of the COPC: (i) companies' public accounts; (ii) restricted information, internally available to the companies. Although the split between ordinary and extraordinary gains/losses in accounting statements is not necessarily consistent with statistical definitions, it was considered by the TF to be an immediately available proxy. For the first solution (public annual accounts) to be considered as an acceptable proxy for the COPC, additional information (internally available to respondents) would be required (notably, the geographical breakdown). Therefore, a combination of both information sources would be necessary in any case.

253. One aspect to be considered is the impact on the data collection from the introduction of the new IAS, which could be expected to affect a larger number of enterprises than was originally expected. In the present draft version of the IAS not all components necessary for a COPC valuation are specified in the *standard presentation*. Within the framework of IAS a study has, however, been initiated aiming at distinguishing various standard components of income.

254. The development of the new IAS will imply a more specific definition of the components which may serve as a firm basis for the harmonisation of MS' application of the COPC. However, the development of the new IAS may pose an additional difficulty for compilers to properly apply the COPC, to the extent that only very exceptional results will be excluded from the ordinary profits and losses.

DIVIDENDS

255. Collection systems are determining the approach for dividends paid vs. payable. Today only SE, IE and FI collect data on dividends when payable. Countries using settlement systems as the main source for dividends will naturally record the transactions when paid. It may, however, be foreseen that the increased use of surveys (monthly or quarterly) will bring the practices closer to the international standards, as these surveys are likely to reflect accounting data, based on accruals. Application of different practices will in this case mainly lead to inconsistent treatments due to differences in time allocation.

256. Treatment of dividends stemming from exceptional capital gains is a problem in so far as it affects the calculation of reinvested earnings. The BoP effect of such dividends is seen in the FDI item of the Financial Account and the subcomponents of Income; total profit is not affected by these transactions. The NL have chosen to treat these dividends as financial transactions (disinvestments) rather than income, as is the practice by other MS. By recording exceptional dividends in the Financial Account the same concept (current operations) will be used for both total profit and dividends. The other MS using the COPC for profits, record the total dividends (all-inclusive) as income, which causes some confusion regarding the concept of reinvested earnings data calculated on this basis. Therefore, the TF concludes that dividends stemming from exceptional capital gains should be recorded as FDI disinvestments. Even though such dividends are easy to recognise, bilateral contacts are recommended in the case of intra euro area/EU flows so as to avoid asymmetries.

GEOGRAPHICAL BREAKDOWN

257. Inconsistent treatments due to dissimilar geographical attribution may also be caused by the different collection systems used. A census-type survey (with no grossing-up) will, for

example, in most cases "allow" a more detailed breakdown on countries than a sample survey. In most cases stratification and sampling for FDI surveys is made on the basis of stocks and economic activity and thus not on geographical variables. In order to produce data with a reliable and detailed country breakdown the samples would have to be increased, which leads to higher costs.

258. Also, the practices used by some MS to estimate the geographical allocation of profits on the basis of stocks will cause asymmetries vis-à-vis countries *collecting* the data with a country breakdown.

PROPOSALS

REINVESTED EARNINGS

259. A fundamental need to reduce asymmetries regarding reinvested earnings within the EU is that all MS compile RIE, and they base their compilation methods on similar concepts, which is not the case at present. Not all MS have yet established a system for this purpose. Since this is of basic importance, the TF-FDI proposes that annual FDI surveys to collect the necessary data be implemented in all MS as soon as possible (in line with the proposal made for FDI equity stocks). This is the first priority.

TOTAL PROFITS

260. In line with the clarified Mandate of the TF and international recommendations the TF-FDI proposes that the Current Operating Performance Concept (COPC) be used by all MS for the valuation of total FDI profit, i.e. exceptional results should be appropriately excluded from the current account.

261. Furthermore, there is a need to follow the development of the new IAS framework as regards the income components, since aligning statistical principles with the new accounting standards to the largest extent possible seems to be the most cost-effective (and perhaps the only possible) approach vis-a-vis respondents. A more general statement concerning the close monitoring of forthcoming changes in statistical standards and the development of the new IAS is suggested as a follow-up action point in chapter 8.

COVERAGE OF INDIRECT RELATIONS

262. The TF-FDI proposes that the coverage of reinvested earnings be made in accordance with one of the simplification procedures addressed in chapter 2, namely (i) coverage of indirect links of ownership above 50%; or (ii) coverage of direct and indirect ownership links above 10%, calculated as the product of the subsequent ownership links along a chain.

DIVIDENDS

PAID/PAYABLE

263. Since MS may increasingly collect data based on accounting, a "natural" transition may also take place to collect dividends "when payable". This foreseeable changeover will, however, not be made in the short term. On the other hand, asymmetries will only occur in short-periodic statistics, since the difference between payable and paid is usually only a matter of time allocation during a fairly limited period. We suggest that MS address the issue in the development of their future systems so as to bring their practices nearer to the international recommendations.

CONTRIBUTIONS TO COVER LOSSES

264. As to contributions to cover losses in direct investment enterprises, the TF-FDI proposes that these transactions, in line with international recommendations, be recorded in the Financial Account, as additional investment flows and not as direct investment income.

DIVIDENDS FROM EXCEPTIONAL CAPITAL GAINS

265. The TF-FDI recommends that dividends stemming from exceptional capital gains be recorded as FDI disinvestments rather than under Income in the Current Account. Such a treatment is supported by international recommendations and will ensure a common concept to be used for the components of reinvested earnings.

5 ISSUES RELATED TO OTHER CAPITAL IN FDI STATISTICS

INTRODUCTION

266. This report investigates the theory and current practices regarding "Other Capital" in foreign direct investment flows and stocks of Member States of the European Union as mandated in the Mandate of the Task Force on Foreign Direct Investment (TF-FDI). By combining theory and current practices, best practices are being put forward for the problems linked to Other Capital in foreign direct investment (FDI) flows and stocks.

267. The report will focus on the directional principle, the identification and impact of the components of Other Capital in FDI, and the treatment and classification of transactions/ positions on Other Capital when Monetary and Financial Institutions (MFIs) are involved. The latter mainly concentrates on the case of subordinated loans. In addition, the treatment and classification of Other Capital when SPEs and other financial intermediaries (not MFIs) are involved and the valuation principles concerned with Other Capital are explored.

268. The report is constructed in the following way: it starts with a description of the current practices in European Union Member States on the treatment of Other Capital in FDI flows and stocks.[40] It continues with the establishment of some conclusions drawn from the previous analysis and with the identification of best practices. The chapter concludes with a short revision of some practical aspects related to the application of the directional principle, including a table summarising the magnitude of the financing by affiliates to parent companies (for both FDI flows and stocks) using the information available in Member States to assess the importance of a correct application of the directional principle. All definitional issues regarding Other Capital in FDI, as contained in international standards, are described in Annex 2, at the end of this report.

CURRENT PRACTICES IN THE TREATMENT OF OTHER CAPITAL IN THE EU MEMBER STATES

269. The current practices of the treatment of FDI-Other Capital in EU Member States are identified by the use of the documents on Current Practices, submitted by Member States and circulated at the first meeting of the TF-FDI in April 2002 and by the use of a questionnaire, conducted in August. The questionnaire was circulated to the participants of the TF-FDI because not all necessary and relevant information for this report was included in the documents submitted initially.

DESCRIPTION OF THE QUESTIONNAIRE

270. The questionnaire was designed specifically to address the issues raised in the Task Force Mandate relating to Other Capital and was conducted in August 2002. This includes the various forms taken by Other Capital, the items included and the special circumstances of MFIs and SPEs. The opportunity was also taken to inquire into methods and use of the directional principle and valuation methods as applied to Other Capital.

271. In November 2002 an other questionnaire was sent to the members of the Task Force which apply the directional principle. This questionnaire investigated the practical aspects of the application within the institutions.

RESULTS FROM THE QUESTIONNAIRE COMBINED WITH THE SUBMITTED DOCUMENTS

272. 12 countries (out of 13) returned completed questionnaires (IE also provided replies at a later stage) and the results are summarised below. No details are known for the two remaining countries (LU and GR).

40 Current practices are also compared with the theoretical aspects contained in the appendix to this chapter.

Table 11 Application of the directional principle

A1. Do you apply the directional principle?	Number of Member States
Yes or partially	12
No	1

273. Those Member States that declare they apply the directional principle do so for both flows and stocks in both inward and outward directions, although, further investigations revealed that most of them only partially do it, i.e. not for all elements of Other Capital.

274. The table summarising the answers to the questionnaire, to be found in Annex 3 at the end of the report, shows that the coverage of the various items included in other capital differs among countries. For instance, five countries only can include transactions/positions on debt securities between affiliates in other capital.

275. In most cases, special internal codes are used to identify and process Other Capital transactions and positions involving the directional principle. The process is generally automated in the Member States, with some having additional manual processes for quality checks mainly. Most Member States can only apply the directional principle for direct relationships.

276. One Member State (BE) which does not apply the directional principle yet, will do this when the new system is introduced. The process, described by BE in the questionnaire, has many similarities with the overall application of the directional principle in the other Member States.

277. Annex 5 (at the end of the report) presents a synthetic table showing empirical evidence of the relative importance of the various components of other capital.

DEBT SECURITIES

278. Six Member States include debt securities in FDI Other Capital. Five (IT, PT, SE, UK, IE) include both flows and stocks for inward and outward directions. Three (IT, SE, IE) of these also collect long and short term data. FI collects stock data for both directions and periodicities but find that the reported values are insignificant.

TRADE CREDITS

279. Nine Member States include trade credits in FDI Other Capital for both flows and stocks and both directions (DE, ES, FI, IT, NL, PT, SE, UK, IE). DK records trade credits as Other Capital only for stocks.

FINANCIAL LEASING/LEASING CREDITS

280. Eleven Member States include financial leasing in FDI-Other Capital. Nine (AT, DE, ES, FI, IT, PT, SE, UK, IE) include it in both flows and stocks and in inward as well as outward. BE only collects flows and DK only stocks. No distinction is made between long-term and short-term financial leasing. In the new reporting system (from April 2003

Table 12 Items included in Other Capital

B1. Which items are included in Other Capital of regular companies?	Number of Member States
Debt securities	6
Trade credits	10
Financial leasing/Leasing credits	11
Financial derivatives	1
Assets in intra-group accounts (intercompany loans)	13
Transferable deposits	9
Permanent debt	10
Other	0

onwards), NL will also include financial leasing in their FDI figures (both stocks and flows).

FINANCIAL DERIVATIVES

281. NL includes financial derivatives in Other Capital but will be discontinuing this collection after the new collection system for direct reporting is introduced (from April 2003 onwards). and DK includes only stocks of financial derivatives.

DEPOSITS

282. Deposits are included in Other Capital by nine Member States (BE, DK, FI, FR, IT, NL, SE, UK, IE) for both flows and stocks in both directions.

INTERCOMPANY LOANS

283. Intercompany loans (assets in intra-group accounts) are included in other capital by all thirteen responding Member States. All thirteen Member States include loans between affiliated companies in both flow and stock data and in inward as well as outward data. Six Member States (DE, DK, FR, NL, SE, IE) report that they make a distinction between long-term (over 1 year) and short-term (up to 1 year) assets and liabilities.

PERMANENT DEBT

284. Ten Member States (AT, BE, DE, DK, ES[41], FI, IT, PT, UK, IE) include permanent debt in Other Capital.

285. Seven Member States (AT, BE, DK, FI, PT, UK, IE) have indicated that subordinated loans between MFIs are included in Other Capital. BE only includes these loans in flows; UK in stocks and the other five include them in both flows and stocks. FR and DE include such loans in equity capital rather than in other capital, for reasons of confidentiality in the case of DE.

286. One Member State (DK) includes flows and stocks, such as deposits and other claims and liabilities, between MFIs in Other Capital.

THE INCLUSION OF DATA ON SPES AND OTHER FINANCIAL INTERMEDIARIES

287. Twelve Member States have indicated that they include data on SPEs and other financial intermediaries in Other Capital flows and stocks for both directions.[42] Valuation methods generally correlated with the overall valuation methods given in the next paragraph. A number of Member States reported that they didn't specifically identify SPEs and that such enterprises were treated as any other company for FDI purposes.

41 Only for "other sectors" and not for negotiable instruments.
42 In the case of ES, the register of external loans enables the identification of SPE's located abroad and only engaged in raising funds. These financial flows/positions when are obtained directly from a bank located abroad and routed through an SPE are not included in *direct investment* but in *other investment*.

Table 13 Treatment of other capital data relating to MFIs

E1. Do you include subordinated loans between MFIs in Other Capital?	Number of Member States
Yes	7
No	6
E2. Do you include deposits between MFIs in Other Capital?	
Yes	3
No	10

Table 14 Valuation principles

C2. Which valuation principle is used for other capital stocks?	
Book value	9 (10)
Market value	1
Both	2

288. For stocks, ten Member States (AT, BE, DE, DK, ES, FR, IT, PT, UK, IE) use book valuation, SE uses market valuation and FI and NL use both valuations.

OVERALL COMPARISON OF THEORY AND PRACTICES[43]

289. Generally, as can be seen in the tables above, there already appears to be a close convergence between theory and practice across the Member States for the main principles and treatment of Other Capital. There is some divergence in the more specialised areas but this appears to be related to the importance of these areas in the individual economies.

290. The *directional principle* is used for Other Capital by the majority of Member States with one of the remainder planning to apply the directional principle in the future. Thus the theory and practice of the directional principle appear to have been adopted by the majority of Member States already.

291. A majority of Member States include data on trade credits, financial leasing, deposits and permanent debt in Other Capital. The totality include intercompany loans. Less than 50 per cent include data on debt securities. In the near future no Member State will any longer include data on financial derivatives, which is in line with the recommendations of the IMF and ECB.

292. The treatment of *Other Capital* data relating to *MFIs* is more erratic. Subordinated loans are included in Other Capital by half of the Member States. The other Member States record such loans as "equity capital" or "other investment", frequently taking the view that they represent permanent debt. To fully meet the theoretical treatment of FDI, Member States would need to be able to distinguish between loans between MFIs and loans between MFIs and some other sector. Deposits between MFIs are considered to belong to Other Investment by 75 per cent of the Member States which accords with the OECD's Benchmark.

293. All twelve responding Member States include data on *SPEs* but few specifically identify them. It is probably more accurate to say that no Member State specifically excludes data on SPEs. Without some method of positively identifying SPEs it seems doubtful that accurate data can be obtained to enable SPEs to be considered separately from any other type of enterprise.

294. Valuation of flows is evenly split between book and market bases, though, as has been mentioned before, market valuation does not have the same implications when considering Other Capital. For stocks, most Member States use book valuation or both book and market valuations.

CONCLUSIONS

THE DIRECTIONAL PRINCIPLE

295. The directional principle is a primary component of the accurate compilation of foreign direct investment. It is recommended that the directional principle is followed consistently across Member States when considering transactions in Other Capital.

43 Theoretical issues are presented in Annex 1.

296. In the case of companies which are fellow subsidiaries – exclusively through their respective relation with their mother company and with no relevant cross-participation, i.e. less than 10 percent ("sister companies") – an investment should be recorded, by the economy providing the investment, as direct investment abroad and, by the economy of the enterprise receiving the investment, as direct investment in the reporting economy.

297. If there exists also a direct investment relationship (cross-participation of at least 10 percent) between two fellow companies the directional principle should be applied accordingly as for any other FDI relationship, since such companies could no longer be considered as fellow companies.

298. In the case of companies with an FDI relationship through an indirect link of ownership, the directional principle should be appropriately applied in accordance with the conclusions stated in chapter 1.

ELEMENTS OF OTHER CAPITAL WHERE APPLICABLE TO NON-MFIS

299. For some instruments used for intercompany financing the current practices of Member States are already largely in accordance with the internationally agreed methodology. However, for several other items, their allocation to a certain category is apparently not so obvious. The conclusions for the latter are motivated hereafter. The recommendations for all considered instruments are presented in the following table:

PREFERRED SHARES

300. The following conclusions can be drawn:

1. Capital in the form of preferred shares is provided on a permanent basis without final maturity. Preferred shares improve the financial stability of a company due to a broadening of its equity base.

2. The three main features of preferred shares are voting power, claims on the company's profits (dividends), and participation in the residual of a company.

3. As indicated above, preferred shareholders have hardly any voting power. In return, preferred shares are endowed with precedences compared to common shares. They are typically ranked ahead of common equity in respect of dividends and distribution of the value on dissolution of the incorporated enterprise.

4. The expression (non-)participating in relation with preferred shares is not related primarily to voting rights, but to the participation in the distribution of the residual value on dissolution and to the

Table 15 Elements of other capital included in FDI statistics

Item of Other Capital	Extra information	Included or excluded?
Debt securities	Except for financial derivatives	Included
Preferred shares	Possibility of identifying non-participating preferred shares	Excluded, unless non-participating
Trade credits		Included
Financial leasing		Included
Financial derivatives		Excluded
Deposits		Included
Intercompany loans		Included
Permanent debt		Included

return on equity (participating preferred shares incorporate dividend payments dependent on the companies profit whereas the payment of fixed dividends (interest) is related to non-participating shares). Thus, if fixed payments are given together with payments on companies' profits, then the preferred shares have to be classified under "Equity Capital".

5. Following a practical view on the issue of the classification of preferred shares and taking into account their "equity nature", preferred shares should be treated in general as *equity capital*. Only in the case when preferred shares can be clearly identified as non-participating according to all specified criteria (which should be rather difficult) they should be treated as a *debt instrument* and recorded as *Other Capital*.

FINANCIAL DERIVATIVES

301. Although financial derivatives are included under debt securities in the Benchmark, the IMF and ECB have concluded that these items should not be included. A supplement to the BPM5 is dealing with financial derivatives as an own category separated from Direct Investment and Portfolio Investment.

302. Therefore financial derivatives should *not* be included in Other Capital.

PERMANENT DEBT

303. Permanent debt shows in some respect similarities to equity capital. This raises the question whether permanent debt should be included either in Other Capital or in Equity Capital.

304. Permanent debt is typically characterised by a higher risk for the creditor compared to 0147ordinary0148 loans due to a more comprehensive liability. In the case of the debtor's insolvency, permanent debt will usually not be repaid until all other debts are paid off. The same applies to interest payments which could be suspended in the case of a liquidity squeeze. However, permanent debt typically incorporates no voting rights unlike common equity capital. Moreover, in general interest is paid on permanent debt indicating its closeness to debt instruments. However, the same can be said for capital endowment of branches, which is nonetheless classified under equity capital.

305. In the case of securitised permanent debt (perpetual bonds) there are further facets to be considered. Perpetual bonds are tradeable and from the point of view of the creditor, a disinvestment of principal through the capital markets is possible. Perpetual bonds as a form of debt securities might be interpreted to be closer to Other Capital, or rather, more remote from equity capital, than subordinated loans. However, no general statement about the ranking of securitised and unsecuritised permanent debt between equity capital and Other Capital can be made. Moreover, the importance of securitised permanent debt as a financing instrument between affiliated enterprises is not significant for most countries.

306. Consequently, from the theoretical point of view there is no clear indication whether permanent debt is closer to equity capital or to Other Capital. The majority of Member States record permanent debt (securitised and unsecuritised) as Other Capital. Thus, from a practical point of view, the inclusion of permanent debt in Other Capital is preferable for the sake of simplicity and in order to avoid asymmetries.

307. Overall, practical aspects are decisive in recommending the *inclusion* of permanent debt (securitised and unsecuritised) in Other Capital.

OTHER CAPITAL TRANSACTIONS BETWEEN MFIS

308. When both parties involved are MFIs, financial intermediaries or financial auxiliaries, permanent debt should be included in Other Capital. The positions of the TF-FDI members as to whether permanent debt should be recorded under equity capital or under other capital in FDI statistics were almost evenly

split. In the end, one of the main reasons to take this option (recording in Direct Investment/ Other capital) was the consistency with the current treatment in money and banking statistics.

309. All other transactions involving Other Capital should be *excluded*.

310. It should be mentioned that this conclusion is not unproblematic for practical reasons. According to this recommendation permanent debt is the only remaining item in Other Capital. Therefore, the inclusion of permanent debt in Other Capital might raise confidentiality concerns in some Member States; in particular due to the fact that the granting of permanent debt to affiliated companies in the banking sector is usually rather limited. Therefore, in some countries where there could be a risk of disclosure, caution will have to be observed at the time of publication/communication of the data, e.g. these data may have to be flagged as confidential when transmitted to the ECB.

OTHER CAPITAL TRANSACTIONS OF SPES

311. Where they can be separately identified, the activities of SPEs should be included in Other Capital unless their activity solely relates to the MFI and financial intermediation sector, when they should be treated as previously explained.

312. Where they cannot be separately identified, their activities should be included in Other Capital as would any other enterprise engaged in FDI.

VALUATION

313. Where valuation specifically applies to Other Capital, market valuation should be used where applicable but it is acknowledged that Other Capital does not always lend itself to market valuation in the true sense, or rather that there is usually little difference between book value and market value for other capital stocks.[44]

METHODS OF COLLECTING DATA ON OTHER CAPITAL

314. In general, methods of collecting data should be considered in terms of FDI as a whole entity, rather than just one particular element. There is a danger that there may be different recommendations for different topics, presenting an incoherent approach across all FDI elements. With this proviso the following conclusions seem applicable to other capital.

SURVEY-BASED SYSTEMS

315. There appear to be two ways in which survey-based systems can collect all elements of other capital. Firstly, questions can be added to the survey form asking for each element of other capital separately, taking into account the directional aspect of the investment. Secondly, the notes accompanying the survey form can be amplified to specify the elements required, giving examples where possible. This option would seem to be cost-effective once set up.

SETTLEMENT-BASED SYSTEMS

316. The settlement-based system uses a series of codes for different transactions. In countries not currently fully compliant with the standards agreed for FDI, these codes should be expanded to include the elements of other capital required. They should also include information on the direction of the investment to satisfy the requirements of the directional principle. The accompanying documentation should be expanded to specify the requirements.

THE APPLICATION OF THE DIRECTIONAL PRINCIPLE: PRACTICAL ISSUES AND EMPIRICAL EVIDENCE

PRACTICAL ISSUES IN IMPLEMENTING THE DIRECTIONAL PRINCIPLE

PRACTICAL ISSUES IN SURVEY-BASED SYSTEMS

317. Surveys typically ask for aggregate data with a geographical breakdown. Therefore no individual information of the group structure

44 Just in the event of write-offs / write-downs.

can be derived. However, a separation of inward and outward direct investment allows the classification of claims and liabilities according to the directional principle also for country-aggregated claims and liabilities. The accuracy of the data with respect to the directional principle crucially depends on the respondent's available information about the intra-group structure and its effort in completing the survey. At this juncture the notes and instructions to the survey given by the compiler should be designed as a useful guideline for the respondent with clear definitions and requirements.

PRACTICAL ISSUES IN SETTLEMENT-BASED SYSTEMS

318. The application of the directional principle for equity capital is for most countries apparently more difficult than for Other Capital. This might be related to the fact that reverse investments below the 10% threshold are often not considered by the system under direct investment but under portfolio investment. However, in the following we will concentrate on aspects related to Other Capital.

319. In countries not currently fully compliant with the standards agreed for FDI, the existing codes could be expanded to include the elements of Other Capital required. They could also include information on the direction of the investment to satisfy the requirements of the directional principle. As in 4.6.1 the accompanying documentation should be expanded to specify the requirements. The incorporation of separate codes in settlement-based systems should enable the compiler to distinguish between three types of relationships, e.g. if the resident enterprise acts as a

- parent company (above the foreign affiliate in the investment chain)
- subsidiary (below the foreign affiliate in the investment chain)
- fellow company (without relevant cross-participation).

320. For outward investment parent companies should usually be aware of their status. For inward investment the resident company may often not assess the information if the foreign counterpart is a (grand)parent or a sister company. When a clear distinction is not possible the foreign affiliate should be treated as a fellow company which implies that the transaction is compiled according to the asset/liability principle. However, the implementation of an extension of the reporting system as a first-best solution is apparently not very realistic in many countries.

321. When the extension of the existing system by additional codes is not possible some other possibilities can be regarded. The systematic registration of transactions in equity capital can provide an opportunity to identify the direct investment relationships between affiliated companies. A database on FDI relationships of resident companies, as in Austria, seems to be a useful tool to ensure that any other capital transaction involving affiliated companies can be classified with respect to the links in equity capital and therefore effectively recorded under direct investment according to the directional principle. However, according to Austrian compilers the maintenance of such a company register and taking care of its completeness and accuracy requires comprehensive human resources.

322. An alternative or additional source to the establishment or cross-check of own company registers are databases maintained by external providers. The "WorldBase" database, a commercial database for company interlinkages provided by Dunn & Bradstreet is deemed to be very helpful for identifying linkages for the use of the directional principle. De Nederlandsche Bank (NL) and the ONS (UK) have a subscription to this database. They use it for all kind of information, such as the directional principle, for the identification of new FDI relationships which have not been covered in the system yet and thus to keep the national registers complete.

323. Furthermore, also the systematic exploration of the information provided by the own system may be helpful. The direction of a transaction can be classified for example in the case of pure subsidiaries, e.g. companies at the bottom of the direct investment chain with no participation in foreign companies and in the case of pure parent companies, e.g. enterprises at the top of the direct investment chain in which no foreign investor has a participation of 10% or more.[45] In this connection also the information from stock statistics can be useful. More precisely, when for example only outward stocks in equity capital are reported by a company all transactions in Other Capital should be recorded as direct investment abroad and if there exist only inward equity stocks all transactions in Other Capital should be treated as direct investment in the reporting economy.

324. Unfortunately, also a geographical breakdown of direct investment flows/stocks without specifying the type of the corresponding direct investment relationships can not provide much additional information with respect to the directional principle. The information about the counterpart country in order to detect the investment relationship vis-à-vis a certain country (pure subsidiary or parent company status) is only useful in the case when the whole group structure is known, because parent companies and subsidiaries could be located in the same counterpart country. However, indirect links (to companies downward or upward the direct investment chain) are usually not covered.

325. In addition to the exploration of the company status, the assignment of special codes when a loan – granted by a company identified as a subsidiary or parent company – was first considered could be helpful. In order to exemplify this approach, the Dutch system is described in Annex 4 of this report, which also contains a description of the application of the directional principle in Germany.

EMPIRICAL EVIDENCE ON THE IMPORTANCE OF THE DIRECTIONAL PRINCIPLE

326. With a view to assessing the impact that a correct application of the directional principle could entail with regard to total FDI figures, Member States which had declared they applied the directional principle were requested to provide detailed information on the different components of direct investment. 11 countries provided figures for flows, while ten also provided information for stocks. Table 16 below shows the outcome of this empirical exercise.

45 This approach is applied in the German b.o.p. for short-term intercompany loans.

Table 16 Impact of the application of the directional principle for "other capital"

(EUR millions)

B.O.P. data for the year 2001

Other capital	Euro area		European Union		National
	Intra	Extra	Intra	Extra	
FDI abroad	22,558	-19,300	16,872	-13,612	3,257
claims on affiliated enterprises	-9,225	-16,573	-12,381	-13,416	-25,799
liabilities to affiliated enterprises [1]	31,784	-2,727	29,253	-196	29,056
FDI in the reporting economy	32,283	-3,226	24,215	4,841	29,057
claims on direct investors [1]	-5,252	-1,953	-6,374	-840	-7,205
liabilities to direct investors	37,535	-1,273	30,589	5,680	36,262
Net	54,841	-22,526	41,086	-8,772	32,314

I.I.P. data at end-December 2000

Other capital	Euro area		European Union		National
	Intra	Extra	Intra	Extra	
FDI abroad [2]	8,308	165,068	25,485	68,903	94,387
claims on affiliated enterprises [3]	55,559	187,441	78,053	85,959	164,012
liabilities to affiliated enterprises [3]	47,252	22,373	52,569	17,057	69,625
FDI in the reporting economy [2]	165,316	125,259	188,047	66,426	254,472
claims on direct investors [3]	28,495	50,523	43,183	35,835	79,017
liabilities to direct investors [3]	193,810	175,782	231,230	102,260	333,489
Net	-157,008	39,809	-162,562	2,477	- 160,084

Euro area I.I.P. (as published in the ECB Monthly Bulletin) at end-December 2000 (EUR millions)

Other capital	
FDI abroad	353,700
FDI in the reporting economy	300,700

1) For FR, only long term loans.
2) No figures for IT.
3) No figures for FR.

327. As it can be seen in these table, the magnitude of the financing flows and stocks by affiliates to their parent companies can be deemed rather substantial in comparison with the financing flows and stocks in the opposite direction (i.e. in the usual direction of FDI flows/stocks, namely from parent companies to their affiliates). On this basis, the TF-FDI concluded that the non-application of the directional principle could cause a substantial and artificial overestimation of the gross assets and liabilities (i.e. inward and outward FDI) flows and stocks registered in the b.o.p. and the i.i.p. respectively.

6 IDENTIFICATION AND TREATMENT OF SPECIAL PURPOSE ENTITIES (SPEs)

INTRODUCTION

328. The development of multinational enterprises and the increasing integration of the world economy, in the process of globalisation, are reflected in a remarkable increase of cross-border financial transactions. The establishment of complex intra group structures is more and more determined by financial and fiscal aspects. Against this background Special Purpose Entities (SPEs) are playing an important role in conducting group financing and in providing financial services. Moreover, profit shifting in order to minimise tax burdens is clearly an important determinant for the establishment of SPEs in countries with a convenient tax environment for foreign companies. Regarding these activities, not only the growing amounts of intra group cross-border capital flows, but also the increased complexity of such transactions may raise problems in the statistical treatment of this phenomenon in some countries.

329. For the time being the recommendations in BPM5 related to SPEs provide no special treatment of SPEs except para. 372, which says that only transactions in equity capital and permanent debt between affiliated banks and affiliated financial intermediaries – including SPEs with the sole purpose of serving as financial intermediaries – should be included in FDI, whereas other capital transactions should be excluded. With the exception of SPEs mentioned in BPM5, para. 372, most member states have no special approach for the identification and treatment of SPEs within FDI statistics. On the one hand, the absence of national legal provisions or specific recommendations in the national statistical framework prevents a coherent approach in dealing with SPEs. On the other hand, the necessity for a separate identification of SPEs seems often not to be obvious. Indeed, one could ask about the reasoning of defining and identifying SPEs. The discussion within the OECD Workshop on Financial Investment Statistics has shown that several compilers do not really recognise the identification of SPEs within the population of FDI enterprises as a top priority issue. Therefore, some arguments will be presented hereafter in order to provide some rationale for the specific importance of SPEs.

REASONING FOR THE IDENTIFICATION OF SPEs AND PROBLEMS IN DEALING WITH SPEs

WHY SHOULD SPEs BE IDENTIFIED SEPARATELY?

330. First of all, there is a good reason to identify SPEs for analytical purposes. Users of FDI statistics may be interested in the nature of FDI activities, e.g. whether they stem from real operational business or merely from fiscal calculus. In this context a key issue is therefore to question the economic incentives related to SPE activities.

331. The term SPE comprises a large variety of enterprises with more or less specific activities. In general, SPEs are primarily engaged in international activities but in few or no local operations. Their functions frequently depend on the legal environment and taxation regime in their host country. SPEs acting as financial vehicles can be economically more accurately characterised as intermediaries rather than as direct investors or direct investment targets. The impact of SPEs on the economy they are operating in is often negligible. In particular, holding companies, shell companies, etc. typically have no real economic activity, no turnover and no significant employment.

332. The so-called green field investments are regarded as an important indicator for the economic attractiveness and competitiveness of regions and countries competing for direct investment. Policy makers and economists do regularly refer to foreign direct investment figures as an indication for economic conditions and the quality of economic policy. These discussions are mainly focused on inward flows and stocks. The increasing amounts of cross-border financial transactions arising from the formation of SPEs – together with the accelerated M&A activities – have extended

gross financial flows significantly. However, these transactions have hardly any real impact on the domestic economy and do commonly not affect the creation of new production capacities and employment opportunities. Therefore, the interpretation of gross flows and the conclusions drawn from this might be misleading, if comprehensive gross direct investment transactions arise from funds channelled through third countries rather that directly from the investor to the final target.

333. There can also be deducted a connection with the calculation of direct investment income. International standards congruently recommend the application of the current operating performance concept including only profits and losses arising from operational business in FDI income. In this context one might argue that all foreign direct investment transactions and positions should be identified according to their "economic background". In the case of holding or shell companies, the assignment of FDI flows and stocks according to the ultimate investor and the ultimate target, respectively, would facilitate a geographical allocation in agreement with real economic incentives.

PROBLEMS IN DEALING WITH SPEs

334. In the context of providing meaningful FDI statistics, severe problems related to SPEs arise from:

– the *identification and classification* of SPEs, in particular holding companies, shell companies, financial intermediaries and financial auxiliaries. Detailed information about the business segment are essential for an assessment of the economic rationale behind the investment activities. In this respect an industry breakdown might often not be sufficient for an unambiguous distinction between SPEs and other FDI enterprises. Moreover, information about the business segment or industry are often limited to domestic entities. In the case of offshore centres one might assume that SPEs play a major role in these countries, simply classifying enterprises located in offshore centres as SPEs. However, there are evident differences between the group of offshore countries. Regarding offshore centres possessing a broad economic basis, e.g. Hong Kong or Singapore, inward and outward direct investment might also be motivated by real economic activities rather than merely by fiscal incentives.

– the *geographical allocation*: When funds are channelled through a SPE, the real economic activity might often not be located in the country where the SPE is resident, but in third countries where the final target of FDI is located. When only direct FDI relationships are taken into account, FDI transactions and positions might be biased towards host countries of SPEs. In this context the identification and coverage of indirect relationships or the possibility of "looking through" holding and shell companies is a critical issue. Several countries have already developed approaches to tackle this problem. For example, in the U.S. FDI statistics, foreign shell companies incorporated abroad having all their physical assets or operations in a second foreign country are treated as incorporated foreign affiliates in the second country where their physical assets or operations are located. However, for the implementation of such a treatment, comprehensive information provided by reporting companies are required; and for the time being such data are apparently not available in most countries.

– *asymmetries* between national statistics: according to international standards, the activities of SPEs integrated in a multinational group structure should be treated as direct investment. However, various national practices in treating SPEs, in particular financial intermediaries and financial auxiliaries, are causing asymmetries. Moreover, the sector classification might be differing among member states.

PREVIOUS INVESTIGATIONS BY THE OECD

335. The analysis of the subgroup on SPEs should also shed some light on the different approaches in dealing with SPEs and off-shore enterprises among the member states. A categorisation of country specific approaches in dealing with SPEs was already attempted within the scope of the OECD Working Party on Financial Statistics in the recent past.[46] Since we do not intend to duplicate this exercise we focused on an empirical investigation, which was designed to analyse the present stage of possibilities in identifying SPEs in national statistics and to evaluate the order of magnitude (of parts) of SPE activities.

336. There is still no common approach in order to tackle these open issues among European countries. Though the results of the OECD study are still preliminary and will be reviewed in a second stage, the OECD paper represents a useful reference providing an overview of the various treatments of SPE activities in different countries. The results indicated that only a few countries possess a legal provision regarding the definition of SPEs and that there rarely exists any specific recommendation for the treatment of SPEs in FDI statistics. As the discussion within the OECD Workshop on International Investment Statistics showed, it proved hard to categorise the treatment of SPEs among countries when most countries have even not established recommendations for a specific treatment of FDI enterprises.

337. What can be learnt from the OECD studies? The large variety of answers and comments provided by compilers indicates the most important obstacles in identifying and analysing SPEs and their activities:

– there is hardly any definition, recommendation or treatment of SPEs applied by at least two countries in the same manner except for those countries not distinguishing between ordinary FDI enterprises and SPEs at all.

– there is no country of the euro area collecting data from resident enterprises on their SPEs abroad.

– information about tasks and activities of SPEs are not collected systematically by most countries. In this context, also the use of short-term instruments is still not analysed comprehensively. However, in particular short-term intra-group financing causes substantial cross-border capital flows.

338. Against the background of the follow-up work of the OECD secretariat, the subgroup on SPEs did not intend to replicate these results by an own survey, but to focus on an empirical exercise exploring the extent of SPE activities that can already be identified for the time being. It might be helpful to identify a least common denominator with respect to the category of SPEs which can already be separated by some Member States.

DEFINITIONS OF SPEs IN INTERNATIONAL GUIDELINES

339. This section presents the conclusions derived from the examination of some selected definitions of SPEs available in the main international guidelines. Mainly the *IMF 5th Manual*, the *IMF BOP Textbook*, the *IMF BOP compilation guide*, the *OECD Benchmark*, the *ESA95*, and the *International Financial Reporting Standards (IFRS-2003 Edition)* have been investigated. The results of these investigations are presented in greater detail in the stand-alone document that served as the basis for this chapter ("Report of the sub-group on Special Purpose Entities").

340. The exploration of various international guidelines has put forward the difficulty for compilers to define SPEs in simple words. However, some common and internationally

46 See "Report on Special Purpose Entities and Off-Shore Enterprises", note by the OECD secretariat prepared for the Workshop on International Investment Statistics, 5-6 March 2003 in Paris, DAFFE/MC/STAT(2003)4.

agreed characteristics that define an SPE could be helpful for the identification and the harmonisation of the treatment of SPEs. The following conclusions rely mainly on the fact-finding exercise done in IMF or OECD Manuals. Information relating to SPEs in the IFRS manual deals mainly with the issue linked to the consolidation of SPEs and the concept of control in accounting standards.

341. SPEs are defined in different ways in international guidelines, the OECD benchmark focusing more on the purpose or the structure of SPEs whilst the IMF puts forward the concept of their engagement in few or no local operations. But the essential point is that all these definitions do not contradict each other. The OECD, in its report on Special Purpose Entities and Off-shore enterprises (p.9), merged both its own definition with the IMF one to present a common understanding of SPEs according to international guidelines, which can be summarised as follows[47]. SPEs are:

- generally organised or established in economies other than those in which the parent companies are resident.
- engaged primarily in international transactions but in few or no local operations.
- SPEs can be a financing subsidiary, a holding company, a base company or a regional headquarter.
- SPEs can act as a sale and regional administration, a management of foreign exchange risk, or have the purpose of facilitating the financing of investment for the whole group.

342. In practice, the concept of "few or no local operation" seems to be the one which is more in line with national definitions currently available in few Member States (mainly DK, the NL and, to some extent, IE).

343. The definitions expressed above, merging both IMF and OECD definitions and not contradicting the current national definitions will constitute the basis for any future work that could be enhanced by Eurostat or the ECB in the field of SPEs.

344. Regarding residency criteria, both the OECD and the IMF consider that offshore enterprises, including SPEs, have to be considered as residents of the economy in which they are established.

345. Regarding the statute of SPEs and the treatment of their FDI transactions, both the OECD and the IMF recommend to consider SPEs as resident direct investment enterprises if they meet the general criteria defining FDI relationships, therefore to treat their FDI transactions accordingly.

346. For SPEs with the sole purpose of serving in a financial intermediary capacity, all international guidelines recommend to restrict their FDI transactions only to equity capital and permanent debt (or fixed assets for branches).

347. The IMF *Textbook* (but not the 5th *Manual*) is the only guide defining SPEs according to their operational presence in the host country (the OECD only raises the question in the "Tax authorities' perception" paragraph):

- SPEs are generally established in economies other than those in which the parent companies are resident.
- SPEs are engaged primarily in international transactions but in few or no local operations.

348. But nothing is said regarding the evolution of the SPEs' population of enterprises (what should be done in case of an expansion of the activities on the local market).

47 Report on Special Purpose Entities and Off-shore enterprises – Workshop on International Investment Statistics, 5-6 March 2003, paragraph 15 p9.

349. Both the OECD and the IMF recognise that some country may net out transactions through SPEs, but they all recommend that national compilers should provide information on a gross basis, for international comparison.

350. All international guidelines agreed on the fact that SPEs can take the form of holding corporations. *ESA95* has a precise definition of holding corporations *(§2.14*), – institutional units whose main function is to control and direct a group of subsidiaries. The identification of holding companies is needed for the sectoral classification of SPEs in S11, S122 to S125. Such an identification is necessary to indicate which FDI treatment should be adopted (the general FDI one or the one defined for SPE acting only as a financial intermediary).

351. Holding SPEs have to be classified in the sector which better reflects the activity of the group of subsidiaries as a whole (measured on the basis of value added*, ESA95 §2.23-e, 2.40-e, 2.43*). ESA95 states that a holding corporation controlling a group of subsidiaries consisting predominantly of insurance corporations and pension funds has to be classified in the financial intermediation sector (S123), instead of the insurance one (*ESA95 §2.43 and 2.63-b*). However, on this specific topic, paragraph 70 of the IMF "Monetary and Financial Statistics Manual" does not mention this exception. This Manual states that (extract):

- "A holding corporation is classified as financial if the preponderant activity of the group of corporations as a whole is financial."

- "Similarly, financial holding corporations should be allocated to subsectors according to the type of financial activities mainly carried out by the group they control."

352. For an SPE not having the statute of holding, it is necessary to check if the SPE is acting as a financial intermediary or simply as a treasury provider (*ESA95 §2.34, 2.37, 2.55-f, IMF Textbook examples §543, 544, OECD Benchmark §69*).

353. *ESA95* states that financial intermediation does not include institutional units providing treasury services, unless subject to financial supervision.

- Units acting as treasury services, and not subject to financial supervision, are allocated to the sector better reflecting the predominant function of the group.

- Finance vehicle corporations holding securitised assets have to be classified under S123, or S122 if they are MFIs.

IMPORTANCE OF SPEs AND OFFSHORE COUNTRIES IN EUROPEAN STATISTICS

354. The TF-FDI highlighted the fact that not all the MS identify SPEs in their regular statistics. Mainly the NL and, to some extent, DK and IE reserve a specific treatment/ definition for transactions involving them. The NL does not include the gross transactions of SPEs in the national FDI statistics. The Central Bureau of Statistics (CBS) of the NL argues that transactions with SPEs do not affect the Dutch economy, and therefore are not relevant for National Accounts purposes (no effect on the net worth). Despite the fact that Eurostat and the ECB compile European aggregates following the same method, the results obtained obviously diverge, which is not satisfactory from an analytical point of view, and from the users' one.[48] Investigations done within the TF-FDI confirmed that the other Member States include transactions with SPEs both in their data transmission to ECB and Eurostat.

48 Even though, from the purely national viewpoint, the exclusion from national statistics of SPE's transactions may make sense, since, in some cases, national statistics could otherwise be blurred by the volume of financial transactions between non-resident entities channelled through domestic SPE's.

355. Eurostat is not able to evaluate directly the global contribution of SPEs using the current Eurostat/OECD questionnaire. Within this questionnaire, information relating to either FDI capital invested abroad by resident direct investors acting as financial/management holding companies, or invested in resident financial/management holding companies, can be found. But it cannot be assumed that all holding companies could be considered as SPEs. Furthermore, non-holding SPEs could exist if we refer to all the international definitions expressed in the previous section. For this reason, Member States have been asked by the TF-FDI to provide an estimation of the direct contribution of SPEs in FDI statistics.

356. The Eurostat/OECD questionnaire asks information about FDI relationships with the so-called offshore centres, a group constituted by "small" economic countries (in term of GDP). FDI transactions are recorded according to the first shot criteria. It is questionable whether large amounts (if not all) invested directly in the EU by offshore centres would need to be reallocated if the UBO criteria had to be applied. Reversibly, EU direct investment towards offshore centres could be seen as investments for which we do not know exactly the final destination.

357. Given the relative "disconnection" between their GDP size and the amount of FDI capital they generate, it seems suitable to go on having a close follow up of this specific population. Another reason rests on a possible correlation between resident SPEs and offshore countries, an assumption clearly stated in Annex 3 of the OECD Benchmark definition ("Location of SPEs", p.45, 1st sentence). But this assumption will be difficult to check, at least on European data.

358. One of the purposes of the following tables is to try to convince Member States to investigate whether it is necessary to have an in-depth analysis about SPEs and offshore centres. All the following tables should be analysed, bearing in mind that:

i) the Eurostat current list of the offshore (financial) centres[49] cover in fact "non-European" offshore (financial) centres.

ii) this list has been updated recently (in October 2002, therefore mainly for the 2001 and 2000 FDI data), which might alter comparisons over time. But the former Eurostat list already contained the most significant offshore countries. Therefore, it could be expected that these (recent) changes do not influence significantly the level of FDI transactions with offshore entities.

OVERVIEW OF THE IMPACT OF OFFSHORE CENTRES ON EUROPEAN AGGREGATES

359. Table 17 presents the evolution of EU FDI transactions with offshore centres since 1995, both in absolute value and with regard to the total extra EU transactions. The non-symmetry between outward and inward flows is quite obvious: whilst the evolution is rather volatile on the outward side, EU inflows received from offshore centres have regularly increased since 1997, from €4.9 bn to €13.4 bn. Furthermore the issue linked to offshore centres seems to be more relevant on the inward side: on average over the 1995-2001 period, EU inflows received from offshore companies accounted for 9.1% of the total extra EU inflows. Two reasons could explain the smaller percentage on the outward side:

i) the Eurostat current list of offshore entities does not contain any European countries. It might be possible that EU direct investors are mainly dealing with similar entities close to the EU border (inside or outside the EU),

49 Eurostat current list of offshore financial centres (31 countries): Antigua and Barbuda, Anguilla, Netherlands Antilles, Barbados, Bahrain, Bermuda, Bahamas, Belize, Cook Islands, Dominica, Grenada, Hong Kong, Jamaica, St Kitts and Nevis, Cayman Islands, Lebanon, Saint Lucia, Liberia, Marshall Islands, Montserrat, Maldives, Nauru, Niue, Panama, Singapore, Turks&Caicos Islands, Saint Vincent and the Grenadines, Virgin Islands (UK), Virgin Islands (US), Vanuatu and Samoa.

Table 17 EU FDI flows transactions with the rest of the world and offshore centres

(EUR million)

	1995	1996	1997	1998	1999	2000	2001	1995-2001
Outward								
Extra EU	-62,407	-68,665	-109,802	-218,754	-302,395	-408,925	-234,800	-1,405,749
Offshore centres	-3,337	-5,561	-6,811	-1,830	-8,971	-7,351	-12,332	-46,194
%	*5.3*	*8.1*	*6.2*	*0.8*	*3.0*	*1.8*	*5.3*	*3.3*
Inward								
Extra EU	42,464	36,509	50,160	96,432	102,118	150,407	118,470	596,559
Offshore centres	3,427	2,583	4,932	5,816	10,234	13,628	13,403	54,023
%	*8.1*	*7.1*	*9.8*	*6.0*	*10.0*	*9.1*	*11.3*	*9.1*

whilst EU direct investment companies receive FDI capital from foreign groups located in other continents (Caribbean area or South East Asia zone).

ii) inward and outward flows related to SPEs reported from the NL are not available in the Eurostat database. May be it could fill in part of the gap of overall flows to and from offshore countries.

360. For direct investors of the Eurozone, the relative interest for investing in offshore countries is quite similar to the one observed at the EU level (3.4% of extra Eurozone outflows, see Table 18 below). But the relative weight of inflows from offshore companies is estimated to 4.1% of the total extra Eurozone inflows, 5 percentage points less that the weight observed on EU aggregates. Despite this gap, it seems reasonable to consider that percentages observed on the inward side are quite substantial, which justify the need of further investigation for analytical purposes.

361. The relative importance of the group of offshore countries is also confirmed by the FDI positions data, however with a better balancing between assets and liabilities: 5.1% and 7.4% respectively, for the European Union as a whole, 3.3% and 3.9% for the Eurozone as a whole entity (see Table 19).

362. Table 4 of the supplementary document "Special Purpose Entities" presents the classification of the main extra EU FDI partners, both on the assets and liabilities sides. At the moment, Eurostat doesn't have the possibility to offer a full breakdown of EU direct investment vis-à-vis all extra EU

Table 18 Euro area FDI flows with extra Eurozone and offshore centres

(EUR million)

	1999	2000	2001	1999-2001
Outward				
Extra Eurozone	-310,409	-411,863	-252,341	-974,613
Offshore centres	-5,523	-11,205	-16,241	-32,969
%	1.8	2.7	6.4	3.4
Inward				
Extra Eurozone	174,459	343,118	157,474	675,052
Offshore centres	8,409	7,788	11,788	27,985
%	4.8	2.3	7.5	4.1

Note: Transactions involving Dutch SPEs are excluded from Euro area calculations.

Table 19 FDI positions with the rest of the world and offshore centres

(EUR million)

	European Union Values at end 2000	Euro area Values at end 2000
Assets		
Extra EU/Eurozone	1,517,186	1,335,073
Offshore centres	77,236	44,493
%	*5.1*	*3.3*
Liabilities		
Extra EU/Eurozone	890,709	1,112,495
Offshore centres	65,800	43,790
%	*7.4*	*3.9*

Note: Transactions involving Dutch SPEs are excluded from EU and Euro area calculations.

individual countries. The current list involves 50 individual extra-EU countries, and it has been necessary to introduce some grouping zones (eight in all) to better approximate a full coverage of the extra EU area. None of these additional groups contains any of individual listed countries and, apart from the "Gulf Arabian countries" (see footnote 5), this list also avoids the possibility of having one non-listed country being included in more than one economic group.

363. When looking at the regional distribution, the results clearly illustrate the dominant positions of offshore companies, in the field of FDI:

i) assets side: offshore financial centres, excluding Singapore and Hong-Kong, hosted altogether €41 billion of EU external FDI assets, ranking in the top 6 countries' list just behind Argentina and before Australia.

ii) liabilities side: offshore financial centres, excluding Singapore and Hong-Kong, were altogether responsible of €52 bn of EU external FDI liabilities, ranking in the 3rd position just behind Switzerland and before Japan.

iii) if we add Singapore and Hong Kong, then it could be seen that the group formed by offshore financial centres, as defined in the current Eurostat list, is the 3rd EU partner both on the assets and liabilities side (€77 bn on the assets side, €66 bn on the liabilities side).

364. From this table it could also be possible to portray also the impact linked to a possible extension of the offshore list. For the moment, no official "offshore" list has been established/approved by the International Institutions. Nevertheless, the "Other European countries" group[50] defined by Eurostat involves countries having (more or less) similar characteristics to those from the Eurostat offshore list. If we had to include them in the Eurostat list, then the total amount of EU external FDI assets located in offshore countries would have jumped from €77 to €115 billion, in the 2nd position behind the United States and far ahead of Switzerland.

365. These results put forward the powerful role played by offshore centres in the field of FDI, if we consider them as a unique entity. With the perspective of improving international comparison it is questionable whether the presence of offshore entities alter significantly the regional distribution picture.

366. The extra EU FDI capital structure could also point out the specificity of these entities, as it is shown in table 20: On the liabilities side, the capital distribution between "equity capital

50 Andorra, Faroe Islands, Guernsey, Gibraltar, Isle of Man, Jersey, Moldova, Macedonia, San Marino and Vatican City State.

and RIE" and "other capital" is around two third/one third respectively. For extra EU FDI liabilities vis-à-vis foreign offshore companies, the FDI capital distribution profile diverges significantly from the extra EU average: 43% of the total assets held in the Union by offshore countries were constituted by inter-company debt stocks (see Table 20).

FOCUS ON US DATA

367. Would the application of UBO criteria alter the importance of offshore entities? A first attempt to this answer is given by the analysis of US figures, shown in Annex C of the "Report of the sub-group on Special Purpose Entities".[51]

368. The main comments are synthesised in the three following points:

(i) The application of the UBO criterion does not alter the large influence of offshore countries[52] in US statistics. Surprisingly, US figures indicate even a reinforcement of this group, when going from first shot to UBO.

(ii) However, if offshore countries are analysed individually, the role played by each of them is drastically affected by the UBO country reallocation.

(iii) There are apparently large differences between offshore centres subject to their economic background. It seems that the move from first shot to UBO does not always enable the identification of the UBO owners' nationality. In fact, the constraints encountered by the BEA for a full application of their UBO definition are not known.

RESULTS OF THE EMPIRICAL EXERCISE ON THE IMPORTANCE OF SPEs IN EU MEMBER STATES

369. An empirical investigation concerning the role of SPEs was conducted by the TF-FDI. The outcome of the empirical exercise on the impact of SPEs in b.o.p. and i.i.p. data illustrates the difficulties of such an exercise in the absence of a specific definition of SPEs in a majority of countries: five countries replied that they could not provide any information and four (BE, DE, FR and GR) provided data, essentially by approximating the definition of SPEs with one or more of the following: co-ordination centres, financial holding companies, management holding companies and "other services for enterprises".

370. The answers received are attached in Annex D of the "Report of the sub-group on Special Purpose Entities". No meaningful aggregation has been deemed feasible, given the disparity of the proxies used to compile the data.

371. The examination of the figures provided show that the amounts involved both for flows

51 See supplementary document "Special Purpose Entities".
52 Offshore centres estimated with Bahamas +Bermuda +Netherlands Antilles +Panama +UK Islands, Caribbean +Other OWH +Liberia +Lebanon +Hong Kong +Singapore.

Table 20 Extra EU FDI positions capital structure at end 2000

(%)

	Equity cap. & RIE	Other Capital	Total
Assets			
Extra EU assets, exc. Offshore centres	79	21	100
Offshore centres	92	8	100
Liabilities			
Extra EU liabilities, exc. Offshore centres	65	35	100
Offshore centres	57	43	100

and for stocks are quite significant, especially in DE. As the four countries which have provided data for the exercise are not known to be particularly attractive for SPEs, (contrary to NL), this would indicate that the validity of the approximation SPEs = holding companies is questionable.

372. As already said, SPEs cannot be identified as such within the NACE classification of activities. In international guidelines, SPEs are identified not only according to their main economic activity, but also through their structure's analysis (holding or non-holding corporation).

373. As some Member States proceed, Eurostat approximated the importance of some type of SPEs using a correspondence table to link the OECD definition (holding company, regional headquarters, management of foreign exchange risk etc.) with the main concerned classes/ groups (of the NACE rev1) for hosting SPEs. Annex E of the above-mentioned report gives an overview of this linkage together with an estimation of the impact of these groups, at the European level.

374. The fact that, apart from the NL, DK and, to a lesser extent, IE, there exists no specific definition of SPEs in EU countries may also indicate that there is no real need for such a definition because the issue is not important in these countries.

SPECIAL TREATMENTS OF SPEs IN EU MEMBER STATES

375. As already mentioned SPEs play an important role in a few countries and therefore special treatments were established in these countries. As the net flows of SPE transactions through the NL are close to zero and hardly affect the national economy, the gross flows are not included in the national FDI statistics of the NL. DK has still not decided if certain SPE activities should be excluded for national reporting and IE identifies separately a part of its SPE population. The treatment of SPEs in DK, IE and the NL is described in Annex F of the "Report of the sub-group on SPEs".

SUMMARY

376. Offshore financial centres are important FDI partners, having a significant impact on European statistics. For international comparison, it would be necessary to have an agreed list of offshore financial countries, which is also stable over time.

377. The US figures show that a moving from first shot to UBO criteria does not "globally" alter the importance of offshore financial centres. But it seems necessary to distinguish between offshore centres with a real economic background and offshore centres whose attractiveness is merely based on fiscal incentives. However, a high sensitiveness to change in criteria classifications has been observed for each offshore country taken individually. The use of UBO implies a geographical breakdown of FDI data better reflecting economic reality. But results obtained on US figures leave some "open questions" in the sense that it is not sure whether they have identified the real UBO company: between the first shot identified partner and the real UBO one, FDI capital could be in the hand of several intermediary offshore entities, and we do not know the real reasons for assuming direct FDI relations between EU SPEs and "offshore SPEs".

378. The restricted analysis on holding activities, using the Eurostat/OECD questionnaire by activity, has put forward the "potential" impact of SPEs in FDI statistics, both on European aggregates and at the Member States level. At the moment, a more accurate measure of SPEs' transactions is not feasible: none of currently available definitions – international guidelines or the national one – considers all holding companies as SPEs.

CONCLUSIONS

379. The analytical interest of a separate identification of transactions/positions related to SPEs was exposed at the beginning of this chapter. However, various problems in dealing with SPEs restrict the separate identification of SPEs. The empirical investigations on the importance of SPEs among member states has revealed that even the identification of domestic SPEs is at present obviously not possible for most member states. At best SPEs could roughly be approximated by certain sectors potentially including SPEs. Moreover, it is clear that a full analysis of the transactions/positions involving SPEs would also require the identification of non-resident SPEs when they are counterpart to a transaction/position of a resident company: this would imply the existence of a world-wide data base on SPEs, which seems an impossible goal to achieve in the absence of a universal definition of SPEs and of a general recognition of the necessity of a separate identification of the activities of SPEs.

380. The importance of SPEs varies significantly among member states. Consequently, practices and efforts in identifying SPEs and the application of special treatments differ between countries. Potential asymmetries between national statistics respectively, differences in data dissemination to international organisations should be avoided, or be properly exposed.

The TF-FDI recommends the inclusion of transactions/positions of/with SPEs or SPE-like companies in b.o.p./i.i.p. reporting concerning the contributions to the euro area/EU aggregates.

Notwithstanding all the practical and conceptual difficulties previously stated, the TF-FDI recommends that the possibility to collect separate statistics for SPEs continue being assessed by both working groups and in the framework of ad-hoc workshops in the future. To this aim, co-ordination should be ensured with the related work currently being developed in the OECD.

381. Additionally, chapter 5[53] recalled the decision of the IMF, in co-ordination with the ECB's WG-BP&ER and the OECD's Working Party on Financial Statistics (WPFS), concerning inter-company loans between affiliated MFIs. In particular, there is an explicit reference in the IMF resolution to SPEs principally engaged in financial intermediation for a group of related enterprises.

According to the IMF decision, SPEs principally engaged in financial intermediation for a group of related enterprises should be included in the category of affiliated financial intermediaries and, therefore, inter-company loans with any other institution included in this category should be excluded from direct investment and should be recorded in other investment[54].

53 See Annex 1.
54 Permanent debt should still be recorded in direct investment.

7 ALLOCATION OF FDI INWARD STOCKS BY COUNTRY OF "ULTIMATE BENEFICIAL OWNER" (UBO)

382. In line with the suggestion made in the BD (§45), the TF FDI investigated into the calculation of inward stocks data broken down by both the country of the first foreign parent and by the country of the UBO (ultimate beneficial owner). The allocation by country of UBO allows allocating FDI stocks according to the country of residence of the entity that exercises control on the capital stock considered. Data on the impact of the UBO criterion as concern the geographical allocation of inward FDI stocks were collected from AT, DK and DE.

CONCEPTUAL FRAMEWORK

INTERNATIONAL STANDARDS

383. The OECD BD does not give a definition of the UBO. During the discussion at the FATS WG, it was accepted that for FATS purposes the following definition would be used:

The *ultimate beneficial owner* is the first person proceeding up the chain (beginning with and including the first foreign owner) that is not controlled by another person.

384. This definition was taken from the one used by the BEA for USA UBO inward FDI stocks, with only difference that the American definition says "majority-owned" instead of "controlled". The use of the term "controlled" was considered preferable for FATS because majority ownership is seen as a practical criterion to approximate the target concept of control at each stage in the chain. In the last proposal of the draft regulation for FATS the UBO has been in fact renamed "ultimate controlling institutional unit" and the new proposal is as follows (article 2):

"Ultimate controlling institutional unit of a foreign affiliate" shall mean the institutional unit, proceeding up a foreign affiliates' chain of control, which is not controlled by another institutional unit."

385. This choice might not appear appropriate for FDI, which measure the lasting interest even for cases in which control on the direct investment enterprise is absent. However, it should be also clarified that the UBO in the above definitions is not necessarily the only unit having rights on the income generated by the direct investment capital considered, as it could be suggested by the term UBO. Income received is proportional to the percentage of *indirect* ownership, calculated by multiplying the percentages of ownership in the chain going up from the direct investment enterprise. This point was clarified during the FATS WG because of the existence of an old definition in the SBS framework based on the % of indirect ownership. This definition has now been deleted from the SBS set of definitions and it is not known if it has ever been applied by any country in the context of FDI statistics.

EXAMPLES

Example1: The resident direct investment enterprise (DIE) is held 100% by the first foreign parent, but then there is a 51% chain leading to the UBO. The other non-resident minority intermediate owners receive some income from the resident DIE, but they are not to be considered UBOs, even if they are not controlled by another person. This kind of calculation would be practically impossible because various different chains would need to be followed.

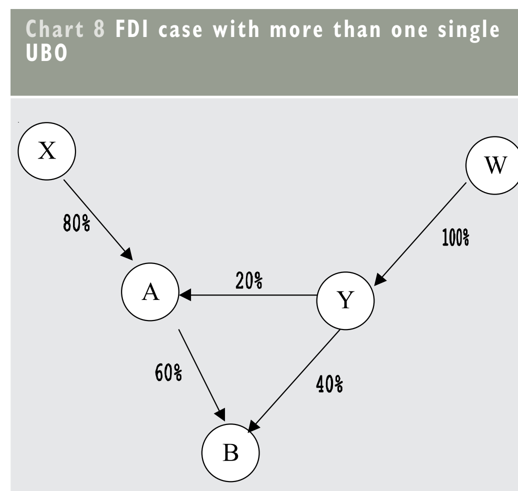
386. Here §42 of the BD can be quoted: "For inward direct investment it is possible to estimate earnings and the stock of net assets due to the immediate investing country and to reanalyse this by country of ultimate control. The share of the earnings and net assets attributable to the ultimate parent company will not normally be known. This is because the host country does not know the percentage shareholdings in the various intermediary companies between it and the ultimate parent."

387. As said before, the main difference between FATS and FDI is that for FDI also shares in resident direct investment enterprises

that are between 10 and 50% should be considered. Therefore, for one direct investment enterprise, there can be more than one UBO. An example discussed at the FATS WG in respect of the use of the rule based on the % of indirect ownership can illustrate this case.

Example 2: B is the resident enterprise while the others are located each in a different country. W holds indirectly 52% of B in the example reproduced below (Chart 8). However, X (holding 48%) should be considered as the controlling unit by the application of the step-by-step majority ownership rule. For FDI, the 60% of the stock should be allocated to the country of residency of X and the remaining 40% to the country of residency of W.

Chart 8 FDI case with more than one single UBO



388. In conclusion, it seems preferable to continue using the term UBO in FDI and not adopt the UCIU terminology introduced for FATS. There are differences with FATS in that also minority shares are considered. However, the selection of the UBO in terms of indirect ownership shares is not correct.

389. The fact that there can be multiple UBOs suggests clarifying the definition given in the beginning as follows:

> The *ultimate beneficial owners* are the first persons proceeding up the chains (beginning with and including the first foreign owner of each FDI position of a direct investment enterprise) that are not controlled by another person.

PRACTICAL APPLICATION IN SOME EU COUNTRIES

RESULTS OF THE SURVEY ON INDIRECT RELATIONS

390. The questionnaire on indirect FDI relationships mentioned in chapter 2 requested information on, inter alia, the availability of data concerning the ultimate beneficial owner of foreign direct investment flows and stocks. The answers to this question have been summarised in Table 21:

Table 21 UBO principle: countries in which the information is available [1)]

Name of ultimate mother	7	(+1)
Country of residence of the UBO	10	(+1)
% of direct ownership of the UBO	2	(+2) [2)]
% of indirect ownership of the UBO	2	(+2)
Details of levels in between	(1)	

1) Numbers in brackets represent countries in which the information is only partially available.
2) These data are only known in case an organisation chart is available.

391. Methodology and information sources: countries normally request the identification of the UBO to the respondents in the FDI survey. If no UBO is mentioned, the directly linked foreign owner is considered as the UBO. For some countries, more than one single UBO could exist (each one holding a share of more than 10%).

392. The production of additional statistics based on the UBO was considered feasible for a large majority of respondents (10). However, the feasibility should be subject to the following conditions:

– All countries should agree on a common approach.

– The methodology to be applied should be clearly defined. For instance, in cases where more than one single UBO exists, the

criterion to allocate the data should be established.

– Suitable software application to extract data should be available;

– In some cases, more detailed data would need to be asked to the resident enterprise;

FURTHER INFORMATION ON COUNTRY PRACTICES

393. From Table 22 below reproduced from the SIMSDI results, it can be seen that 8 EU MS (AT, Belgium, DK, DE, IE, Luxembourg, Portugal and Sweden) compile inward FDI stocks also according to the country of UBO. The remaining EU MS do not have plans for calculating stocks on the UBO principle.

394. Descriptions of the method used and data comparing FDI stocks with first shot and UBO allocation have been supplied by AT, DK and DE. These contributions are given in Annex 6, at the end of this report.

395. As concerns the methods, the main difference is that in DE and in DK only the country of the UBO is known. The information is asked to the respondents and if the reply is not supplied, the first shot and the UBO are assumed to coincide. Also in AT the

Table 22 Allocation of geographical FDI position data

	Countries compiling geographical breakdown in respect of the:			
	Immediate host/investing country		Ultimate host/investing country	
OECD countries	Inward	Outward	Inward	Outward
Australia	IM	IM		
Austria		IM	UL	
Belgium	IM	IM	UL	UL
Canada	IM	IM		
Czech Republic	IM	IM		
Denmark	IM	IM	UL	UL
Finland	IM	IM		
France	IM	IM		
Germany	IM	IM	UL	
Greece	IM	IM		
Hungary	IM	-		
Iceland	IM	IM		
Ireland	IM	IM	UL	-
Italy	IM	IM		
Japan	IM	IM		
Korea	IM	IM		
Luxembourg	IM	IM	UL	UL
Mexico	IM			
Netherlands	IM	IM		
New Zealand	IM	IM		
Norway	IM	IM		
Poland	IM	IM		
Portugal	IM	IM	UL	
Slovak Republic	IM	IM		
Spain	-	-	-	-
Sweden	IM	IM	UL	UL
Switzerland	IM			UL
Turkey	-	-	-	-
United Kingdom	IM	IM		
United States	IM	IM	UL	
Total OECD (30)				
Immediate host/investing	**24**	**21**		
Ultimate host/investing			**9**	**5**
Response not available or not applicable	**2**	**5**		

information is asked to the respondents, but with more detail including the name and the % of ownership in the intermediate steps of the chain of control. Another important difference is that in AT and in DE the allocation by UBO is made on total FDI stocks (including other capital) whereas in DK equity capital only is considered. The detailed information supplied by the three countries is annexed to the report.

396. The countries participating in the subgroup also sent data that can be used to compare the geographical allocation of FDI stocks under the first shot and the UBO criterion. The impact of the UBO criterion on the intra-EU vs. extra-EU allocation is very important in DE and in even more so in DK. In DE, FDI stocks controlled by the extra-EU at the end of 2000 increase by 33,690 million EUR on a total (first shot, extra-EU) of 106,101 million EUR (i.e. 32%). In DK, the extra-EU stocks according to the UBO criterion are 29,271 million EUR against 10,141 EUR million according to the first shot criterion. In AT, the impact was lower: 7,315 with the UBO vs. 6,967 with the first shot.

397. Within the extra-EU aggregate, the allocation to main partners is also affected. In the case of DE, for instance, the USA has 66,602 EUR million with the first shot criterion and 87,273 EUR million with the UBO. In DK, the FDI stock held by the USA is 4,175 EUR million with the first shot and 19.829 EUR million with the UBO. In AT the effect is 13,325 EUR million with the first shot versus 23,923 EUR million with the UBO.

EU AGGREGATES AND UBO ALLOCATION

398. The national data calculated by Member States (see Annex 6 for the tables with data) cannot be aggregated directly to produce Extra-EU aggregates according to the UBO. If there is an enterprise in DE held by an Austrian and then ultimately by the USA, both DE and AT would record the USA as the UBO (for AT the USA is also the first shot). EU inward stocks held by the USA would be inflated.

399. To avoid double counting, only the inward stocks directly held by an extra-EU country should be reallocated according to the country of the UBO. As a result, the size of the inward stocks controlled by the extra-EU cannot increase for the effect of the reallocation from the first shot to the UBO country of ownership. It would decrease in those cases when the first shot is extra-EU, but the UBO is intra-EU.

400. However, the value of the FDI liabilities directly and indirectly controlled by extra-EU countries (the consolidated Austrian and German enterprise FDI parts in the example above) would be correctly assessed only if the FDI stock recorded by the point of entry (the Austrian enterprise in the example) are recorded according to the consolidated system.

CONCLUSIONS AND RECOMMENDATIONS

401. The TF-FDI discussed some definitional aspects of the UBO. Firstly, the main methodological sources do not contain a definition of the UBO. Secondly, the present formulation of the methodology in the BD refers to net assets. Therefore, it was discussed whether the allocation of FDI inward stocks by country of UBO should be limited to equity capital (including reserves) or should concern also other capital.

- Concerning the definition of the UBO, the TF-FDI recommends the following definition that takes into account the possibility that different UBOs exist for the same direct investment enterprise. The *ultimate beneficial owners* are the first persons proceeding up the chains (beginning with and including the first foreign owner of each FDI position of a direct investment enterprise) that are not controlled by another person.

- Concerning whether or not FDI other capital stocks could/should also be allocated according to the UBO principle, the TF-FDI could not find a way out towards a convergent opinion.

402. Special cases. In the chain above the first foreign owner, there can be an entity that is not majority-owned by another, although control may be exercised by another person with a minority share of ownership. In this case there are 3 alternatives: 1) Try to identify the controller (UBO). 2) Use the majority-ownership criterion and assign the UBO to the country of the unit in question because it is not majority-owned in its turn. 3) Split the country of UBO among the minority-owners of the unit according to the respective percentage of ownership. The last treatment is applied by AT.

403. The TF-FDI also discussed the practical methods applied in 3 MS to collect information about the UBO. In all 3 MS, the information is collected from the respondents. DK and DE ask information about the country of residence of the UBO, whereas AT requires more detailed information about intermediate owners and percentages of ownership.

404. Both approaches are acceptable, as the only information needed for the statistics is the country of the UBO. A problem of comparability may arise with less information asked, because respondents may apply different criteria for identifying the UBO in cases in which there not a clear link of control. The request of additional information is certainly helpful also for validation and quality checks of the information, but implies a higher reporting burden.

405. As a possible source for the information on the UBO, the TF-FDI discussed a short report on the state of advancement of the recent work on enterprise groups from Eurostat (unit D1) and Member States in the framework of the business register. Information about the *group head* is to become available from the business register.[55]

– The *group head*, apart from minor differences, is equivalent to the Ultimate controlling institutional unit considered in FATS. The concept of UBO applied in FDI statistics is also the same, but it differs because it is applied to FDI stocks and not to the whole enterprise. In the case of minority participation this source would therefore not be useful. The same conclusion applies to private databases giving information about the ultimate controller of an enterprise.

406. The TF-FDI also analysed the data supplied by the three MS of the sub-group about the effect of the reallocation by UBO of FDI stocks.

– The impact of the UBO criterion on the intra-EU vs. extra-EU allocation is very important in DE and is even more so in DK. It is less important in AT, although also in AT main partners such as the USA are substantially affected.

407. Finally, the TF-FDI discussed obstacles and possible solutions for the calculation of EU aggregates based on the UBO allocation.

– An aggregate based on the UBO could not be calculated by summing up the respective parts of the MS because the same UBO can be counted more than once at the EU level.

– A possibility for calculating EU aggregates could be based on data re-allocated by UBO only for the part of direct investment enterprises of each MS that are directly owned by an extra-EU country. However, the value of intra-EU stocks controlled by extra-EU countries would be correctly assessed only if these data reflect the consolidated value of the FDI stocks that is controlled in the intra-EU by these units.

408. The TF-FDI did not discuss the practical implementation of data collection on the UBO principle at the EU level. As seven MS do not collect or plan to collect UBO data, this type of discussion was not possible. Furthermore, the

55 Complete documents on the enterprise group methodology (Chapter 21 of the *Business Register Recommendations Manual*) is available on Business Methods web site in Eurostat's CIRCA at the address:http://forum.europa.eu.int/irc/dsis/bmethods/info/data/new/embs/registers/embs1_5.html

theoretical discussion held about the calculation of EU aggregates showed that this topic should be further analysed in the light of the conclusions and further actions taken in respect of the consolidated system for FDI statistics.

8 GENERAL CONCLUSIONS AND RECOMMENDATIONS

INTRODUCTION

409. This final chapter aims at condensing all conclusions and recommendations that the TF-FDI has addressed along the previous sections of this report, while providing with a certain prioritisation for the measures to be taken hereafter.

410. At the time of elaborating follow-up proposals, the TF-FDI always borne in mind the fairly demanding context of changes in collection systems in which most member states are currently embarked. However, this specific situation was the main reason why the TF-FDI considered this as the right moment to address all possible minimum requirements that any future system will need to accomplish in the foreseeable future.

411. As it has been the case of previous task forces, the TF-FDI started its work by trying to identify the most significant problems experienced by national systems at present. With a view to finding the best solutions to those problems, the TF-FDI undertook a detailed analysis aimed at identifying best practices from the methods currently in place in member states so as to promoting their wide spread use across European Member States.

412. The analysis of current practices offered a fairly dissimilar picture across individual Member States. The coexistence of different systems may be to some extent at odds with the need to produce consistent European aggregates and guarantee a certain degree of homogeneity. For this reason, the TF-FDI is of the opinion that sharing common solutions to common problems as well as general shifts towards further standardisation should be deemed positive steps which may provide substantial benefits.

413. The TF-FDI mandate encompassed five main issues, namely: (i) valuation of stocks; (ii) reinvested earnings; (iii) other capital; (iv) SPEs; and (v) indirect FDI relationships and statistics based on the ultimate beneficial owner (UBO) principle. Across the analysis carried out by the TF-FDI, it became obvious that the fifth item (mostly in relation to the coverage of indirect FDI relationships) required a higher prioritisation since it influenced how to interpret the conclusions of most other items. For that reason, item (v) was split into three parts, the first two referring to indirect FDI relationships (from the conceptual and the practical viewpoints, respectively) and the third one referring to the UBO.

414. The most significant issues encountered in the analysis of these individual items are briefly presented after this introduction. Subsequently, following the request from the Statistics Committee, a prioritisation of the measures recommended is provided, in which the most urgent problems to be solved are highlighted. Finally, those issues that have not been covered by the TF-FDI (as they were not part of its mandate) and for which some follow-up work seems recommendable are listed in the final section of this chapter.

CONCLUSIONS AND RECOMMENDATIONS FOR INDIVIDUAL ITEMS

THE FULLY CONSOLIDATED SYSTEM AND THE COVERAGE OF INDIRECT FDI RELATIONSHIPS

415. This chapter aimed at providing a unique interpretation of international standards as regards whether or not and how indirect FDI relationships should be covered by FDI statistics, purely on conceptual grounds. The practical application of this unique interpretation was developed in the following chapter.

416. Firstly, the TF-FDI agreed that indirect relationships should undoubtedly be covered by FDI statistics.[56]

56 This recommendation is very relevant for all FDI items, namely equity capital, reinvested earnings and other capital. For a more detailed analysis of the conceptual treatment suggested for the different FDI components, please refer to chapter 1 of this report.

417. Concerning indirect FDI relationships, two different types were identified: (i) parent company – affiliate (without any reciprocal direct links of ownership above 10%); and (ii) sister/fellow companies, i.e. pertaining to the same group, but without either direct or indirect links of ownership. As a very general summary of the main recommendations, for the first group of companies, flows and stocks should be classified by the parent company as outward FDI and by the (indirectly owned) direct investment enterprise as inward FDI. In the case of sister companies, flows and stocks should be classified as outward FDI by the country which provides the investment or grants the loan and as inward FDI for the country receiving the investment/loan.

418. Additionally, both the book-value-based FDI equity stocks and reinvested earnings should incorporate indirect relationships to the extreme described in chapter 1. Since all practical measures to be taken henceforth in connection with this issue are addressed in the next section, the TF-FDI just recommends that all countries agree and put into practice the methodology described in chapter 1 so as to avoid asymmetries and inconsistent treatments.

PRACTICAL ASPECTS RELATED TO THE COVERAGE OF INDIRECT FDI RELATIONSHIPS

SIMPLIFICATION PROPOSALS TOWARDS THE COVERAGE OF INDIRECT FDI RELATIONSHIPS

419. The common interpretation of international standards established in chapter one implies that indirect FDI relationships should be undoubtedly covered by FDI statistics. Therefore, the TF-FDI investigated into the difficulties currently faced by member states to comply with standards. The review of current practices in the compilation of FDI statistics revealed that EU member states are essentially split into two groups: those that only cover direct FDI relationships at present and those that also cover indirect FDI relationships to a larger or fewer extent in practice.

420. The TF-FDI considers that a full application of the fully consolidated system (FCS) by all countries is virtually unfeasible on practical grounds. The possibility to restrict FDI statistics to only cover direct FDI relationships has the advantage of simplicity and a lower burden on respondents (which are obliged to report less information) and, in same cases, also on compilers. In addition, and mainly from the point of view of the compilation of supranational aggregates, this approach would suffer from fewer problems concerning the geographical allocation of flows and stocks. However, this approach would not be compliant with international standards and the outcome would offer a lower analytical value, specially considering the increasing role of special financial vehicles, clearing centres, etc. in the investment strategy of multinational groups.

421. In order to find out an alternative that could be consistent with international standards but also easier to apply in practice (than the full application of the FCS), the TF-FDI explored other solutions. The most important difficulty is how to find practical ways for collecting the necessary information, since the longer the chain of links between companies, the more difficult it is to get access to the balance sheet of foreign subsidiaries with no direct link to the domestic mother company.

422. Against this background, the TF-FDI suggests a simplification of the rules described in the FCS as the minimum with which all countries should be compliant. Such a minimum common approach would narrow down the risk of asymmetries and would reduce the impact on the European aggregates of the different methodologies applied in member states.

The two admissible simplifications that should constitute the bottom line for all practices at the EU level would be as follows:

(i) *The coverage of indirect links of ownership above 50%.*[57, 58]

(ii) *The coverage of direct and indirect links of ownership above 10%, calculated as the simple product of the subsequent links of ownership along a chain.*

GEOGRAPHICAL DISTRIBUTION OF FDI FLOWS/STOCKS RELATED TO INDIRECT FDI LINKS

423. The use of non-fully harmonised criteria for the geographical allocation of country contributions to the European aggregates (in relation to the existence of indirect FDI ownership links) implies a high risk of double recording and/or missing information. With a view to avoiding such a risk, the TF-FDI recommends that, for both reinvested earnings and FDI equity stocks, all (indirect) FDI transactions/positions should be geographically allocated to the immediate affiliate (direct investment abroad) or immediate parent company (direct investment in the reporting economy), i.e. the one with which the investor/direct investment enterprise maintains a direct link of ownership.

424. It is acknowledged that this criterion may result in less valuable statistics from the analytical viewpoint. For this reason, the TF-FDI would encourage countries to collect and publish additional information on the geographical allocation of FDI flows and stocks based on the residence of the ultimate beneficial owner, whenever such information were not too difficult to obtain (see also the UBO section).

EUROPEAN DATABASE ON OWNERSHIP STRUCTURES

425. The TF-FDI analysed the issue from two different points of view: (i) as potential data providers; and (ii) as users of the information.

426. From the point of view of potential data providers, four countries (DE, FR, ES and IT) investigated their ability to contribute to a European database with the information on ownership structures for multinational groups available in the statistical departments of their respective NCBs.

427. The main findings of the TF-FDI pointed out that, while the existence of a centralised database with information about the structure of multinational groups would be seen as a very useful tool for the compilation of FDI statistics, the provision of the necessary information would imply a number of significant problems, such as (i) a need for additional (monetary and human) resources would exist; (ii) the respective national legal backgrounds would force to ensure confidentiality; (iii) there could be technical problems to adapt the information of the database to the structure of multiple and different national collection systems; (iv) the availability of the data would remain a concern, inter alia, since most public sources only cover listed enterprises; (v) the specific situation of each individual group at different time periods should be maintained in the database so as to allow the compilation of statistics across time; (vi) the existence of individual identification codes (e.g. ISIN) for each enterprise would be an absolute must.

428. From the point of view of potential users, the TF-FDI suggests that a harmonised and multilateral solution should be highly welcome. In this context, the TF-FDI received late notice about the ongoing project on a European Business Register, currently being developed by Eurostat in collaboration with the ECB. In this regard, it is suggested that other bodies, for instance, the ECB's WG-BP&ER and the Eurostat's Balance of Payments WG, elaborate the list of user requirements which would permit that the final product could be used for the compilation of FDI statistics.

57 All direct links of ownership above 10% would still need to be covered.

58 Some testimonies in the TF-FDI pointed towards the significant proportion represented by FDI relationships above 50% over the total FDI figures. Additionally, this information is more easily available to domestic respondents in those cases in which there is an obligation to compile consolidated accounts. Therefore, it was concluded that efforts should aim at appropriately covering at least this kind of links.

VALUATION OF FDI EQUITY STOCKS

429. The TF-FDI considered practical problems for the implementation of the STC decisions concerning how to value FDI equity stocks. No other alternative methods were considered in this analysis. The decisions of the STC could be summarised as follows:

1. FDI in listed companies' shares shall be valued on the basis of stock exchange prices in the euro area i.i.p.

2. FDI in non-listed companies' shares shall be valued on the basis of book values in the euro area i.i.p.

3. Book values consist of the application of ownership percentages to the sum of selected accounts extracted from the liabilities side of the target FDI company's balance sheet (according to the common definition of OFBV).

4. Two (four) memorandum items will be compiled on a centralised way: inward and outward euro area FDI based on market values and book values for all types of companies, respectively (with no geographical or sector details).

5. To this aim, inward and outward FDI equity stocks should be reported to the ECB with an split between listed and non-listed FDI companies, and FDI stocks in listed companies' shares should be reported on the basis of both market values and book values.

430. In reviewing all possible practical problems that the implementation of all these proposals could entail, the TF-FDI considered the absence of FDI surveys for the compilation of stock statistics as a major difficulty. Such a problem has implications on the ability of certain member states to implement the decisions adopted by the STC as regards valuation of FDI equity stocks.

Concerning this issue, the TF-FDI is of the opinion that the compilation of FDI equity stocks should be based on information collected via FDI surveys, at least on an annual basis.[59] *The provision of annual FDI stocks based on accumulation of b.o.p. flows should be discontinued as soon as possible.*[60]

In relation to this subject, the TF-FDI ranks this issue as the first priority for any follow-up work subsequent to the delivery of this report.

431. Concerning practical solutions to collect the necessary information to comply with the STC agreements, the TF-FDI makes the following recommendations:

DISTINCTION BETWEEN LISTED AND NON LISTED COMPANIES

432. The TF-FDI considered the following as possible and acceptable information sources: (i) registers of (resident) listed companies maintained by stock exchange authorities; (ii) information provided by respondents; (iii) manual distinction based on internal databases and/or publicly available sources (e.g. financial press, stock exchange web sites, etc.)

VALUATION OF STOCKS IN LISTED COMPANIES

433. The TF-FDI, on the basis of the results of the individual national feasibility studies carried out by six Member States, has come to the conclusion that:

The collection of FDI equity stocks for listed companies on the basis of two different valuation methods (market values and book values on the basis of the common definition of OFBV) can be deemed feasible and not too costly for member states running FDI surveys.

434. Good/acceptable practices: the most feasible way to collect market values and book values for listed companies' shares is through

59 Some additional information such as a market valuation of FDI in listed companies could be compiled by other means, as previously stated in this report.
60 Exception made of the delivery of provisional estimates by end-September (where applicable) and of real-state investments.

the information provided by respondents via the addition of supplementary questions to the FDI surveys. Additionally, individual valuation methods based on stock exchange prices combined with internal databases and publicly available information have also proved to be a viable way to get this information, especially in the case of inward FDI. This is also a very powerful tool to double-check the consistency and accuracy of the information provided by respondents, although it is less feasible concerning outward FDI (at least, until a fully operational Centralised Securities Database is available).

435. In addition, the TF-FDI has identified the following non-acceptable practices:

1. To leave the choice to the respondents on the valuation criterion (market values or book values) they wish to use to report FDI stocks. This can neither ensure the provision of the necessary information to the ECB nor guarantee the compilation of consistent FDI equity stocks.

2. Application of perpetual inventory methods/ accumulation of b.o.p. flows.[61] This relies on the reasons previously explained.

COMPILATION OF FDI STOCKS AT T+9 MONTHS

436. The TF-FDI concluded that, in the current situation, only four member states are already in a position to provide pure stocks data, based on surveys, within the required timeliness. The others can only accumulate flows to the last available stocks (perpetual inventory method), usually adjusted for exchange rate changes, and in few instances for price changes. The provision of figures with the required geographical breakdown (shortly on a step-3 basis) does not seem to pose significant problems for most countries.

REINVESTED EARNINGS

437. A review of current practices revealed that some member states have not established yet any system to calculate/estimate reinvested earnings.

The TF-FDI deems the non-inclusion of reinvested earnings as the most relevant problem in this area. This difficulty seems to be closely connected with the lack of FDI surveys, which should be resolved promptly, in line with the proposal made for FDI equity stocks.

438. All other TF-FDI recommendations are basically determined by how reinvested earnings (RIE) are calculated. RIE are calculated as the difference between two variables: total profits from current operations and dividends payable. The first component is normally available later than the second one and, hence, RIE (or rather total profits) are often temporarily estimated from the projection of total profits as presented in the last available FDI survey.

TOTAL PROFITS

439. International standards prescribe the application of the Current Operating Performance Concept for the measurement of total profits, i.e. the exclusion of extra-ordinary gains and losses. Only five EU countries are compliant with this so far. In considering the need to adapt systems to the application of the COPC, the TF-FDI suggests two types of information sources, both connected with the accounting statements of the respondents: (i) companies' public accounts; and (ii) restricted information internally available to the companies.

440. Although the split between ordinary and extraordinary gains/losses in accounting statements is not necessarily consistent with statistical definitions, it was considered by the TF-FDI to be an immediately available proxy for the time being. The first information source (public annual accounts) on its own cannot be considered as an acceptable proxy for the COPC without additional information internally available to respondents, notably, the geographical breakdown of the information.

61 Exception made of the delivery of provisional estimates by end-September (where applicable) and of real-state investments.

Therefore, a combination of both information sources would be necessary in any case.

441. The development of the new IAS will imply a more specific definition of the components which may serve as a firm basis for the harmonisation of MS' application of the COPC. However, the development of the new IAS may pose an additional difficulty for compilers to properly apply the COPC, to the extent that only very exceptional results will be excluded from the ordinary profits and losses.

The TF-FDI concluded that inconsistent treatments caused by different practices imply serious distortions for the euro area/EU current account. Therefore, since the data necessary for a COPC valuation of profit is available from the respondents' accounting:

> *The same concept for the compilation of total profits, namely the COPC, should be used by all MS, i.e. exceptional results should be appropriately excluded from the current account.*
>
> *As current practices within the EU indicate how difficult this may be on practical grounds, the TF-FDI concluded that acceptable solutions for the application of the COPC should aim at covering at least the reduced number of companies which contribute the most to extraordinary results.*

442. Concerning the second recommendation, the experience of some member states (e.g. UK and Germany) is that a reduced number of companies involved in FDI relations (in some cases, holding companies[62]) contribute to most of the extraordinary gains/losses. For the other companies, the all-inclusive approach may be applied, since it often provides similar results to the COPC. An acceptable practice would therefore be to apply the COPC, as a minimum, only to such companies (namely the biggest ones plus holding companies) in each MS, and to collect the rest on an all-inclusive basis.

DIVIDENDS

443. Time of recording: international standards prescribe the recording of dividends when payable rather than when they are paid. The foreseeable increase in the use of direct reporting through surveys may bring the practices closer to international standards, as they are likely to reflect accruals-based accounting data. This changeover though will not take place in the short term. Nevertheless, asymmetries will only occur in short time spans, since the difference between payable and paid is usually only a matter of time allocation during a fairly limited period.

444. The treatment of dividends stemming from exceptional capital gains may be a problem in so far as it affects the calculation of reinvested earnings. While exceptional results are not included in total profits (according to the COPC definition), it is questionable whether or not, once payable, they should be recorded in the current account as income on direct investment.

445. As regards the provision of funds to affiliates to cover losses, some countries record it as negative dividends, while some others do it in the financial account.

Conclusions

- *Concerning the time of recording, the TF-FDI suggests that member states keep on with their current practices for practical reasons and due to the limited impact on the resulting statistics in prolonged time spans. However, member states are requested to switch from paid-up dividends to payable dividends (where relevant) if they move towards direct reporting systems.*

- *Concerning payment of dividends stemming from exceptional capital gains, in accordance with international standards, the TF-FDI recommends their recording in the*

62 Such holding companies normally present very high profits/losses in the financial year compared with a relatively low volume of equity capital.

financial account as FDI disinvestments (thus not entering in the calculation of RIE).

– *As to contributions to cover losses in direct investment enterprises, in line with international recommendations, the TF-FDI proposes that these transactions should be recorded in the Financial Account, as additional investment flows and not as direct investment income.*

446. Finally, as a reference to the recommendations related to the treatment of indirect FDI relationships, it should also be noted that the coverage of reinvested earnings generated by indirectly related direct investment enterprises should at a minimum meet one of the following simplified rules: (i) coverage of indirect links of ownership above 50%[63]; or (ii) coverage of all (direct and indirect) ownership links above 10%, calculated as the simple product of the subsequent ownership links along a chain.

OTHER CAPITAL

447. The TF-FDI tried to seek clearer guidance on the inclusion/exclusion of some borderline cases within FDI other capital. In particular, the TF-FDI addresses the following recommendations:

– *Preferred shares* should be excluded from other capital and recorded as Direct Investment/Equity capital unless they take the form of *non-participating shares.*[64]

– *Permanent debt* (e.g. subordinated loans, perpetual bonds, etc.) should be included in Direct Investment/Other capital, regardless whether or not it takes the form of securities.

– Trade credits, financial leasing, and any other type of intercompany loans should be included in Direct Investment/Other capital, while financial derivatives (in accordance with final agreements between the ECB and the IMF) should be excluded from FDI statistics.

– When both parties involved in lending activities are MFIs, financial intermediaries or financial auxiliaries, only permanent debt should be included in Direct Investment/ Other Capital. This recommendation could raise some confidentiality concerns in some Member States, as the granting of permanent debt to affiliate companies in the banking sector is usually rather limited. In such cases, the contributions to the European aggregates could be flagged as confidential.

448. Additionally, the TF-FDI tried to find practical solutions to collect the necessary information from reporting agencies. The identification of best practices necessarily entailed an analysis of general collection systems for FDI statistics notably to avoid the risk that different recommendations could be addressed for different topics, presenting an incoherent approach across all FDI elements.

In this framework, the TF-FDI is of the opinion that the two main problems concerning FDI other capital are: (i) the incomplete coverage of both transactions and stocks between affiliated companies, such as securities and trade credits, lending activities between fellow companies (i.e. companies with the same ultimate parent company but not belonging to the same ownership chain), etc. and (ii) the partial application of the directional principle by some Member States.

449. The general collection methods for FDI flows and stocks can be split into two main categories: survey-based and settlement-based systems. The practical solutions acknowledged by the TF-FDI for a consistent application of the directional principle could most probably not be deemed very innovative, but no other alternatives have been found.

63 All direct links of ownership above 10% would still need to be covered.

64 Non-participating shares do not provide the right to participate in the distribution of the residual value on dissolution and to the return on equity, but rather to the payment of fixed dividends (interest). They should be recorded under Direct Investment/ Other capital.

450. For survey-based systems, the TF-FDI is of the opinion that the most effective way to collect the necessary information would be the *addition of questions to the survey form*, requesting separately each component of other capital and taking into account the directional aspect of the investment (i.e. from parent companies to their affiliates and from affiliates to their parent companies, separately). One alternative to the direct request of separate information from reporters could be to instruct the reporters on how to reclassify (from inward to outward FDI or vice versa) the funds provided by affiliates to their parent companies. This would require that the instructions accompanying the survey form were appropriately amplified to clearly specify in which cases and how this reclassification should be made and the elements required, giving examples where possible. This second option could be more cost-effective (from the standpoint of both reporters and compiler) once appropriately set up. However, it could also be more incomplete and could not suffice to fulfil all requirements (e.g. would not provide separate information on the split between loans provided by mother companies to their affiliates and loans provided by affiliates to their mother companies).

451. For settlement-based systems (which, according to a previous recommendation of the TF-FDI, are only suitable to collect FDI flows), *the codes used to collect information from reporters should be expanded* (where necessary) to include the elements of other capital required. They should also include information on the direction of the investment to satisfy the requirements of the directional principle. The TF-FDI also recommends that instructions to reporters should also be expanded to specify the requirements. A database on FDI relationships of resident companies, as in Austria, is a useful tool to ensure that any other capital transaction involving affiliated companies is effectively recorded under direct investment, although its maintenance normally requires a significant amount of resources.

SPECIAL PURPOSE ENTITIES (SPEs)

452. Due to the increasing role of these companies in the provision of intra-group financing and other services, the TF-FDI examined the appropriateness of collecting separate statistics for this type of companies and, in particular, of an alternative treatment for transactions and positions in which SPEs are involved. More specifically, the TF-FDI considered the possibility of "passing through" this kind of enterprises (i.e. do not record either assets or liabilities) in those cases in which SPEs do not carry out any real economic activity in the territory in which they are located.

453. The TF-FDI disregarded both options (i.e. a different treatment and the collection of separate statistics) on the grounds that international standards recommend treating SPEs as any other FDI enterprise (exception made of some special cases[65]) and do not require any separate statistics for this kind of institutions. Additionally, the non-existence of a single harmonised definition of SPE would hamper their identificantion as well as the application of different rules for the recording of transactions and positions in which these entities are involved.

454. At present, most countries do not distinguish transactions/positions with non-resident SPEs from those with any other foreign transactor. Furthermore, most member states do not separately identify domestic SPEs in their regular statistics.[66] A change in the methodology applied to these companies would be confronted with the difficulty to calculate consistent historical series.

65 For instance, in the case of holding companies (for which a reclassification in the economic sector of activity is recommended) or SPEs with a financial nature (for which it is recommended excluding from FDI statistics intra-group lending and borrowing vis-à-vis other related corporations with a financial nature).

66 One country excludes SPEs from national statistics, since, if that were not the case, national statistics would be blurred by the volume of financial transactions between non-resident entities channelled through domestic SPE's.

– *The TF-FDI recommends the inclusion of transactions/positions of/with SPEs or SPE-like companies in b.o.p./i.i.p. reporting concerning the contributions to the euro area/EU aggregates.*

– *Notwithstanding all the practical and conceptual difficulties previously stated, the TF-FDI recommends that the possibility to collect separate statistics for SPEs continue being assessed by both working groups and in the framework of ad-hoc workshops in the future.*[67]

– *Following the latest decisions of the IMF and the ECB, SPEs principally engaged in financial intermediation for a group of related enterprises should be included in the category of affiliated financial intermediaries and, therefore, inter-company loans with any other institution included in the category of MFIs / affiliated financial intermediaries should be excluded from direct investment and should be recorded in other investment.*[68]

ALLOCATION OF FDI INWARD STOCKS BY COUNTRY OF "ULTIMATE BENEFICIAL OWNER" (UBO)

455. Following its mandate, the TF-FDI analysed the possibility and implications of classifying inward FDI stocks by the country of the UBO.[69] The compilation of FDI statistics based on the UBO principle implies allocating FDI stocks according to residence of the entity that exercise control on the capital stock considered.

456. The TF-FDI assessed the impact of applying the UBO principle on the intra/extra-EU allocation and concluded that such impact was significant in most of the cases analysed (namely on two out of the three countries for which this information was available).

DEFINITION OF UBO

457. *Ultimate beneficial owners* are the first persons proceeding up along the chain that are not controlled by any other company. This definition should be applied at least to equity capital.

PRACTICAL METHODS TO COLLECT INFORMATION BASED ON THE UBO PRINCIPLE

458. Two approaches were identified by the TF-FDI to apply the UBO through the FDI surveys: (i) direct collection of UBO-based FDI stocks from respondents; and (ii) calculation by the compiler on the basis of more basic information (e.g. on all intermediate owners plus percentages of ownership) collected from respondents.

CALCULATION OF EU AGGREGATES BASED ON THE UBO ALLOCATION

459. In the case of the EU aggregates, the application of the UBO criterion may imply some double recording related to the inward FDI stocks held by non-euro area countries. For this reason, the TF-FDI recommends that the UBO should only be applied in those cases in which EU direct investment companies are directly owned by an investor located in an extra-EU country. However, the value of the FDI equity stocks controlled by extra-EU countries should also reflect the consolidated value of the group, including other affiliates (inside or outside the EU/euro area), in line with the recommendations related to the treatment of indirect FDI relationships.

460. The TF-FDI did not hold a conclusive discussion on the practical ways in which these proposals could be implemented in practice. Therefore, it is proposed that some further work in this area should be part of the follow-up to the TF-FDI.

67 To this aim, co-ordination should be ensured with the related work currently being developed in the OECD.
68 Permanent debt should still be recorded in direct investment.
69 The mandate did not explicitly request assessing the possibility of a mandatory collection of statistics based on the UBO principle and, therefore, the TF-FDI did not analyse such a possibility. Being of a more political nature, such a discussion should most probably take place in both working groups.

PRIORITISATION AND TIMING FOR IMPLEMENTATION OF THE TF-FDI RECOMMENDATIONS

461. The TF-FDI was requested by the Statistics Committee to provide an appropriate prioritisation of its recommendations, with a clear emphasis on those actions which were considered more urgent for the quality of FDI statistics. Following this request, the TF-FDI has divided its recommendations into three categories according to the potential distortions that departing from its recommendations could entail for the European aggregates: high, medium and low importance, respectively.

462. Additionally, a second dimension refers to the effort that each individual action would

Table 23 Matrix of conclusions: prioritisation and timing for implementation of the TF-FDI recommendations

	Importance		
Timeframe	**High**	**Medium**	**Low**
Short-term	• All countries should start compiling FDI equity stocks and reinvested earnings on the basis of the results of FDI surveys, at least annually. [1] • FDI equity stocks should be collected separately for listed (both book [2] and market values) and non-listed companies. • All indirect FDI relationships [3] should be conceptually treated in accordance with the interpretation of standards outlined in chapter 1. • All (indirect) FDI transactions/positions should be geographically allocated to the immediate affiliate or parent company.[4]		• Contributions to cover losses of direct investment enterprises should be recorded in the financial account.
Medium-term	• The COPC should be used by all MS. [5] • The components of other capital should be identified on the basis of the recommendations provided in chapter 6.	• Contribute to the development of a European database with information about the structure of multinational groups. • Payment of dividends from exceptional capital gains should be recorded in the financial account (thus not entering in the calculation of RIE).	
Long-term	• Indirect FDI relationships [6] should cover in practice (as a minimum) either (i) indirect links of ownership above 50%; or (ii) direct and indirect links of ownership above 10%, calculated as the product of the subsequent links of ownership along a chain. • The directional principle should be (fully) applied by all member states for FDI flows and stocks.		• Dividends should be recorded when payable rather than when paid.

1) Exception made of provisional results to be provided at T+9 and real-state investments. The following non-acceptable practices should be abandoned: (i) to leave the choice to the respondents on the valuation criterion (market values or book values); and (ii) the application of a perpetual inventory method/accumulation of b.o.p. flows to compile stocks.
2) Based on the common definition of own funds at book value.
3) To the extent that they can be identified, considering the practical difficulties existing at present, as addressed in chapter 2 of this report.
4) For both reinvested earnings and FDI equity stocks.
5) MS may focus on a reduced number of companies (the biggest ones and/or holding companies) to perform the distinction between ordinary and extraordinary gains and losses.
6) For all elements of FDI statistics (namely equity capital, reinvested earnings and other capital).

require from member states and the time lag with which the application of its recommendations could be reasonably expected. On that basis, the proposed actions could also be classified in three additional categories: short, medium and long-term. The TF-FDI did not intend to define (in terms of more specific timing) the deadlines corresponding to each slot, since this was considered out of its mandate.

463. By combining both dimensions (i.e. importance and timeframe), the most significant recommendations of the TF-FDI have been integrated in a matrix for illustrative purposes.

ISSUES FOR FOLLOW-UP WORK

464. Due to its limited time horizon, the TF-FDI could not expand the topics defined in its mandate with other subjects identified in the course of its investigations. Additionally, the TF-FDI did not hold discussions on more strategic issues. Therefore, it is proposed that some work could follow the delivery of this report in the following areas:

– Elaborate an implementation calendar with specific deadlines to put the recommendations of the TF-FDI in practice.

– Monitor on a regular basis the implementation status of the TF-FDI recommendations as well as other matters related to FDI (e.g. exchange of experiences and information on FDI) through, for instance, the regular meetings of the working groups and/or ad-hoc workshops. Among the different issues to be considered in the future, the TF-FDI recommends that the possibility to collect separate statistics for SPEs continue being assessed in the future.[70]

– Develop a twofold monitoring task, which should focus on: (i) the definition of the new international accounting standards; and (ii) the update of the IMF Balance of Payments Manual. This monitoring task should aim at promoting further convergence between statistical and accounting standards, while keeping in mind that FDI statistics should always be able to serve analytical needs from the macroeconomic viewpoint.[71]

– Explore practical ways to put the proposals to compile statistics based on the UBO in practice.

– Elaborate the list of user requirements for the European Business Register project currently being developed by the Eurostat's Business Statistics Directorate. Such a contribution should ensure that the final product will have the necessary features for the compilation of FDI statistics.

70 To this aim, co-ordination should be ensured with the related work currently being developed in the OECD.

71 In particular, the TF-FDI discussed two alternatives to try to approximate statistical rules to accounting standards: (i) change the 10% rule defining all FDI relationships to a 20% criterion; (ii) consider only indirect FDI relationships over 50% (i.e. restrict the coverage of indirect relationships to cases of majority control). The TF-FDI tentatively expressed a preference for the second option, which is already a practical simplification addressed in this report.

LIST OF ANNEXES

I COMPILATION OF FDI STOCKS AT T+9 MONTHS

465. The issue of the compilation of FDI stocks at T+9 months was raised by the CMFB in connection with the compilation of the international investment position (i.i.p.) statistics of which they are an integral part. I.i.p. statistics have to be provided to Eurostat and to the ECB within nine months of the end of the year to which the data relate. In the framework of the Special Data Dissemination standard (SDDS) of the IMF, the timeliness required for the i.i.p. is nine months after the end of the reference year, provided that SDDS subscribers publish quarterly external debt statistics; otherwise, the timeliness for the i.i.p. is six months.

466. During the meeting of the TF-FDI in Frankfurt in February 2003, a brief stock-taking exercise was conducted among the participants on the possibility of providing annual FDI stocks statistics within this nine-month time-frame.

467. The outcome of the discussion was that in the current situation, only four Member States are already in a position to provide pure stocks data, based on surveys, within the required timeliness. The others can only continue accumulating flows to the last available stocks (perpetual inventory method), usually adjusted for exchange rate changes, and in few instances for price changes.

468. The country details are as follows:

- FR uses the perpetual inventory method, with an adjustment for exchange rate and market price changes.
- ES collects pure stocks only for the MFI sector and for the other sectors' external loans; these are available within the prescribed timeliness. The perpetual inventory method will be applied to the equity capital position of the other sectors,
- GR runs a survey system in which questionnaires are sent out in April and have to be returned one month later, together with the balance sheet, the profit and loss statement and the distribution of profits statement of the company. Economic sector and geographical breakdowns are available. The T+9 deadline can be met.
- DE uses the perpetual inventory method, with an adjustment for exchange rate changes and for some other changes. Pure stocks for the i.i.p. are available at T+15 months.
- IE runs a quarterly survey of stocks and has therefore no problem to provide annual data by end-September.
- NL prepares an i.i.p. statement within six months, along the same line as DE and FR.
- BE: in the present system, the i.i.p. is produced as in DE, at T+9, except for the MFI and general government sectors for which it is available at T+6. Adjustments are made for exchange rate and price changes. In the future, BE intends to implement a quarterly survey.
- PT: the situation is equivalent to that of FR.
- FI runs an annual survey for equity capital and monthly and annual surveys for other capital (a perpetual inventory is used for the equity component of the quarterly i.i.p.). The results of the annual surveys are available at T+9.
- DK: the results of the annual surveys are available at T+9.
- IT uses the perpetual inventory method with exchange rates and price adjustments in the current system.
- SE runs an annual sample survey whose results are only available at T+10/11 months and will have to make estimates to compile FDI stocks at T+9.
- AT: since survey results are available only at T+18, stocks for T+9 can only be calculated by adding annual flows to the latest available stocks. A breakdown by individual countries would be available.

469. Regarding the geographical breakdown of the FDI stocks, a majority of countries will have no difficulty for providing the level 1 details of Eurostat at T+9, albeit on a very provisional basis. ES, however, can only provide an intra/extra euro area/EU breakdown.

SE pointed out that the fact of using a sample survey makes it difficult to capture information concerning small counterpart countries.

470. On the whole, it appears that the provision of FDI stocks at T+9, with a level 1 geographical breakdown, i.e. according to the ECB's narrow list for step-3, is not seen as causing major difficulties. However, this would be in many cases on the basis of flows accumulated to the last available stocks.

2 DEFINITIONAL ISSUES RELATED TO FDI/OTHER CAPITAL

471. In this annex, the definitions and recommendations concerning Other Capital in Foreign Direct Investment flows and stocks will be described. These definitions and recommendations are based on the IMF's Balance of Payments Manual, 5th Edition (1993; BPM5), the OECD Benchmark Definition of Foreign Direct Investment, 3rd Edition (1996; Benchmark) and ad hoc recommendations by international institutions such as the IMF, the OECD, the ECB, etc. The definitions and recommendations construe the basis for the determination and identification of best practices in Sections 3.

472. First, the broad concepts of foreign direct investment capital and other capital transactions will be defined. Second, the directional principle, an important item of Other Capital, is discussed. Third, different items of Other Capital, such as debt securities and trade credits, are described. Fourth, intercompany transactions involving Monetary and Financial Institutions (MFIs) are investigated.

DIRECT INVESTMENT CAPITAL AND OTHER DIRECT INVESTMENT CAPITAL

473. In general, according to BPM5, "Direct investment capital" is:

> "capital provided (either directly or through other related enterprises) by a direct investor to a direct investment enterprise or capital received from a direct investment enterprise by a direct investor.
>
> (…) Direct investment capital does not include funds provided by, or received from, any other source – including funds for which the direct investor merely makes the arrangements or guarantees repayment (e.g., loans from outside parties to an incorporated direct investment enterprise." *(BPM5*, paragraph 368)

"The components of direct investment capital transaction, which (…) are recorded on a directional basis (i.e., resident direct investment abroad and non-resident direct investment in the recording economy), are equity capital, reinvested earnings, and other capital associated with various intercompany debt transactions." (*BPM5*, paragraph 369).

474. Other direct investment capital (or intercompany debt transactions) covers

"the borrowing and lending of funds – including debt securities and suppliers' credits – between direct investors and subsidiaries, branches, and associates. The borrowing and lending are reflected in intercompany claims and liabilities (receivables and payables), respectively. Both loans to subsidiaries from direct investors and loans from subsidiaries to direct investors are included. In contrast to the treatment of other investment, no distinction is made between short- and long-term investment". (*BPM5*, paragraph 370)

475. The OECD recommends that:

> "*inter-company flows* – with the exception of certain flows between affiliated banks, affiliated financial intermediaries (e.g. security dealers), and Special Purpose Entities (SPEs) with the sole purpose of serving as financial intermediaries – be encompassed within the scope of foreign direct investment transactions. Such flows include those flows routed through SPEs (. . .).
>
> OECD also recommends that loans provided by all subsidiaries to parent companies be included in foreign direct investment transactions, with the exception of financial loans provided by banks and other financial intermediaries to the parent bank. Recognising that some countries may not include (or may net out) transactions through SPEs, and/or inter-company debt flows, and loans provided by subsidiaries to parents within direct

investment transactions, OECD recommends that countries provide information on gross flows to facilitate international comparability of direct investment data." (*Benchmark*, paragraph 39).

DIRECTIONAL PRINCIPLE

476. The application of the directional principle is one of the main items of the Mandate of the TF-FDI. The IMF states the following on *reverse investments* and the directional principle:

> "Reverse investment in the form of other instruments (other than equity capital) should be recorded, under direct investment in reporting economy – other capital or direct investment abroad – other capital. In cases in which the equity participation is at least 10 percent in both directions, two direct investment relationships are established. Such transactions are recorded as direct investment claims and liabilities in both directions; that is, as direct investment in reporting economy and as direct investment abroad, for each economy as appropriate." (*BPM5*, paragraph 371)

> "Direct investment is classified primarily on a directional basisresident direct investment abroad and non-resident investment in the reporting economy and is subdivided into equity capital, reinvested earnings, and other capital. (paragraph 330). Unlike other financial investment, direct investment is *not* recorded in the BOP on a straight asset/ liability basis. Instead, direct investment is recorded on a directional basis – resident direct investment abroad and non-resident direct investment in the reporting economy." (*IMF's Balance of Payments Textbook*, paragraph 529).

477. This means that all transactions in other capital between a direct investor and its direct investment enterprise should be recorded under direct investment abroad in the BOP of the direct investors country and as direct investment in the reporting economy in the BOP of the country where the direct investment enterprise is resident. The investment direction is thus determined by the direction of the equity investment. Consequently, from the point of view of the economy of the direct investor, loans to direct investment enterprises are treated as direct investment abroad as well as claims by the direct investment enterprise on its investor. This application of the directional principle may lead to negative FDI stocks in cases where loans by the direct investment enterprise to its direct investor outweigh the amount of equity capital and loans provided by the direct investor.

478. With respect to transactions when sister companies are involved, the Balance of Payments Textbook states:

479. "When a direct investment enterprise invests in an enterprise related to its direct investor, this investment is recorded, by the economy providing the investment, as resident direct investment-abroad and, by the economy of the enterprise receiving the investment, as direct investment-reporting economy." (*IMF's Balance of Payments Textbook,* paragraph 529).

ITEMS IN OTHER CAPITAL

480. This paragraph describes certain different items, which can be included in Other Capital. The following items are explored:

- Debt securities (including financial derivatives)
- Preferred shares
- Trade credits
- Financial leasing
- Deposits
- Intercompany loans (assets in intra-group accounts)
- Permanent debt

481. According to BPM5, paragraph 370 (see above), intercompany debt securities and trade (or suppliers') credits must be *included* under FDI-Other Capital. The other items listed above are not covered explicitly in the chapter on Foreign Direct Investment in the Manual (Chapter 18), though intercompany transactions including these items can be viewed upon as FDI-Other Capital.

DEBT SECURITIES

482. Intercompany debt securities are included in FDI-Other Capital (BPM5, paragraph 370) and comprise several types of instruments that are defined in BPM5 under "Portfolio Investment":

483. "Debt securities cover

1. bonds, debentures, notes, etc.;
2. money market or negotiable debt instruments, and
3. financial derivatives or secondary instruments, such as options, that usually do not extend to actual delivery and are utilised for hedging of risks, investment, and trading purposes.)" (*BPM5*, paragraph 389.)

484. In 2000, the IMF published a new booklet on financial derivatives and modifications to the existing material on financial derivatives in BPM5 ("Financial derivatives, a supplement to the Balance of Payments Manual", IMF, 2000). Initially, intercompany financial derivatives were classified as direct investment. In the meantime, however, the IMF and the ECB recommended excluding transactions in financial derivatives between affiliated enterprises from direct investment.

485. The summary of the March 2002 meeting of the Working Group on Balance of Payments and External Reserves (WG-BP&ER) states that "the WG-BP&ER (…) "supports the approach (…) to report financial derivatives between affiliates under the functional category of "financial derivatives" rather than under "FDI-Other Capital", noticing that in practice some FDI transactions/positions may, however, still be recorded under FDI."

PREFERRED SHARES

486. Preferred shares are a hybrid form of financing, combining features of debt and common shares. In the event of liquidation, a preferred shareholder's claim on assets comes after that of creditors but before that of common shareholders. Usually, this claim is restricted to the par value of the share (equals the maximum settlement of the principal amount). Preferred shares have the following features:

- A cumulative feature, providing for unpaid dividends in any one year to be carried forward. Before a company can pay a dividend on its common shares, it must pay dividends in arrears on its preferred shares.

- A participating feature, allowing preferred shareholders to participate in the residual earnings of the company. Essential is that preferred shareholders have a prior claim on income and an opportunity for additional return if the dividends to common shareholders exceed a certain amount.

- Voting power: because of their priority claim on assets and income, preferred shareholders normally are not given a voice in management. The voting power that preferred shareholders may be granted is usually restricted to issues relating to their status.

487. Preferred shares have no maturity. This does not mean, however, that most preferred shares issues will remain outstanding forever, because provision for retirement of the shares invariably is made. For instance, many preferred shares issues provide call prices, a sinking fund, and convertibility.

488. A straight preferred stock issue has no final maturity; in essence, it is a perpetual loan. From the standpoint of creditors, preferred

stock adds to the equity base of the company and thereby strengthens its financial condition. The additional equity base enhances the ability of the company to borrow in the future. The implicit cost of preferred stock financing, from the standpoint of investors penalizing the equity-capitalization rate of the common stock, may be somewhat less than that of debt financing. To the extent that investors are apprehensive over legal bankruptcy, they would regard debt as a riskier form of leverage. Unlike creditors, preferred stockholders cannot force a company into legal bankruptcy. Therefore, the potential costs of bankruptcy are not a factor as they are with debt financing.

489. The mix of perpetuity and the option features, makes preferred shares a hybrid form.[72]

490. Non-participating preferred shares can be described as a type of preferred share where the holder has no entitlement to a share in any of the excess returns of the issuing entity. Return on equity comprises only a dividend payment (usually at a fixed rate) which is calculated according to a pre-determined formula. Payment of interest is not dependent upon earnings of the issuer.

491. The treatment of preferred shares in BPM5 is discriminated between participating and non-participating preferred shares:

> "non-participating, preferred shares […] are treated as debt securities and included under *direct investment*-other capital." (*BPM5*, paragraph 369).

492. The BPM5 is dealing with preferred shares in other paragraphs as well:

> "Shares, stocks, participation (..) usually denote ownership of equity. Preferred stock of shares, which also provide for participation in the distribution of the residual value on dissolution of an incorporated enterprise, are included." (*Paragraph 388* in the BPM5)

493. Paragraph 390 in the BPM5 is dealing with instruments that

> "usually give the holder the unconditional right to a fixed money income or contractually determined variable money income. (..) With the exception of perpetual bonds, bonds and debentures also provide the holder with the unconditional right to a fixed sum as a repayment of principal on a specified data or dates. Included are non-participating preferred stocks or shares (...)."

TRADE CREDITS

494. In BPM5, trade credits are included in Other Capital and are defined in the chapter on "Other Investment":

"*Trade credits* consist of claims and liabilities arising from the direct extension of credit by suppliers and buyers for transactions in goods and services and advance payments for work in progress (or to be undertaken) that is associated with such transactions (loans to finance trade are not included as these are classified under loans). In the absence of actual data, trade credits may be measured by the difference between entries for the underlying transactions in goods and services, which are recorded as of the dates when ownership changes, and the entries for payments related to these transactions. Although frequently short-term in nature, trade credits and advances are subdivided into short- and long-term categories'. For trade credits between affiliated enterprises recorded under other capital, no maturity breakdown is required. (*BPM5*, paragraph 414)

72 This information is extracted from "Financial Management and Policy" by James Van Horne, Prentice Hall, Tenth Edition, 1995, pages 576-580.

FINANCIAL LEASING

495. In BPM5, *financial leases* are briefly described in the chapter on "Other Investment". In case of financial leasing between affiliated companies, this paragraph can be applied to FDI flows and stocks.

> "*Financial leases* are included under loans because such arrangements are taken as presumptive evidence that a change in the ownership of goods has occurred (see BPM5, paragraph 206). The financial lease essentially is a method by which the lessee finances the purchase of goods. The financial lease entails a financial claim, which is the asset of the lessor and the liability of the lessee. At the time the imputed change in ownership occurs, the market value of the goods is recorded and counterpart entries, as assets or liabilities, are made in the financial account. In subsequent periods, the actual lease payment is divided into interest, which is recorded in the current account as income payable or receivable, and principal (debt) repayment, which is recorded in the financial account and reduces the value of the asset of the lessor and the liability of the lessee." (*BPM5*, paragraph 417)

496. A very comprehensive description of financial leasing can be found in the *Benchmark*:

> "Wherever an operator (the lessee) employs assets which are held under financial lease (as distinct from operating lease) rather than being owned outright, the legal owner of the assets (the lessor) should be regarded as making a loan to the lessee, which the lessee uses to buy the assets. If this arrangement is between a direct investor and its branch, subsidiary or associate, the loan should be regarded as direct investment, and be treated according to the provisions of this benchmark definition, in the same way as a conventional loan would be regarded and treated.

497. In BPM5 (paragraph 206), it is stated that financial leases are lease arrangements

> "for 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". Therefore, 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.

498. The financial lease essentially is a method of financing the purchases of the good by the lessee (as opposed to taking out a loan for the purchase). The OECD defines a financial lease as

> "a contract involving payments over a basic period (during which the agreement cannot be terminated) sufficient in total to cover in full the capital outlay of the lessor together with all subsidiary or financing cost and to give some profit to him. This obligatory period does not exceed the estimated useful life of the asset. The asset is selected by the lessee (...). The cost of maintenance and repair, on the subject of the lease, and all risks connected therewith, are borne by the lessee. At the end of the primary lease, the contract may be extended for a further (secondary) period at a much reduced and perhaps purely nominal rental, or the asset may be sold to the lessee at a very low and perhaps purely nominal price, or the asset may be sold to a third party with some, or perhaps most, of the proceeds from the sale being passed on to the lessee as a "rebate of rental"." It is hoped that in due course a common definition of financial leasing will be established." (*Benchmark*, paragraph 57)

DEPOSITS

499. *Deposits* are described as follows in the Manual:

> "Deposits comprise both transferable and other deposits. Transferable deposits consists of deposits that are exchangeable on demand at par without restriction or penalty, freely transferable by check or giro order, and otherwise commonly used to make payments. Deposits may be denominated in domestic or foreign currencies. Other deposits include all claims reflecting evidence of deposit other than transferable deposits. Typical examples are non-transferable saving deposits; time deposits; and shares (evidence of deposit) – which are legally (or practically) redeemable on demand or on short notice – in savings and loan associations, credit unions, building societies, etc." (*BPM5*, paragraph 421)

INTERCOMPANY LOANS (ASSETS AND LIABILITIES IN INTRA-GROUP ACCOUNTS) AND PERMANENT DEBT

500. Though the following items are under investigation in the survey, there are no clear definitions and recommendations describing them. These items are intercompany loans (assets in intra-group accounts) and permanent debt. Intercompany loans are, in the survey, defined as current accounts between group companies.

501. Permanent debt is typically provided for an indefinite period of time without a fixed repayment obligation. It can be seen as part of a company's own funds as it is presented on the liabilities side of the company's balance sheet on a permanent basis. It can take the form of debt securities or loans.

502. Subordinated loans are loans that rank behind debt senior to these loans with respect to the claim on assets. In the event of liquidation, subordinated debenture holders usually receive settlement only if all senior creditors are paid the full amount owed to them. These holders still would rank ahead of preferred shareholders in the event of liquidation.

INTER-COMPANY TRANSACTIONS BETWEEN AFFILIATED MFIs AND AFFILIATED FINANCIAL INTERMEDIARIES

503. The Manual describes inter-company transactions between affiliated MFIs and affiliated financial intermediaries as follows:

> "Inter-company transactions between affiliated banks (depository institutions) and affiliated financial intermediaries (e.g., security dealers) – including SPEs with the sole purpose of serving as financial intermediaries – recorded under direct investment capital transactions are limited to those transactions associated with permanent debt (loan capital representing a permanent interest) and equity (share capital) investment or, in the case of branches, fixed assets. Deposits and other claims and liabilities related to usual banking transactions of depository institutions and claims and liabilities of other financial intermediaries are classified, as appropriate, under portfolio investment or other investment. The stock of foreign assets and liabilities of banks and other financial intermediaries (international investment position) should be treated in a parallel manner." (*BPM5*, paragraph 372).

504. Because there was much confusion about this paragraph, the IMF Committee on Balance of Payments Statistics (BOPCOM) has released some final decisions, after consulting with the ECB's WG-BP&ER and the OECD's Working Party on Financial Statistics (WPFS), on the subjects described[73].

73 See the OECD Document DAFFE/MC/STAT(2002)2, released at the Working Party on Financial Statistics' meeting on 20 and 21 February 2002.

505. The final decisions on the recommended treatment of transactions with affiliated financial intermediaries are as follows:

> "The BPM5 definition of the scope of enterprises included under "banks and other financial intermediaries such as security dealers" should be clarified as being equivalent to the following SNA93 financial corporations sub-sectors: other depository corporations (other than the central bank); other financial intermediaries, except insurance corporations and pension funds; and financial auxiliaries. As a result, SPEs principally engaged in financial intermediation for a group of related enterprises would be encompassed in that definition.
>
> The implications of the above clarification are that financial (and investment income) transactions between two affiliated enterprises that are part of (1) other depository corporations (other than the central bank); (2) other financial intermediaries, except insurance corporations and pension funds; or (3) financial auxiliaries would be excluded from FDI except for transactions in the form of equity capital or permanent debt." (*DAFFE/MC/STAT(2002)2*, paragraph 5)

506. A simplified version of the IMF matrix chart of this proposal shows the present and proposed situation.

507. To further dissipate any confusion, it is clear from the preceding tables that e.g. deposits by non-banks (S125+Other) with affiliated banks (S122+S123+S124) have to be recorded under Other Capital. Loans by banks to affiliated non-banks have to be recorded similarly.

Table 1 Coverage of capital transactions (other than in equity and permanent debt) in FDI statistics

Present position

	S122	S123	S124	S125	Other
S122	Excluded	Excluded	Included	Included	Included
S123	Excluded	Excluded	Included	Included	Included
S124	Included	Included	Included	Included	Included
S125	Included	Included	Included	Included	Included
Other	Included	Included	Included	Included	Included

Proposed position

	S122	S123	S124	S125	Other
S122	Excluded	Excluded	Excluded	Included	Included
S123	Excluded	Excluded	Excluded	Included	Included
S124	Excluded	Excluded	Excluded	Included	Included
S125	Included	Included	Included	Included	Included
Other	Included	Included	Included	Included	Included

Note: S122 MFIs other than central banks S123 Other financial intermediaries (exc. 125) S124 Financial auxiliaries S125 Insurance and pension funds 507. To further dissipate any confusion, it is clear from the preceding tables that e.g. deposits by non-banks (S125+Other) with affiliated banks (S122+S123+S124) have to be recorded under Other Capital. Loans by banks to affiliated non-banks have to be recorded similarly.

3 SUMMARY OF THE ANSWERS TO THE QUESTIONNAIRE ON OTHER CAPITAL

Table 1 Summary of the answers to the questionnaire on Other Capital Directional principle

OTHER CAPITAL DIRECTIONAL PRINCIPLE			AT	BE	DE	DK	ES	FI	FR[1]	IT	NL	PT	SE	UK	12
A1		At least partially[2]	AT		DE	DK	ES	FI	FR	IT	NL	PT	SE	UK	11
		No		BE											1
A11		Technology		BE											1
		Theory													0
		Other													0
A2		I/O	AT		DE	DK	ES	FI	FR	IT	NL	PT	SE	UK	11
		In													0
		Out													0
A21	In	F/S	AT		DE	DK	ES	FI	FR	IT	NL	PT	SE	UK	11
		Flows													0
		Stocks													0
A22	Out	F/S	AT		DE	DK	ES	FI	FR	IT	NL	PT	SE	UK	11
		Flows													0
		Stocks													0
A23															
A24															
A3	Flow	Yes	AT		DE	DK	ES	FI	FR	IT	NL	PT	SE		10
		No												UK	1
A31		Yes												UK	1
		No													
A4	Stock	Yes	AT		DE	DK	ES	FI	FR	IT	NL	PT	SE	UK	11
		No													0
A41		Yes													0
		No													0
A411															
A5	Comment														
A6	All items?	Yes	AT			DK		FI	FR	IT			SE	UK	7
		No			DE		ES				NL	PT			4
A7	Comment														

1) As of 2004.
2) From the discussions on the answers to the questionnaire, it appears that the initial "yes" answers regarding the application of the directional principle should be understood in many cases as meaning "yes, at least partially".

Table 2 Summary of the answers to the questionnaire on Other Capital
Items included in other capital

ITEMS INCLUDED IN OTHER CAPITAL		AT	BE	DE	DK	ES	FI	FR	IT	NL	PT	SE	UK	12
B 1	Debt Sec						FI		IT		PT	SE	UK	5
	Trade Cr			DE	DK	ES	FI		IT	NL	PT	SE	UK	9
	Fin Lease	AT	BE	DE	DK	ES	FI		IT		PT	SE	UK	10
	Derivatives				DK									1
	I/C	AT	BE	DE	DK	ES	FI	FR	IT	NL	PT	SE	UK	12
	Deposits		BE		DK		FI	FR	IT	NL		SE	UK	8
	Perm Debt	AT	BE	DE	DK	ES	FI		IT		PT		UK	9
	Other													0
B 21 Debt Sec	F/S								IT		PT	SE	UK	4
	Flows													0
	Stocks						FI							1
B211														
B212														
B22	I/O						FI		IT		PT	SE	UK	5
	In													0
	Out													0
B23	L/S F/S						FI		IT			SE		3
	L/S Flows													0
	L/S Stocks													0
	L/S No										PT		UK	2
B231														
B232														
B233														
B24	Bonds								IT		PT	SE	UK	4
	Notes								IT		PT	SE	UK	4
	Prom Notes								IT			SE	UK	3
	Oth Instr								IT			SE	UK	3
	Other													0
B25	Bonds								IT		PT	SE	UK	4
	Notes								IT		PT	SE	UK	4
	Prom Notes								IT			SE	UK	3
	Oth Instr								IT			SE	UK	3
	Other													0
B 31 Trade Cr	F/S			DE		ES	FI		IT	NL	PT	SE	UK	8
	Flows													0
	Stocks				DK									1
B311														
B312														
B32	I/O			DE	DK	ES	FI		IT	NL	PT	SE	UK	9
	In													0
	Out													0
B 41 Fin Lease	F/S	AT		DE		ES	FI		IT		PT	SE	UK	8
	Flows		BE											1
	Stocks				DK									1
B411														
B412														
B42	I/O	-	BE	DE	DK	ES	FI		IT		PT	SE	UK	10
	In													0
	Out													0
B43	L/S Yes													0
	L/S No	-	BE	DE	-	ES	FI		IT		PT	SE	UK	10
B 51 Derivatives	F/S									NL				1
	Flows													0
	Stocks				DK									1
B511														
B512														
B52	I/O				DK					NL				2
	In													0
	Out													0
B53	L/S Yes													0
	L/S No				DK					NL				2
B 61 Interco	F/S	AT	BE	DE	DK	ES	FI	FR	IT	NL	PT	SE	UK	12
	Flows													0
	Stocks													0
B611														
B612														
B62	I/O	AT	BE	DE	DK	ES	FI	FR	IT	NL	PT	SE	UK	12
	In													0
	Out													0
B63	L/S Yes			DE	DK			FR		NL		SE		5
	L/S No					ES	FI		IT		PT		UK	5
B 71 Deposits	F/S		BE		DK		FI	FR	IT	NL		SE	UK	8
	Flows													0
	Stocks													0

Table 3 Summary of the answers to the questionnaire on Other Capital Valuation principles, and other capital data on MFIs

VALUATION PRINCIPLES			AT	BE	DE	DK	ES	FI	FR	IT	NL	PT	SE	UK	12
C1	Flows	Book		BE		DK	ES			IT				UK	5
		Market	AT		DE			FI	FR			PT	SE		6
		Both									NL				1
C11															
C2	Stock	Book	AT	BE	DE	DK	ES		FR	IT		PT		UK	9
		Market											SE		1
		Both						FI			NL				2
C21															
C3															
SPEs and Other Financial Intermediaries															
D1	Flows	Yes	AT	BE	DE	DK	ES	FI	FR	IT	NL	PT	SE	UK	12
		No													0
D11		Book		BE		DK	ES			IT				UK	5
		Market	AT		DE			FI	FR			PT	SE		6
		Both									NL				1
D111															
D12		I/O	AT	BE	DE	DK	ES	FI	FR	IT	NL	PT	SE	UK	12
		In													0
		Out													0
D13		Debt Sec						FI		IT		PT	SE	UK	5
		Derivatives				DK					NL				2
		Deposits		BE		DK		FI	FR	IT	NL		SE	UK	8
		Fin Lease		BE	DE	DK	ES	FI		IT		PT	SE	UK	9
		Other	AT	BE		DK	ES		FR		NL	PT			7
D2	Stock	Yes	AT	BE	DE	DK	ES	FI	FR	IT	NL	PT	SE	UK	12
		No													0
D21		Book	AT	BE	DE	DK	ES			IT		PT		UK	8
		Market											SE		1
		Both						FI			NL				2
D211															
D22		I/O	AT	BE	DE	DK	ES	FI	FR	IT	NL	PT	SE	UK	12
		In													0
		Out													0
D23		Debt Sec						FI		IT		PT	SE	UK	5
		Derivatives				DK					NL				2
		Deposits		BE		DK		FI	FR	IT	NL		SE	UK	8
		Fin Lease			DE	DK	ES	FI		IT		PT	SE	UK	8
		Other	AT	BE	DE	DK	ES		FR		NL	PT			8
D3															
TREATMENT OF OTHER CAPITAL DATA ON MFIs															
E1	Sub Loans	F/S	AT			DK		FI				PT			4
		Flows		BE											1
		Stocks												UK	1
		No			DE		ES		FR	IT	NL		SE		6
E11															
E12															
E13															
E2	Deposits	F/S				DK	ES								2
		Flows													0
		Stocks										PT			1
		No	AT	BE	DE			FI	FR	IT	NL		SE	UK	9
E21															
E22															
E23															
E3															

4 APPLICATION OF THE DIRECTIONAL PRINCIPLE IN DIFFERENT COUNTRIES

THE GERMAN SYSTEM

508. German balance of payments statistics are up to now only partially designed according to the directional principle. Therefore only approximate information can be derived from existing data sources, and only in case of loans between affiliated companies.

509. In case of shares and bonds it is not possible to distinguish "reverse transactions", therefore these transactions can only be classified as portfolio investment according to the asset/liability-principle.

DIRECTIONAL PRINCIPLE FOR SHORT-TERM LOANS

510. Short-term loans in the b.o.p. are derived from the corresponding stocks. German residents are required to report all claims on and liabilities to non-residents arising from financial and trade credits if total claims or total liabilities exceed €5 mill (DM 3 mill prior to 2002) at the end of the month ("Z 5 stocks statistics").

511. Consequently, in the case of short-term loans granted by German non-banks to foreign non-banks it is possible to differentiate in a first step between:

– short-term loans between non-affiliated companies (these loans are classified as other investment)

– and short-term loans between affiliated companies (these loans are classified as direct investment).

512. Moreover, German residents have to report assets held abroad and non-residents' assets in Germany are required to be reported by German enterprises in which non-residents hold shares or voting rights ("capital links statistics"). These data are requested by separate forms on a yearly basis. Referring to the capital links statistics all reporting companies are classified according to their inward and outward direct investment relationships, e.g. the share in equity capital held by non-residents and whether the reporting company has a participation in non-resident companies. Thus, resident enterprises reporting outward and inward direct investment relationships can be identified as so-called double-status enterprises. An identification code – which is the same for the capital links statistics and the Z 5 statistics – and a code indicating the investment relationships are registered in a business register.

513. Though the relationship between the reporting company and affiliated foreign enterprises is not precisely specified in the Z 5 statistics, we are able to identify the hierarchical structure – derived from the capital links statistics – automatically via the business register. For example, if a mere German subsidiary of a foreign parent company grants a loan to a foreign affiliated enterprise this foreign company cannot be a subsidiary of the reporting company and this loan is treated as reverse investment.

514. Consequently, with regard to short-term loans between affiliated companies we can distinguish between:

– loans granted by German companies, in which foreign investors have a participation of more than 10% and which have no participation in foreign companies (mere subsidiary status), to foreign affiliated companies

– loans granted by German companies, in which foreign investors have a participation of up to 10% or no participation, to foreign affiliated companies

– loans received by German companies, in which foreign investors have a participation of more than 10%, from foreign affiliated companies

– loans received by German companies, in which foreign investors have a participation of up to 10 % or no participation, from foreign affiliated companies.

515. These information enable us to classify

– as direct investment in the reporting country, claims on direct investors

– as direct investment abroad, claims on affiliated enterprises

– as direct investment in the reporting country, liabilities to direct investors

– as direct investment abroad, liabilities to affiliated enterprises

DIRECTIONAL PRINCIPLE FOR LONG-TERM LOANS

516. Whereas short-term transactions are derived from monthly stock statistics, transactions in long-term loans are reported transaction by transaction. Due to the required declaration of the object, e.g. the name of the non-resident counterpart, it is possible to check every reported transaction manually with regard to the classification according to the directional principle. Thus, also transactions between German fellow subsidiaries of foreign parent companies and foreign fellow subsidiaries and transactions between foreign fellow subsidiaries of German parent companies and German fellow subsidiaries, respectively, can be separated. Furthermore, loans granted by foreign special purpose entities (SPE's) acting as financial intermediaries have been separated to exclude them from direct investment transactions.

THE DUTCH SYSTEM

Present situation:

All companies in the Balance of Payments system of De Nederlandsche Bank have a so-called micro-section number (MSNR). In the Register used for the compilation of the Balance of Payments, all MSNRs of the companies which have direct or indirect relationships, are linked together. If the account managers and compilers are not certain, the database of the Chamber of Commerce or the Dunn and Bradstreet database are consulted or the company involved is approached to check whether the right interlinkages are used.

In the Register, all mother companies, subsidiaries, fellow companies, etc. are separately identified. However, there are no specific MSNRs for the identification of mother companies, subsidiaries or fellow companies. The account managers of the companies involved know how the company is built up and what the interlinkages are.

For the application of the directional principle, a specific register is used. In this Register all companies (with their specific MSNR) involved in intercompany reverse flows or positions are registered. Every month, this Intercompany Register (ICR) is put together with all the transactions in Direct Investment in the Balance of Payments. When a loan from daughter company to its mother company is registered by the reporting system, the ICR will recognize this as a directional principle loan and will put this particular loan on a different reporting code than an "ordinary loan" while compiling the Balance of Payments. On a macro level, these directional principle loans are then deducted from the total of intercompany loans.

For example, when a loan is granted from a mother company to a subsidiary, the loan is given a specific reporting code. The amortization of the loan will also follow the same MSNRs and reporting codes and the amortized amounts are deducted from the principal amount to obtain the loan stocks.

When the subsidiary provides a loan to the mother company the same MSNRs and reporting codes are used. With the conversion of the single reports into macro-economic

statistics, the reports are first compared with the ICR (no manual work involved). When companies grant loans to their parent company and these companies are recognised by the ICR, the particular loans will be given a specific directional principle code. At the end of the month, the amounts on the "directional principle" are deducted from the amounts on the "ordinary" loan codes to obtain the macro amount on intercompany loans. The same procedure is applied for stocks.

New system: (new direct reporting system from April 2004 onwards):

In the new reporting system, the application of the directional principle is also done automatically by the system. On the reporting forms, companies have to fill in how much they have borrowed from their foreign daughters, affiliates, etc (for outward FDI) or how much they have lent to their foreign mother company (for inward FDI). The applicable codes are immediately generated by the system; no conversion to other codes is necessary. The rest of the procedure described above is the same as in the new situation.

5 QUESTIONNAIRE ON IMPORTANCE OF THE MAIN SUB-ITEMS OF "OTHER CAPITAL" IN FDI STATISTICS

Table 1 Questionnaire on importance of the main sub-items of "Other Capital" in FDI statistics

(FDI data for 2001 in EUR millions)

Other Capital Item	Flows		Stocks	
	Inward	Outward	Inward	Outward
Debt securities, preference shares, bonds, debentures, loan stock, etc. for the following countries, that have reported data:				
flows (IT, UK)	2,879	8,324		
stocks (UK)			17,300	38,200
Total other capital for the countries included above:				
flows	*31,572*	*17,132*		
stocks			*146,400*	*51,400*
Share of the item in total other capital (%)	-	-	11.8	74.3
Trade credits for the following countries, that have reported data:				
flows (DE, ES, FI, IT, PT, SE)	-621	2,742		
stocks (DE, ES, FI, IT, PT, SE)			28,755	31,145
Total other capital for the countries included above:				
flows	*34,789*	*36,811*		
stocks			*118,383*	*113,981*
Share of the item in total other capital (%)	-	-	24.3	27.3
Financial leasing / leasing credits	not reported or included elsewhere			
Other inter-company assets/liabilities (inter-company accounts, short-term loans, long-term loans, transferable deposits, permanent debt, other) for the following countries, that have reported data:				
flows (AT, BE, DE, ES, FI, FR, IT, PT, SE, UK)	103,431	-43,306		
stocks (AT, DE, ES, FI, FR, IT, PT, SE, UK)			550,575	270,829
Total other capital for the countries included above:				
flows	*105,688*	*-32,240*		
stocks			*596,629*	*340,172*
Share of the item in total other capital (%)	-	-	92.3	79.6

517. The results of the questionnaire are difficult to interpret owing to the variety of response rates for the different cells of the table.

518. For transactions/positions on debt securities between affiliated companies, only Italy and the United Kingdom have provided data concerning flows and only the United Kingdom regarding stocks. In this particular case, the position on debt securities between affiliates is very important in the outward stocks as compared to the total of other capital (nearly 75%). However, evidence from a single country is not sufficient. Finland, for instance, mentioned that some information is available in this respect in their annual stocks survey but that the figures are so insignificant that they are not even included at all in the published stocks.

519. Regarding trade credits, six countries out of the ten that have returned the questionnaires have provided figures both for flows and for stocks, even though not all of them make a separate entry for this item in their publications. This item represents around 25% of the total of other capital for inward and outward stocks as well.

520. As regards, financial leasing/leasing credits, not a single country was in a position to provide any figures, either because this item is not reported at all or it is included indistinguishably in inter-company loans.

521. The answers provided to the second questionnaire, showing a very detailed disaggregation of other inter-company assets and liabilities, were so different and inconsistent that it has not been possible to keep the disaggregated layout in the synthetic table. Instead, they have been grouped under a single heading “other inter-company assets/ liabilities“. For the nine countries that have reported stocks under one or several headings, the total position represents 92% of the total of other capital for inward stocks and 80% for outward stocks.

6 NATIONAL DESCRIPTIONS OF UBO-BASED FDI STATISTICS

UBO IN AUSTRIAN FDI-STATISTICS

522. In the Austrian FDI-statistics inward stocks can be allocated according to both, the First-Shot and the Ultimate-Beneficiary Ownership principle (UBO). The OeNB started compiling of FDI statistics around 1970 following the first-shot principle. Austrian residents were asked for the "immediate owner or owners" only. But as soon as in 1980 it was felt that the allocation according to FS might be misleading. Therefore the OeNB introduced the so called "Stammhausbereinigung", which in fact is UBO. The need for UBO was explained with the growing popularity of holding companies, which resulted in a clear bias for certain countries (with favorable tax and regulatory framework).

523. An additional question (3A) had been introduced in the annual survey, which should be filled in, "if the immediate owner is not the ultimate beneficiary" (see simplified question; original available only in German).

524. The example is a graphical representation of a four level chain of ownership, with a guideline for the calculation of one or more UBOs. It is stated that one FS-owner may belong to several UBOs. On the other hand several FS-owners may have only one identical UBO. Respondents have to supply %-shares, names, and domicile of UBOs. The answer to this question is subject to the condition that the foreign influence measured at the FS-level is of the same size as the foreign influence at UBO-level. The number of owners on FS and UBO-level may of course be different. It turned out that in some cases the UBO behind a FS-investor was in fact an Austrian. Respondent are encouraged to supply ownership trees to explain the relation between companies. If UBOs are identical with FS-investors or if they are unknown, the respondent leaves the question empty.

525. In the most recent survey for 515 out of 3312 investment relations an UBO has been mentioned by the respondent. This, of course, does not imply that the country of origin of UBO and FS are different in every case. In 2000 34 countries are mentioned as ultimate countries of origin, the most important ones being DE (98 cases), the US (88), GB (51), JP (43), CH (41), FR (41) and IT (34). AT is mentioned in 24 cases. These invest-ment relations are eliminated from the FDI statistics, when UBO is used.

526. A comparison of the inward FDI-statistic according to FS and UBO-principle respectively produce the expected pattern. Switching from FS to UBO typically leads to a reduction of the share of the Netherlands, Switzerland and Luxemburg, while the US and Japan, but also a number of EU-member states are the "winners" of the reallocation. DE looses investment relations, but wins invested capital and employees. Table 1 gives the comparison of the two concepts measured in number of investment relations, total capital and employment for the year 2000.

527. For outward FDI-stocks we do not apply the UBO-principle with one exception. According to the requirements of outward FATS-statistics one should only take into consideration outward investments (of more than 50%), if the resident investor is a "domestic enterprise", meaning that it is not "foreign controlled". At

3A. Parent company form (Information about ultimate beneficial owner)
Share of the ultimate beneficial owner

Complete name of company according to Commercial Register, domicile, country	Identification number (do not fill out)	in % with one decimal figure
a) .... b) .... Total /1070		

Example: explains how to calculate the share of the ultimate beneficial owner

Table 1 Inward FDI-stocks according to FS and UBO-concepts

(EUR millions)

AUSTRIA	Inward FDI-Stock 2000		
	First shot	Ultimate owners	Difference UBO-FS
Intra-EU15	**25,816**	**25,389**	**-427**
Netherlands	6,368	2,053	-4,315
Germany	15,051	15,295	244
Luxembourg	1,145	859	-285
Sweden	252	636	384
France	983	1,399	416
United Kingdom	1,138	1,881	743
Italy	378	1,692	1,314
Austria [1)]	*0*	*79*	*79*
oth. Intra-EU	502	1,494	992
Extra-EU15	**6,967**	**7,315**	**348**
Switzerland	3,712	2,306	-1,406
Japan	118	841	723
USA	1,672	2,024	352
oth. Extra	1,465	2,144	679
Total	**32,783**	**32,783**	**0**

Source: OeNB.
1) Eliminated in publications using UBO.

least in cases where the resident investor himself is at the same time an investee, it is possible to check whether the foreign influence is below or above 50%. For the time being it is not possible to follow the chain of ownership within AT. Therefore this procedure overestimates the role of "domestic" enterprises. At least some of the "domestic" enterprises may be indirectly foreign controlled.

528. The foreign influence on Austrian investors is in fact important. Table 25 in our annual publication on outward stocks shows, that 199 Austrian FDI-investors (out of a total of 917) are at the same time affiliates of foreign investors. 161 are actually foreign controlled. The total outward stock of equity capital in 2000 was 23.9 bio €. Almost one third of it (7.5 bio €) belonged to foreign controlled resident investors.

COMPILATION OF FDI STOCK FIGURES BASED ON THE UBO PRINCIPLE IN GERMANY

529. We have a yearly FDI stock survey in DE. For inward FDI all enterprises in DE have to report, if a foreign investor has a participating interest in this enterprise of 10 % or more and the balance sheet total of the enterprise in DE is above 3 Mio € (for the figures from 2002 on; up to the year-end 2001 the threshold for the balance sheet total for minority-foreign ownership – between 10% and less than 50% – was 5 Mio € and for majority-foreign ownership – 50 % and more – was 0,5 Mio €). In the reporting form the following question is included: "If the non-resident holding the participating interest is a dependent enterprise itself: country in which the registered office of the controlling enterprise is located _________". With this information we are able to compile the FDI inward stock figures either according to the first shot or according to the UBO. If there is no answer to this question in the reporting form, we assume, that the first foreign owner is also the UBO.

530. We are only able to provide *inward* FDI figures in a country breakdown according to the first owner or the UBO. We do neither have any information about the chain of ownership from the UBO to the first foreign owner of the enterprise in DE nor do we have any information about the name of the UBO.

Table 2 Primary FDI stock in Germany at year-end 2000

(EUR millions)

Country/country group	First shot	UBO	Difference
Total	**447,347**	**443,532**	**3,815**
EU-countries	**341,337**	**303,832**	**37,505**
of which:			
Austria	5,370	4,802	568
Belgium	12,714	6,092	6,622
Denmark	4,446	2,056	2,390
Finland	3,946	5,887	-1,941
France	31,334	33,059	-1,725
Ireland	1,180	669	511
Italy	5,615	7,105	-1,490
Luxembourg	145,839	3,571	142,268
Netherlands	88,398	59,218	29,180
Spain	1,929	1,340	589
Sweden	7,735	6,610	1,125
United Kingdom	32,703	172,931	-140,228
Other industrial countries	**99,899**	**131,944**	**-32,045**
of which:			
Australia	142	1,120	-978
Canada	1,397	3,142	-1,745
Japan	8,414	11,500	-3,086
Switzerland	21,689	27,166	-5,477
United States	66,602	87,273	-20,671
Countries in transition	**1,006**	**979**	**27**
Developing countries	**5,105**	**6,777**	**-1,672**
of which:			
developing countries in Africa	126	1,925	-1,799
developing countries in America	1,729	1,485	244
developing countries in Asia and Oceania	3,249	3,367	-118

531. Attached please find a table 2 with a comparison of the primary inward FDI stock figures in DE at the year-end 2000 in a country breakdown according to the first foreign owner and the UBO. In that table you can see, that the total for first shot is higher than for UBO. The reason for this is, that the UBO of some enterprises in DE with direct capital links to foreign investors is located in DE (see Table 2).

THE UBO PRINCIPLE IN DANISH FDI-STATISTICS

532. Our annual FDI-survey covers the UBO at the inward side. All inward FDI-data can be allocated to first shot or to the UBO if any. All enterprises in DK with a foreign investor participating in an enterprise with 10 percent or more have to report to the inward FDI-statistics. All enterprises have to report first shot and the UBO if any.

533. We only compile the country code related to the first shot and the UBO and not the name of the investor (first shot or the UBO). We do not cover the chain of ownership between first shot and the UBO. We allocate equity capital to the UBO if any. Other capital is always allocated to the first shot.

534. We are able to provide figures allocated to first shot or to the UBO at a geographical breakdown. For dissemination-purposes we use the UBO for the geographical breakdown in the national statistics as well as the international reporting, including the inward FDI-data for Eurostat.

535. From Table 3 you will notice that there is considerable deviation between the geographical breakdown using first shot and the UBO as a basis for the geographical breakdown. The deviation is mainly due to elimination of the passing through effect from holding companies - SPEs.

Table 3 Comparison of the geographical breakdown using first shot and the UBO Inward FDI Stock in Denmark, 2000 – Equity

(EUR millions)

Country	First shot	UBO	Difference
Total	**51,823**	**51,823**	**0**
EU-countries	**41,682**	**22,552**	**19,129**
of which:			
Austria	786	446	340
Belgium	893	1,001	-108
Finland	497	465	33
Germany	647	620	26
France	1,676	1,403	273
Ireland	87	40	47
Italy	641	724	-84
Luxembourg	16,951	606	16,345
Netherlands	5,929	2,704	3,225
Spain	779	273	506
Sweden	10,106	9,192	914
United Kingdom	2,689	5,078	-2,389
Other essential countries			
Canada	48	58	-9
Japan	96	141	-45
Norway	2,432	2,430	1
Switzerland/Liechtenstein	749	776	-27
United States	4,175	19,829	-15,654

7 REINVESTED EARNINGS IN NATIONAL ACCOUNTS AND IMPACT ON GDP

INTRODUCTION

536. Reinvested earnings on direct foreign investment (FDI) was introduced in the national accounts (NA) with the SNA 93/ESA 95, as one of the items in the transition from gross domestic product (GDP) to gross national income (GNI). It is also an item in the transition from GDP according to ESA 95 to gross national product (GNP) according to ESA 79, which is currently used as a base for calculating payments from Member States to the EU. In Eurostat, Unit B1 is responsible for assessing the quality of the GDP, GNI and GNP estimates in the Member States. The conceptual and practical aspects of the compilation of reinvested earnings data is part of this assessment.

537. Reinvested earnings on direct foreign investment is also part of statistics on foreign direct investment (FDI) flows which is a part of the Balance of Payments (BoP) statistics. In most Member States, FDI statistics are compiled by Central Banks. In Eurostat, Unit B5 is responsible for FDI statistics. FDI data, including reinvested earnings are available in NewCronos and in the publication "European Union foreign direct investment yearbook 2000, Data 1992-1999". Eurostat recommends that countries follow guidelines issued by IMF and OECD: IMF Balance of Payments Manual, Fifth edition and OECD Benchmark Definition of Foreign Direct Investment, Third edition. These guidelines are both consistent with SNA 93/ESA 95.

538. This annex presents the relevant definitions in ESA 95 and compares available data from NA and BoP.

ESA 95 DEFINITIONS

539. In the ESA 95, reinvested earnings on direct foreign investment are discussed in Chapter 4 Distributive transactions:

Reinvested earnings on direct foreign investment (D.43)

4.64. Definition:

Reinvested earnings on direct foreign investment (D.43) are equal to:

the operating surplus of the direct foreign investment enterprise

plus any property incomes or current transfers receivable

minus any property incomes or current transfers payable, including actual remittances to foreign direct investors and any current taxes payable on the income, wealth, etc., of the direct foreign investment enterprise.

4.65. A direct foreign investment enterprise is an incorporated or unincorporated enterprise in which an investor resident in another economy owns 10 per cent or more of the ordinary shares or voting power (for an incorporated enterprise) or the equivalent (for an unincorporated enterprise). Direct foreign investment enterprises comprise those entities that are identified as subsidiaries (investor owns more than 50 per cent), associates (investor owns 50 per cent or less) and branches (wholly or jointly owned unincorporated enterprises), either directly or indirectly owned by the investor. Consequently, 'direct foreign investment enterprises' is a broader concept than 'foreign controlled corporations'.

4.66. Actual distributions may be made out of the entrepreneurial income of direct foreign investment enterprises in the form of dividends or withdrawals of income from quasi-corporations.

In addition, retained earnings are treated as if they were distributed and remitted to foreign direct investors in proportion to their ownership of the equity of the enterprise and then reinvested by them.

Reinvested earnings on direct foreign investment can be either positive or negative.

4.67. Time of recording: Reinvested earnings on direct foreign investment are recorded when they are earned.

In the system of accounts, reinvested earnings on direct foreign investment appear:

a) among uses and resources in the allocation of primary income account of the sectors;

b) among uses and resources in the external account of primary incomes and current transfers.

REINVESTED EARNINGS IN PERCENT OF GDP

540. 14 EU countries reported data for reinvested earnings on FDI to Eurostat in the GNP Questionnaire 2002. Greece did not report any data on this item, and Italy reported data only from 1998 onwards. As can be seen from the Table 1 below, net flows of reinvested earnings are below 0.5% of GDP in most Member States. In Sweden and the UK there are net inflows of around 1.5% of GDP, while Ireland and Luxembourg have large net outflows.

COMPARISON OF REINVESTED EARNINGS DATA IN FDI STATISTICS AND GNP QUESTIONNAIRE 2002

541. The Table 2 below shows that reinvested earnings data in FDI statistics and in the GNP Questionnaire 2002 are quite similar in Austria, Finland (the difference in 1998 is due to different treatment of one very large and rather special dividend transaction), Germany, Ireland, Italy, Portugal and the United Kingdom.

542. Because of missing data, no comparisons are possible for Belgium and Luxembourg (reported together in FDI statistics), Greece and Spain.

543. For the other EU countries, in particular France and the Netherlands, the differences can be quite large. Possible reasons include revisions made at different times (in particular for the latest years, 2000 and 2001) and adjustments to the BoP data made by the national accounts.

Table 1 Reinvested earnings on direct foreign investment

(net, in percent of GDP)

	1995	1996	1997	1998	1999	2000	2001	Ave 95-01
Austria	-0.5	-0.1	-0.3	-0.3	-0.4	-0.4	-0.4	-0.3
Belgium	0.1	-0.1	-0.4	-0.4	-0.5	-0.4	-0.2	-0.3
Denmark	0.0	0.0	0.2	0.6	0.2	0.0	0.2	0.2
Finland	-0.4	-0.2	0.3	-0.3	0.4	-0.1	-2.4	-0.4
France	-0.2	0.1	0.1	0.2	0.7	0.4	0.3	0.2
Germany	0.2	0.4	0.2	0.3	0.5	0.3	0.2	0.3
Greece	:	:	:	:	:	:	:	:
Ireland	-2.6	-3.3	-2.8	-3.7	-8.1	-9.6	-7.8	-5.4
Italy	:	:	:	0.1	0.0	-0.2	-0.4	-0.1
Luxembourg	-8.7	-6.4	-11.2	-7.7	-12.3	-11.8	-5.0	-9.0
Netherlands	1.2	0.1	0.6	-1.9	0.2	0.2	-1.9	-0.2
Portugal	-0.4	-0.6	-0.5	-0.4	-0.6	-0.1	-0.1	-0.4
Spain	0.0	0.0	-0.1	-0.2	0.1	0.2	0.2	0.0
Sweden	1.1	1.4	1.3	1.3	1.8	2.5	1.4	1.5
United Kingdom	1.3	1.2	1.2	1.5	1.9	1.5	1.4	1.4

Source: GNP Questionnaire 2002.

Table 2 Reinvested earnings on foreign direct investment

(net, ECU/EUR millions)

		1995	1996	1997	1998	1999	2000	2001
Austria	FDI Stat	-959	-229	-542	-529	-765	-815	-958
	GNPQ 2002	-918	-223	-544	-533	-765	-815	-857
	Share	1.04	1.02	1.00	0.99	1.00	1.00	1.12
Belgium	FDI Stat	:	:	:	:	:		
	GNPQ 2002	218	-267	-778	-926	-1,096	-897	-630
	Share							
Denmark	FDI Stat	:	:	:	600	500	744	
	GNPQ 2002	-67	33	225	931	370	-5	302
	Share				0.64	1.35		
Finland	FDI Stat	-370	-180	330	-3,766	526	-193	-3,217
	GNPQ 2002	-355	-176	327	-384	526	-194	-3,226
	Share	1.04	1.02	1.01	9.81 1)	1.00	0.99	1.00
France	FDI Stat	:	:	1,739	2,939	3,540	3,412	3,142
	GNPQ 2002	-1,792	1,251	1,753	2,954	9,794	5,170	4,953
	Share			0.99	1.00	0.36	0.66	0.63
Germany	FDI Stat	3,529	8,364	3,563	5,637	9,800	5,900	
	GNPQ 2002	3,370	8,160	3,560	5,680	9,800	5,900	3,600
	Share	1.05	1.03	1.00	0.99	1.00	1.00	
Greece	FDI Stat	:	:	:	:	:		
	GNPQ 2002	:	:	:	:	:		:
	Share							
Ireland	FDI Stat	:	:	:	-2,876	-7,284	-9,898	-8,884
	GNPQ 2002	-1,383	-1,895	-1,858	-2,871	-7,283	-9,898	-8,883
	Share				1.00	1.00	1.00	1.00
Italy	FDI Stat	:	:	:	:	258	-2,911	-5,474
	GNPQ 2002	:	:	:	801	256	-2,904	-5,396
	Share					1.01	1.00	1.01
Luxembourg	FDI Stat	:	:	:	:	:		
	GNPQ 2002	-1,150	-889	-1,736	-1,309	-2,294	-2,450	-1,065
	Share							
Netherlands	FDI Stat	3,855	524	3,710	-4,218	-2,695	-9,804	-8,486
	GNPQ 2002	3,671	304	1,975	-6,585	571	847	-7,986
	Share	1.05	1.72	1.88	0.64	-4.72	-11.57	1.06
Portugal	FDI Stat	:	-509	-435	-442	-601	-151	-108
	GNPQ 2002	-285	-497	-431	-445	-601	-151	-108
	Share		1.02	1.01	0.99	1.00	1.00	1.00
Spain	FDI Stat	:	:	:	:	:		
	GNPQ 2002	26	18	-371	-1,160	495	948	1,307
	Share							
Sweden	FDI Stat	:	:	:	:	4,187	5,711	1,788
	GNPQ 2002	2,123	2,952	2,751	2,797	4,187	6,368	3,318
	Share					1.00	0.90	0.54
United Kingdom	FDI Stat	11,352	11,943	14,596	19,063	25,490	23,471	20,882
	GNPQ 2002	11,009	11,548	14,049	18,552	25,481	23,446	22,720
	Share	1.03	1.03	1.04	1.03	1.00	1.00	0.92

Sources: FDI Stat: FDI statistics in NewCronos, November 2002. GNPQ 2002: GNP Questionnaire 2002, reported in September/October 2002.
Note: Share: Value in FDI statistics relative to the value in GNP Questionnaire 2002.
1) For Finland in 1998, see the explanation in the text above.

8 LIST OF MEMBERS OF THE TASK FORCE ON FOREIGN DIRECT INVESTMENT

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SUPPLEMENTARY DOCUMENT: SPECIAL PURPOSE ENTITIES

CONTENTS

INTRODUCTION 143

1 REASONING FOR THE IDENTIFICATION OF SPES AND PROBLEMS IN DEALING WITH SPES 144
- 1.1 Why should SPEs be identified separately 144
- 1.2 Problems in dealing with SPEs 144
- 1.3 Previous investigations by the OECD 145

2 DEFINITIONS OF SPES IN INTERNATIONAL GUIDELINES 147
- 2.1 OECD Benchmark definition of Foreign Direct Investment 147
- 2.2 IMF: 5th Manual, BOP Textbook and BOP compilation guide 147
- 2.3 European System of Accounts ESA95 148
- 2.4 International Accounting Standards (IAS) 149
- 2.5 Conclusions 150

3 THE IMPORTANCE OF SPES AND OFFSHORE ENTITIES IN EUROPEAN STATISTICS 153
- 3.1 Overview of the impact of offshore centres on European aggregates 154
- 3.2 Impact of offshore (financial) centres at national level 157
- 3.3 Result of the empirical exercise on the importance of SPEs in EU Member States 158
- 3.4 Special treatments of SPEs in EU Member States 159
- 3.5 Conclusions 159

4 CONCLUSIONS 160

Annex A **Example by NL** 161

Annex B **Overview of the different definitions of SPEs and offshore centres in international guidelines** 163

Annex C **Importance of offshore countries in US data** 171

Annex D **Data on the importance of SPEs in EU Member States** 175

Annex E **SPEs in the Eurostat classification by sector (NACE rev1)** 181

Annex F **Special treatment of SPEs in EU Member States** 184

INTRODUCTION

1. The proceeding globalisation and the formation of multinational enterprises and the increasing integration of the world economy are reflected by a remarkable increase of cross-border financial transactions. The establishment of complex intra group structures is more and more determined by financial and fiscal aspects. Against this background Special Purpose Entities (SPEs) are playing an important role in conducting group financing and in providing financial services. Moreover, profit shifting in order to minimise tax burdens is clearly an important determinant for the establishment of SPEs in countries with a convenient tax environment for foreign companies. Regarding these activities, not only the growing amounts of intra group cross-border capital flows, but also the increased complexity of such transactions may raise problems in the statistical treatment of this phenomenon in some countries.

2. For the time being the recommendations in BPM5 related to SPEs provide no special treatment of SPEs except para. 372, which says that only transactions in equity capital and permanent debt between affiliated banks and affiliated financial intermediaries – including SPEs with the sole purpose of serving as financial intermediaries – should be included in FDI, whereas other capital transactions should be excluded. With the exception of SPEs mentioned in BPM5, para. 372, most member states have no special approach for the identification and treatment of SPEs within FDI statistics. On the one hand the absence of national legal provisions or specific recommendations in the national statistical framework prevent a coherent approach in dealing with SPEs. On the other hand the necessity for a separate identification of SPEs seems often not to be obvious. Indeed one could ask about the reasoning of defining and identifying SPEs. The discussion within the OECD Workshop on Financial Investment Statistics has shown that several compilers do not really recognise the identification of SPEs within the population of FDI enterprises as a top priority issue. Therefore, some arguments will be presented in the following in order to provide some rationale for the specific importance of SPEs.

1 REASONING FOR THE IDENTIFICATION OF SPEs AND PROBLEMS IN DEALING WITH SPES

1.1 WHY SHOULD SPEs BE IDENTIFIED SEPARATELY?

3. First of all, there is a good reason to identify SPEs for analytical purposes. Users of FDI statistics may be interested in the nature of FDI activities, e.g. whether they are stemming from real operational business or merely from fiscal calculus. In this context a key issue is therefore to question the economic incentives related to SPE activities.

4. The term SPE comprises a large variety of enterprises with more or less specific activities. In general, SPEs are primarily engaged in international activities but in few or no local operations. Their functions frequently depend on the legal environment and taxation regime in their host country. SPEs acting as financial vehicles can be economically more accurately characterised as intermediaries rather than as direct investors or direct investment targets. The impact of SPEs on the economy they are operating in are often negligible. In particular, holding companies, shell companies, etc. typically have no real economic activity, no turnover and no significant employment.

5. The so-called green field investments are regarded as an important indicator for the economic attractiveness and competitiveness of regions and countries competing for direct investment. Policy makers and economists do regularly refer to foreign direct investment figures as an indication for economic conditions and the quality of economic policy. These discussions are mainly focused on inward flows and stocks. The increasing amounts of cross-border financial transactions arising from the formation of SPEs – together with the accelerated M&A activities – have extended gross financial flows significantly. However, these transactions have hardly any real impact on the domestic economy and do commonly not affect the creation of new production capacities and employment opportunities. Therefore, the interpretation of gross flows and the conclusions drawn from this might be misleading, if comprehensive gross direct investment transactions arise from funds channelled through third countries rather that directly from the investor to the final target.

6. There can also be deducted a connection to the calculation of direct investment income. International standards congruently recommend the application of the current operating performance concept including only profits and losses arising from operational business in FDI income. In this context one might argue that all foreign direct investment transactions and positions should be identified according to their "economic background". In the case of holding or shell companies, the assignment of FDI flows and stocks according to the ultimate investor and the ultimate target, respectively, would facilitate a geographical allocation in agreement with real economic incentives.

1.2 PROBLEMS IN DEALING WITH SPEs

7. In the context of providing meaningful FDI statistics, severe problems related to SPEs arise from:

– the *identification and classification* of SPEs, in particular holding companies, shell companies, financial intermediaries and financial auxiliaries. Detailed information about the business segment are essential for an assessment of the economic rationale behind the investment activities. In this respect an industry breakdown might often not be sufficient for an unambiguous distinction between SPEs and other FDI enterprises. Moreover, information about the business segment or industry are often limited to domestic entities. In the case of offshore centres one might assume that SPEs play a major role in these countries, simply classifying enterprises located in offshore centres as SPEs. However, there are evident differences between the group of offshore countries. Regarding offshore centres possessing a broad economic basis, e.g. Hong Kong or Singapore, inward and outward direct investment might also be

motivated by real economic activities rather than merely by fiscal incentives.

– the *geographical allocation*: When funds are channelled through a SPE, the real economic activity might often not be located in the country where the SPE is resident, but in third countries where the final target of FDI is located. When only direct FDI relationships are taken into account, FDI transactions and positions might be biased towards host countries of SPEs. In this context the identification and coverage of indirect relationships or the possibility of "looking through" holding and shell companies is a critical issue. Several countries have already developed approaches to tackle this problem. For example, in the U.S. FDI statistics, foreign shell companies incorporated abroad having all their physical assets or operations in a second foreign country are treated as incorporated foreign affiliates in the second country where their physical assets or operations are located. However, for the implementation of such a treatment, comprehensive information provided by reporting companies are required; and for the time being such data are apparently not available in most countries.

– *asymmetries* between national statistics: according to international standards, the activities of SPEs integrated in a multinational group structure should be treated as direct investment. However, various national practices in treating SPEs, in particular financial intermediaries and financial auxiliaries, are causing asymmetries. Moreover, the sector classification might be differing among member states.

1.3 PREVIOUS INVESTIGATIONS BY THE OECD

8. The analysis of the subgroup on SPEs should also shed some light on the different approaches in dealing with SPEs and off-shore enterprises among the member states. A categorisation of country specific approaches in dealing with SPEs was already attempted within the scope of the OECD Working Party on Financial Statistics in the recent past.[1] Since we do not intend to duplicate this exercise we focused on an empirical investigation, which was designed to analyse the present stage of possibilities in identifying SPEs in national statistics and to evaluate the order of magnitude (of parts) of SPE activities.

9. There is still no common approach in order to tackle these open issues among European countries. Though the results of the OECD study are still preliminary and will be reviewed in a second stage, the OECD paper represents a useful reference providing an overview of the various treatments of SPE activities in different countries. The results indicated that only a few countries possess a legal provision regarding the definition of SPEs and that there rarely exists any specific recommendation for the treatment of SPEs in FDI statistics. As the discussion within the OECD Workshop on International Investment Statistics showed, it proved hard to categorise the treatment of SPEs among countries when most countries have even not established recommendations for a specific treatment of FDI enterprises.

10. What can be learnt from the OECD studies? The large variety of answers and comments provided by compilers indicates the most important obstacles in identifying and analysing SPEs and their activities:

– there is hardly any definition, recommendation or treatment of SPEs applied by at least two countries in the same manner except for those countries not distinguishing between ordinary FDI enterprises and SPEs at all.

1 See "Report on Special Purpose Entities and Off-Shore Enterprises", note by the OECD secretariat prepared for the Workshop on International Investment Statistics, 5-6 March 2003 in Paris, DAFFE/MC/STAT(2003)4.

– there is no country of the euro area collecting data from resident enterprises on their SPEs abroad.

– information about tasks and activities of SPEs are not collected systematically by most countries. In this context, also the use of short-term instruments is still not analysed comprehensively. However, in particular short-term intra-group financing causes substantial cross-border capital flows.

11. Against the background of the follow-up work of the OECD secretariat, the subgroup on SPEs does not intend to replicate these results by an own survey, but to focus on an empirical exercise exploring the extent of SPE activities that can already be identified for the time being. It might be helpful to identify a least common denominator with respect to the category of SPEs which can already be separated by some Member States.

2 DEFINITIONS OF SPEs IN INTERNATIONAL GUIDELINES

12. This section presents some selected definitions of SPEs available in the main international guidelines. Mainly the *IMF 5th Manual*, the *IMF BOP Textbook*, the *IMF BOP compilation guide*, the *OECD Benchmark*, the *ESA95*, and the *International Financial Reporting Standards (IFRS-2003 Edition)* have been investigated.

2.1 OECD BENCHMARK DEFINITION OF FOREIGN DIRECT INVESTMENT

13. The Benchmark points out the fact that SPEs are the results of groups' strategy aiming at *facilitating* the financing of their investment over the world and contributing to *profit maximisation* for the whole group *(§69)*. As a result, most SPEs have a management or an administrative function, and are acting mainly as:

– financing subsidiaries, that is in raising funds or allocating funds from one unit of the group to another.

– conduits, that is (only) transferring funds among different entities of the group.

– holding companies, managing either financial or non-financial assets. *Annex 3* states that holding companies should be considered as financial corporations even though the investment that they hold may be in other industries.

– base or regional headquarters companies.

– tax haven corporations, "sheltering" income generated by the whole activity of the group and "minimizing" the overall tax cost of the Group's business.

14. According to the OECD, SPEs are usually located in tax havens (*Annex 3*), and may be structured in a number of ways, including separate legal entities and branches of legally constituted entities.[2] Because of this reference to tax havens, it should be interesting to note the statistical FDI treatment devoted to offshore entities *(§68)*: where a company Z incorporated in country A has its management office in another country B, country A in its outward direct investment statistics regard the foreign management office as direct investment by country A in a branch in country B etc.

15. Furthermore, SPEs could be found also in the manufacturing sector or could deal with a wide variety of activities such as merchandising, insurance or shipping activities (*Annex 3, p. 46*).

16. As regard to direct investment transactions, the *Benchmark* also stipulates that, since SPEs are an integral part of the organizational structure of a multinational enterprise, their transactions that arise from direct investment relationships should be reflected in the statistics and, if possible, shown as a sub-component *(§69)* and on a gross basis *(§38)*. When acting only as financial intermediaries, the FDI treatment has to be similar to the one defined for the banks *(§60 and 61)*.

2.2 IMF: 5TH MANUAL, BOP TEXTBOOK AND BOP COMPILATION GUIDE

17. The IMF deals with SPEs in chapter IV (Resident Units of an Economy) and chapter XVIII (Direct investment) of the *5th Manual*, in Chapter IX of the *Textbook* and, to some extent, under chapter XVI of the *Compilation guide*.

18. Regarding the residency criteria, the IMF states that offshore enterprises engaged in manufacturing processes or non-manufacturing operations, including so-called special purpose entities (SPEs), are residents of the economy in which the offshore enterprises is located *(§79 and 381)*. The *Textbook* adds that SPEs are *(§542)*:

2 In recent years not only the population of SPEs but also the magnitude of their activities in countries other than tax havens, like DK, IE and NL, has been increasing.

– generally organised or established in economies other than those in which the parent companies are resident.

– engaged primarily in international transactions but in few or no local operations. Engaged in few or no local operations means that the company does not carry out production, have no employee and do not pay income tax. Books or accounts may be maintained elsewhere and, thus, be unavailable for the host country compiler *(§706 of the Compilation guide*).

19. The *Textbook* also provides two examples on the recording of typical SPEs' transactions, one SPE acting as a "treasury (or assets) management company" *(§543*), another one acting as a pure financial intermediary *(§544*).

20. IMF *Manuals give* some recommendations on the statute of SPEs and the treatment of SPEs' transactions in the field of direct investment. The most important ones are shown below:

– it is recommended to consider SPEs as resident direct investment enterprises *(§365),* if they meet the general criteria that define FDI relationships. Transactions through SPEs have to be also included in direct investments *(§372)*.

– for SPEs with the sole purpose of serving as in a financial intermediary capacity, the Manual recommends to restrict their FDI transactions only to those associated with permanent debt and equity, or fixed assets in the case of branches *(§365 and 372)*.

– whatever the treatment used by the reporting country, the Manual recommends to separately identify the value of SPE transactions as a group, to permit consistent international comparison *(§365*).

– always to improve international comparison, compilers should record and send to the IMF the complete b.o.p. entries of SPEs (i.e. on a gross basis), even if it is recognised that some compilers may prefer to exclude transactions considered to be of no relevance for the domestic economy (*Compilation guide, §708*).

21. SPEs can have the structure of a holding company, a base company, or a regional headquarters, could serve for administration, management of foreign exchange risk purposes, or facilitate the financing of investments *(§365-brackets*).

2.3 EUROPEAN SYSTEM OF ACCOUNTS ESA95

22. *Chapter 2 of ESA95* (Units and groupings of Units) might help the TF-FDI in the classification of SPEs by National Account sectors. The TF-FDI proposal for the new IMF matrix chart is to exclude transactions other than equity and permanent debt between all entities belonging to S122, S123 and S124. Unlike other international guides, *ESA95* provides a clear definition of holding companies, which could be helpful given that both the *OECD benchmark* and *IMF Manuals* consider that some SPEs could have the statute of holding companies.

23. *Paragraph 2.14 of ESA95* states that holding corporations are institutional units whose main function is to control and direct a group of subsidiaries.

24. For SPEs identified as holding corporations, *ESA95* suggests to classify holding corporations in the sector better reflecting the activity of the group of subsidiaries as a whole:

– *paragraph 2.23-e)* states that holding corporations controlling a group of corporations which are market producers (i.e. a group of subsidiaries) are 'non-financial corporations' (S11) if the preponderant type of activity of the group of corporations/ subsidiaries (measured on the basis of value

added) is the production of goods and non-financial services.

– *paragraph 2.40-e)* states that holding corporations controlling a group of subsidiaries are financial corporation (S12) if the group of subsidiaries within the economic territory as a whole is principally engaged in financial intermediation and/or in auxiliary financial activities.

– *paragraph 2.43 (and footnote 9)* states that holding corporations which only control and direct a group of subsidiaries principally engaged in financial intermediation and/or in auxiliary financial activities are classified in sub-sector S123 "other financial intermediaries except insurance corporation and pension funds". However, holding corporations which are financial corporations themselves (holdings of holdings?) are to be allocated to the sub-sectors according to the main type of financial activities.

– with a more precise wording, *paragraph 2.63-b)* says that sub-sector S125 (insurance corporations and pension funds) does not include holding corporations which only control and direct a group consisting predominantly of insurance corporations and pension funds, but which are not insurance corporation and pension funds themselves. They are classified in sub-sector S123.

25. For "non-holding" SPEs (mainly SPEs with no subsidiaries) further guidance is provided by ESA95 depending if the SPE is acting as a financial intermediary or as a treasury services provider.

– *paragraphs 2.32-2.34* states that financial intermediation is the activity in which an institutional unit acquires financial assets and at the same time incurs liabilities on its own account by engaging financial transactions on the market. Funds are channelled between third parties with a surplus on one side and those with a lack of fund on the other. Financial intermediaries may invest their funds in non-financial assets including real estate. However, in order to be considered as a financial intermediary, a corporation should, in addition incur liabilities on the market and transfer funds. For this reason, real estate corporations are not considered as financial intermediaries.

– *paragraphs 2.37* states that financial intermediation does not include institutional units providing treasury services to a company group, unless subject to financial supervision. When they are not subject to financial supervision, units acting as treasury services are allocated to the sector better reflecting the predominant function of the company group within the economic territory.

– *paragraphs 2.55-f)* states that financial vehicle corporations, created to be holders of securitized assets have to be classified under S123, unless they are MFIs (S122).

2.4 INTERNATIONAL ACCOUNTING STANDARDS (IAS)

26. Most of the information available in the *International Financial Reporting Standards (IFRS-2003 edition)* refers to SPEs' consolidation issues (IAS 27 and SIC-12 Interpretation). However, the Standing Interpretation Committee-SIC-12 presents an SPE definition, which is more or less presented in a similar way than the OECD one. The main key points of the definition can be summarised as follows:

– an SPE is an entity created to accomplish a narrow and well-defined objective (e.g., to effect a lease, research and development activities or a securitisation of financial assets).

– an SPE can be a corporation, a trust, a partnership or an unincorporated entity.

– SPEs are often created with legal arrangements that impose strict and

sometimes permanent limits on the decision-making powers of their governing board, trustee or management over the operations of the SPE.

– the creator of the SPE frequently transfers assets to the SPE, obtains the right to use assets held by the SPE or performs services for the SPE, while other parties may provide the funding to the SPE.

27. But the main issue raised in SIC-12 relates to how SPEs should be consolidated, when it should be done and which kind of SPE has to be consolidated. In very simple terms, SIC-12 states that:

– an enterprise should consolidate an SPE when, in substance, the enterprise controls the SPE.

– the concept of control used in IAS requires having the ability to direct or dominate decision-making, regardless of whether this power is actually exercised. The ability to govern decision-making must be accompanied by the objective of obtaining benefits from the SPEs' activities.

– SPEs frequently operate in a predetermined way so that no enterprise has explicit decision-making authority over the SPE's ongoing activities after this formation. Because virtually all activities are predetermined, control may exist for the sponsoring party even though it may be particularly difficult to assess.

– control may exist even in cases where an enterprise owns little or none of the SPE's equity.

2.5 CONCLUSIONS

28. The exploration of various international guidelines has put forward the difficulty for compilers to define SPEs in simple words. However, some common and internationally agreed characteristics that define an SPE could be helpful for the identification and the harmonisation of the treatment of SPEs. The following conclusions rely mainly on the fact-finding exercise done in IMF or OECD Manuals. Information relating to SPEs in the IFRS manual deals mainly with the issue linked to the consolidation of SPEs and the concept of control in accounting standards.

29. SPEs are defined in different ways in international guidelines, the OECD benchmark focusing more on the purpose or the structure of SPEs whilst the IMF puts forward the concept of their engagement in few or no local operations. But the essential point is that all these definitions do not contradict each other. The OECD, in its report on Special Purpose Entities and Off-shore enterprises (p.9), merged both its own definition with the IMF one to present a common understanding of SPEs according to international guidelines, which can be summarised as follows [3]. SPEs are:

– generally organised or established in economies other than those in which the parent companies are resident.

– engaged primarily in international transactions but in few or no local operations.

– SPEs can be a financing subsidiary, a holding company, a base company or a regional headquarter.

– SPEs can act as a sale and regional administration, a management of foreign exchange risk, or have the purpose of facilitating the financing of investment for the whole group.

30. In practice, the concept of "few or no local operation" seems to be the one which is more in line with national definitions currently available

3 Report on Special Purpose Entities and Off-shore enterprises – Workshop on International Investment Statistics, 5-6 March 2003, paragraph 15, p. 9.

in few Member States (mainly DK, NL and, to some extent, IE).

31. The definitions expressed above, merging both IMF and OECD definitions and not contradicting the current national definitions will constitute the basis for any future work that could be enhanced by Eurostat or the ECB in the field of SPEs.

4) Regarding residence criteria, both the OECD and the IMF consider that offshore enterprises, including SPEs, have to be considered as residents of the economy in which they are established.

5) Regarding the statute of SPEs and the treatment of their FDI transactions, both the OECD and the IMF recommend to consider SPEs as resident direct investment enterprises if they meet the general criteria defining FDI relationships, therefore to treat their FDI transactions accordingly.

6) For SPEs with the sole purpose of serving in a financial intermediary capacity, all international guidelines recommend to restrict their FDI transactions only to equity capital and permanent debt (or fixed assets for branches).

7) The IMF *Textbook (*but not the *5th Manual*) is the only guide defining SPEs according to their operational presence in the host country (the OECD only raises the question in the "Tax authorities' perception" paragraph):

– SPEs are generally established in economies other than those in which the parent companies are resident.

– SPEs are engaged primarily in international transactions but in few or no local operations.

But nothing is said regarding the evolution of the SPEs' population of enterprises (what should be done in case of an expansion of the activities on the local market).

8) Both the OECD and the IMF recognise that some country may net out transactions through SPEs, but they all recommend that national compilers should provide information on a gross basis, for international comparison.

9) All international guidelines agreed on the fact that SPEs can take the form of holding corporations. *ESA95* has a precise definition of holding corporations *(§2.14*), – institutional units whose main function is to control and direct a group of subsidiaries. The identification of holding companies is needed for the sectoral classification of SPEs in S11, S122 to S125. Such an identification is necessary to indicate which FDI treatment should be adopted (the general FDI one or the one defined for SPE acting only as a financial intermediary).

10) Holding SPEs have to be classified in the sector which better reflects the activity of the group of subsidiaries as a whole (measured on the basis of value added*, ESA95 §2.23-e, 2.40-e, 2.43*).

11) ESA95 states that Holding corporation controlling a group of subsidiaries consisting predominantly of insurance corporations and pension funds has to be classified in the financial intermediation sector (S123), instead of the insurance one (*ESA95 §2.43 and 2.63-b*). However, on this specific topic, paragraph 70 of the IMF "Monetary and Financial Statistics Manual" does not mention this exception. This Manual states that (extract):

"A holding corporation is classified as financial if the preponderant activity of the group of corporations as a whole is financial."

"Similarly, financial holding corporations should be allocated to subsectors according to the type of financial activities mainly carried out by the group they control."

12) For an SPE not having the statute of holding, it is necessary to check if the SPE is acting as a financial intermediary or simply as a

treasury provider (*ESA95 §2.34, 2.37, 2.55-f, IMF Textbook examples §543, 544, OECD Benchmark §69*).

13) ESA95 states that financial intermediation does not include institutional units providing treasury services, unless subject to financial supervision.

- Units acting as treasury services, and not subject to financial supervision, are allocated to the sector better reflecting the predominant function of the group.

- Finance vehicle corporations holding securitized assets have to be classified under S123, or S122 if they are MFIs.

3 IMPORTANCE OF SPEs AND OFFSHORE COUNTRIES IN EUROPEAN STATISTICS

32. The TF-FDI highlighted the fact that not all the MS identify SPEs in their regular statistics. Mainly NL and, to some extent, DK and IE reserve a specific treatment/definition for transactions involving them. The Central Statistical Bureau (CSB) of NL does not include the gross transactions of SPEs in the national FDI statistics, nor in the data provided to Eurostat. The CSB argues that transactions with SPEs do not affect the Dutch economy, and therefore are not relevant for National Accounts purposes (no effect on the net worth). Despite the fact that Eurostat and the ECB compile European aggregates following the same method, the results obtained obviously diverge, which is not satisfactory from an analytical point of view, and from the users' one[4]. Investigations done within the TF-FDI confirmed that the other Member States include transactions with SPEs both in their data transmission to ECB and Eurostat.

33. Eurostat is not able to evaluate directly the global contribution of SPEs using the current Eurostat/OECD questionnaire. Within this questionnaire, information relating to either FDI capital invested abroad by resident direct investors acting as financial/management holding companies, or invested in resident financial/management holding companies, can be found. But it cannot be assumed that all holding companies could be considered as SPEs. Furthermore, non-holding SPEs could exist if we refer to all the international definitions expressed in the previous section. For this reason, Member States have been asked by the TF-FDI to provide an estimation of the direct contribution of SPEs in FDI statistics.

34. The Eurostat/OECD questionnaire asks information about FDI relationships with the so-called offshore centres, a group constituted by "small" economic countries (in term of GDP). FDI transactions are recorded according to the first shot criteria. It is questionable whether large amounts (if not all) invested directly in the EU by offshore centres would need to be reallocated if the UBO criteria had to be applied. Reversibly, EU direct investment towards offshore centres could be seen as investments for which we do not know exactly the final destination.

35. Given the relative "disconnection" between their GDP size and the amount of FDI capital they generate, it seems suitable to go on having a close follow up of this specific population. Another reason rests on a possible correlation between resident SPEs and offshore countries, an assumption clearly stated in Annex 3 of the OECD Benchmark definition ("Location of SPEs", p. 45, 1st sentence). But this assumption will be difficult to check, at least on European data.

36. One of the purposes of the following tables is to try to convince Member States to investigate whether it is necessary to have an in-depth analysis about SPEs and offshore centres. All the following tables should be analysed, bearing in mind that:

i) the Eurostat current list of the offshore (financial) centres[5] cover in fact "non-European" offshore (financial) centres.

ii) this list has been updated recently (in October 2002, therefore mainly for the 2001 and 2000 FDI data), which might alter comparisons over time. But the former Eurostat list already contained the most significant offshore countries. Therefore, it could be expected that these (recent) changes do not influence significantly the level of FDI transactions with offshore entities.

4 Even though, from the purely national viewpoint, the exclusion from national statistics of SPE's transactions may make sense, since, in some cases, national statistics could otherwise be blurred by the volume of financial transactions between non-resident entities channelled through domestic SPE's.

5 Eurostat current list of offshore financial centres (31 countries): Antigua and Barbuda, Anguilla, Netherlands Antilles, Barbados, Bahrain, Bermuda, Bahamas, Belize, Cook Islands, Dominica, Grenada, Hong-Kong, Jamaïca, St Kitts and Nevis, Cayman Islands, Lebanon, Saint Lucia, Liberia, Marshall Islands, Montserrat, Maldives, Nauru, Niue, Panama, Singapore, Turks&Caicos Islands, Saint Vincent and the Grenadines, Virgin Islands (UK), Virgin Islands (US), Vanuatu and Samoa.

3.1 OVERVIEW OF THE IMPACT OF OFFSHORE CENTRES ON EUROPEAN AGGREGATES

37. Table 1 presents the evolution of EU FDI transactions with offshore centres since 1995, both in absolute value and with regard to the total extra EU transactions. The non-symmetry between outward and inward flows is quite obvious: whilst the evolution is rather volatile on the outward side, EU inflows received from offshore centres have regularly increased since 1997, from €4.9 bn to €13.4 bn. Furthermore the issue linked to offshore centres seems to be more relevant on the inward side: on average over the 1995-2001 period, EU inflows received from offshore companies accounted for 9.1% of the total extra EU inflows. Two reasons could explain the smaller percentage on the outward side:

i) the Eurostat current list of offshore entities does not contain any European countries. It might be possible that EU direct investors are mainly dealing with similar entities close to the EU border (inside or outside the EU), whilst EU direct investment companies receive FDI capital from foreign groups located in other continents (Caribbean area or South East Asia zone).

ii) inward and outward flows related to SPEs reported from NL are not available in the Eurostat database. May be it could fill in part of the gap of overall flows to and from offshore countries.

38. For direct investors of the Eurozone, the relative interest for investing in offshore countries is quite similar to the one observed at the EU level (3.4% of extra Eurozone outflows, see Table 2). But the relative weight of inflows from offshore companies is estimated to 4.1% of the total extra Eurozone inflows, 5 percentage points less that the weight observed

Table 1 EU FDI flows transactions with the rest of the world and offshore centres

(EUR millions)

	1995	1996	1997	1998	1999	2000	2001	1995-2001
Outward								
Extra EU	-62,407	-68,665	-109,802	-218,754	-302,395	-408,925	-234,800	-1,405,749
Offshore centres	-3,337	-5,561	-6,811	-1,830	-8,971	-7,351	-12,332	-46,194
%	*5.3*	*8.1*	*6.2*	*0.8*	*3.0*	*1.8*	*5.3*	*3.3*
Inward								
Extra EU	42,464	36,509	50,160	96,432	102,118	150,407	118,470	596,559
Offshore centres	3,427	2,583	4,932	5,816	10,234	13,628	13,403	54,023
%	*8.1*	*7.1*	*9.8*	*6.0*	*10.0*	*9.1*	*11.3*	*9.1*

Table 2 Euro area FDI flows with extra Eurozone and offshore centres

(EUR millions)

	1999	2000	2001	1999-2001
Outward				
Extra Eurozone	-310,409	-411,863	-252,341	-974,613
Offshore centres	-5,523	-11,205	-16,241	-32,969
%	1.8	2.7	6.4	3.4
Inward				
Extra Eurozone	174,459	343,118	157,474	675,052
Offshore centres	8,409	7,788	11,788	27,985
%	4.8	2.3	7.5	4.1

Note: Transactions involving Dutch SPEs are excluded from Euro area calculations.

Table 3 FDI positions with the rest of the world and offshore centres

(EUR millions)

	European Union Values at end 2000	Euro area Values at end 2000
Assets		
Extra EU/Eurozone	1,517,186	1,335,073
Offshore centres	77,236	44,493
%	*5.1*	*3.3*
Liabilities		
Extra EU/Eurozone	890,709	1,112,495
Offshore centres	65,800	43,790
%	*7.4*	*3.9*

Note: Transactions involving Dutch SPEs are excluded from EU and Euro area calculations.

on EU aggregates. Despite this gap, it seems reasonable to consider that percentages observed on the inward side are quite substantial, which justify the need of further investigation for analytical purposes.

39. The relative importance of the group of offshore countries is also confirmed by the FDI positions data, however with a better balancing between assets and liabilities: 5.1% and 7.4% respectively, for the European Union as a whole, 3.3% and 3.9% for the Eurozone as a whole entity.

40. Table 4 presents the classification (in descending order) of the main extra EU FDI partners, both on the assets and liabilities sides. At the moment, Eurostat doesn't have the possibility to offer a full breakdown of EU direct investment vis-à-vis all extra EU individual countries. The current list involves 50 individual extra-EU countries, and it has been necessary to introduce some grouping zones (eight in all) to better approximate a full coverage of the extra EU area (see footnotes under Table 4). None of these additional groups contains any of individual listed countries and, apart from the "Gulf Arabian countries" (see footnote 5), this list also avoids the possibility of having one non-listed country being included in more than one economic group.

41. When looking at the regional distribution, the results clearly illustrate the dominant positions of offshore companies, in the field of FDI:

i) assets side: offshore financial centres, excluding Singapore and Hong-Kong, hosted altogether €41 billion of EU external FDI assets, ranking in the top 6 countries' list just behind Argentina and before Australia.

ii) liabilities side: offshore financial centres, excluding Singapore and Hong-Kong, were altogether responsible of €52 bn of EU external FDI liabilities, ranking in the 3rd position just behind Switzerland and before Japan.

iii) if we add Singapore and Hong-Kong, then it could be seen that the group formed by offshore financial centres, as defined in the current Eurostat list, is the 3rd EU partner both on the assets and liabilities side (€77 bn on the assets side, €66 bn on the liabilities side).

42. From this table it could also be possible to portray also the impact linked to a possible extension of the offshore list. For the moment, no official "offshore" list has been established/approved by the International Institutions. Nevertheless, the "Other European countries" group[6] defined by Eurostat involves countries

6 Andorra, Faroe Islands, Guernsey, Gibraltar, Isle of Man, Jersey, Moldova, Macedonia, San Marino and Vatican City State.

Table 4 Main extra EU partners countries, according to (end 2000) FDI positions

EU external FDI ASSETS (end 2000)		EU external FDI LIABILITIES (end 2000)	
US	762,842	US	546,014
CH	106,323	CH	128,962
BR	69,325	**Offshore centres [1]**	**52,034**
CA	64,574	JP	47,326
AR	44,684	CA	36,719
Offshore centres [1]	**41,006**	AU	19,001
Other European c. [2]	38,426	NO	18,478
AU	30,042	Other European c. [2]	18,438
JP	29,271	**HK [1]**	**7,101**
NO	26,660	**SG [1]**	**6,664**
PL	23,940	Gulf Arabian countries [5]	5,606
SG [1]	**21,533**	LI	5,451
Other Africa [3]	18,701	Other Africa [3]	2,979
MX	18,305	RU	2,739
HU	16,597	BR	2,601
HK [1]	**14,696**	NZ	2,101
CL	14,425	CY	1,951
CZ	14,306	IR	1,669
CN	13,788	IL	1,666
ZA	13,389	ZA	1,599
KR	8,194	MX	1,534
Other South America [4]	7,646	TR	1,321
VE	6,341	KR	1,273
TR	6,228	MY	1,056
Gulf Arabian countries [5]	5,931	Other North African c. [6]	1,000
MY	5,878	AR	979
TW	5,566	TW	688
IN	5,303	PL	615
RU	5,003	VE	595
CO	4,817	Other Near & Middle East	586
Other North African c. [6]	4,255	CN	584
TH	4,057	ID	583
NZ	3,944	MA	539
EG	3,697	UY	533
PH	3,652	IN	511
MA	3,285	MT	465
SK	3,244	EG	245
ID	2,561	HU	239
CY	2,520	IS	234
RO	2,227	Other Oceanian c. [7]	183
Other Near & Middle East	1,840	CZ	170
HR	1,697	TH	152
LI	1,567	CO	150
IL	1,541	SI	149
SI	1,387	BG	116
EE	1,122	RO	103
LT	1,058	YU	90
UY	1,022	PH	86
BG	1,012	Other South America [4]	85
MT	871	UA	42
LV	815	HR	37
Other Oceanian c. [7]	791	SK	33
IR	677	BY	21
UA	526	AL	11
YU	467	LT	9
IS	143	LV	2
AL	117	EE	-1
BY	34	CL	-15

1) Eurostat current list, excluding Singapore and Hong Kong (shown separately).
2) Andorra, Faroe Islands, Guernsey, Gibraltar, Isle of Man, Jersey, Moldova, Macedonia, San Marino and Vatican City State.
3) Other African countries (as defined by Eurostat) minus South Africa.
4) South America, excluding AR, BR, CL, CO, UY and VE (shown separately).
5) The Gulf Arabian countries' list include Bahrain, whis is also an offshore (financial) centres.
6) Algeria, Tunisia and Libya.
7) Oceanian countries – Australia – New-Zealand.

Table 5 Extra EU FDI positions capital structure at end 2000

(%)

	Equity cap. & RIE	Other Capital	Total
Assets			
Extra EU assets, exc. offshore centres	79	21	100
Offshore centres	92	8	100
Liabilities			
Extra EU liabilities, exc. offshore centres	65	35	100
Offshore centres	57	43	100

having (more or less) similar characteristics to those from the Eurostat offshore list. If we had to include them in the Eurostat list, then the total amount of EU external FDI assets located in offshore countries would have jumped from €77 to €115 billion, in the 2nd position behind the United States and far ahead of Switzerland.

43. These results put forward the powerful role played by offshore centres in the field of FDI, if we consider them as a unique entity. With the perspective of improving international comparison it is questionable whether the presence of offshore entities alter significantly the regional distribution picture.

44. The extra EU FDI capital structure could also point out the specificity of these entities, as it is shown in Table 5: On the liabilities side, the capital distribution between "equity capital and RIE" and "other capital" is around two third/one third respectively. For extra EU FDI liabilities vis-à-vis foreign offshore companies, the FDI capital distribution profile diverges significantly from the extra EU average: 43% of the total assets held in the Union by offshore countries were constituted by inter-company debt stocks.

3.2 IMPACT OF OFFSHORE (FINANCIAL) CENTRES AT NATIONAL LEVEL

3.2. I OVERVIEW

45. Data presented in this chapter refer to FDI positions observed at end 2000, mainly because of high volatility observed on the data flows. In addition, Eurostat do not have any FDI data with offshore centres, reported by Belgium/ Luxembourg, Greece, Spain and Ireland, which constitute another restriction of the analytical framework. Data for Switzerland and the United States have been added to enlarge the overview at national level. For the United States, information has been extracted from regular tables available in the Bureau of Economic Analysis (BEA) website (www.bea.doc.gov). Offshore aggregates reported by the USA have been calculated by Eurostat (according to the Eurostat current list), by summing up all available information in their detailed geographical breakdown list. Given the few number of missing (confidential) information, it can be assumed that the estimated results obtained are reliable.

46. At first glance, Table 6 seems to point out a rather limited impact of offshore centres, in Member State FDI positions statistics[7], with a maximum around 6% (Austria) for the assets side, slightly below 10% for the liabilities side (Denmark).

47. Amazingly, significant percentages shares – close to 14% – can be observed on Swiss and US assets side. For the US data, a possible explanation could be linked to the fact that the Eurostat current offshore list favours mainly US companies, as most of offshore countries recorded in this list are concentrated in the

7 Here the relative importance is measured on MS total external FDI positions, i.e. with the world total. It explains partially the lower percentage level observed on MS figures, in comparison with those shown on European aggregates.

Table 6 Importance of offshore centres in MS FDI statistics

(%) Reporter	FDI positions at end 2000	
	Assets	Liabilities
Belgium/Luxembourg	:	:
Denmark	0.4	9.7
Germany	2.2	0.4
Greece	:	:
Spain	:	:
France	1.5	0.9
Ireland	:	:
Italy	3.6	1.9
Netherlands [1)]	1.5	5.8
Austria	6.1	0.3
Portugal	5.2	5.2
Finland	0.7	0.0
Sweden	1.1	:
United Kingdom	3.2	3.1
Switzerland	13.6	0.9
United States	13.8	4.6

Data with offshore centres are not available.
1) Excluding SPEs

Caribbean Islands. On the liabilities side, offshore entities have more or less the same importance on the US figures as those observed on European aggregates (4.6%). On the contrary, FDI activities of offshore companies, in Switzerland, are negligible.

3.2.2 FOCUS ON US DATA

48. Would the application of UBO criteria alter the importance of offshore entities? A first attempt to this answer is given by the analysis of US figures, shown in Annex C.

The main comments are synthesised in the three following points:

1) The application of the UBO criteria does not alter the large influence of offshore countries[8] in US statistics. Surprisingly, US figures indicate even a reinforcement of this group, when going from first shot to UBO.

2) However, if offshore countries are analysed individually, the role played by each of them is drastically affected by the UBO country reallocation.

3) There are apparently large differences between offshore centres subject to their economic background. It seems that the move from first shot to UBO does not always enable the identification of the UBO owners' nationality. In fact, the constraints encountered by the BEA for a full application of their UBO definition are not known.

3.3 RESULTS OF THE EMPIRICAL EXERCISE ON THE IMPORTANCE OF SPEs IN EU MEMBER STATES

An empirical investigation concerning the role of SPEs was conducted by the TF-FDI. The outcome of the empirical exercise on the impact of SPEs in b.o.p. and i.i.p. data illustrates the difficulties of such an exercise in the absence of a specific definition of SPEs in a majority of countries: four countries replied that they could not provide any information and five (BE, DE, FI, FR and GR) provided data, essentially by approximating the definition of SPEs with one or more of the following: co-ordination centres, financial holding companies, management holding companies and "other services for enterprises".

The answers received are attached in Annex D. No meaningful aggregation has been deemed feasible, given the disparity of the proxies used to compile the data.

The examination of the figures provided show that the amounts involved both for flows and for stocks are quite significant, especially in DE. As the four countries which have provided data for the exercise are not known to be particularly attractive for SPEs, (contrary to NL), this would indicate that the validity of the approximation SPEs = holding companies is questionable.

As already said, SPEs cannot be identified as such within the NACE classification of

8 Offshore centres estimated with Bahamas +Bermuda +Netherlands Antilles +Panama +UK Islands, Caribbean +Other OWH +Liberia +Lebanon +Hong Kong +Singapore.

activities. In international guidelines, SPEs are identified not only according to their main economic activity, but also through their structure's analysis (holding or non-holding corporation).

As some Member States proceed, Eurostat approximated the importance of some type of SPEs using a correspondence table to link the OECD definition (Holding company, regional headquarters, Management of foreign exchange risk etc…) with the main concerned classes/ groups (of the NACE rev1) for hosting SPEs. Annex E gives an overview of this linkage together with an estimation of the impact of these groups, at the European level.

The fact that, apart from NL, DK and, to a lesser extent, IE, there exists no specific definition of SPEs in EU countries may also indicate that there is no real need for such a definition because the issue is not important in these countries.

3.4 SPECIAL TREATMENTS OF SPEs IN EU MEMBER STATES

As already mentioned SPEs play an important role in a few countries and therefore special treatments were established in these countries. As the net flows of SPE transactions through NL are close to zero and hardly affect the national economy, the gross flows are not included in the national FDI statistics of NL. DK has still not decided if certain SPE activities should be excluded for national reporting and Ireland identifies separately a part of its SPE population. The treatment of SPEs in DK, IE and NL is described in Annex F.

3.5 CONCLUSIONS

1. Offshore financial centres are important FDI partners, having a significant impact on European statistics. For international comparison, it would be necessary to have an agreed list of offshore financial countries, which is also stable over time.

2. The US figures show that a moving from first shot to UBO criteria does not "globally" alter the importance of offshore financial centres. But it seems necessary to distinguish between offshore centres with a real economic background and offshore centres which attractiveness is merely based on fiscal incentives. Such a distinction could also help to further elaborate the final offshore list expressed in 1. However, a high sensitiveness to change in criteria classifications has been observed for each offshore country taken individually. The use of UBO implies a geographical breakdown of FDI data better reflecting economic reality. But results obtained on US figures leave some "open questions" in the sense that it is not sure whether they have identified the real UBO company: between the first shot identified partner and the real UBO one, FDI capital could be in the hand of several intermediary offshore entities, and we do not know the real reasons for assuming direct FDI relations between EU SPEs and "offshore SPEs".

3. The restricted analysis on holding activities, using the Eurostat/OECD questionnaire by activity, has put forward the "potential" impact of SPEs in FDI statistics, both on European aggregates and at the Member States level. At the moment, a more accurate measure of SPEs' transactions is not feasible: None of currently available definitions – international guidelines or the national one – considers all holding companies as SPEs entities.

4 CONCLUSIONS

The analytical interest of a separate identification of transactions/positions related to SPEs was derived in chapter 1. However, various problems in dealing with SPEs restrict the separate identification of SPEs. The main problem in identifying SPEs is simply the absence of an appropriate data basis. The empirical investigations on the importance of SPEs among member states has revealed that even the identification of domestic SPEs is at present time obviously not possible for most member states. At the best SPEs could roughly be approximated by certain sectors potentially including SPEs. Moreover, it seems that a full analysis would also require the identification of non-resident SPEs when they are counterpart to a transaction/position of a resident company, which seems an impossible goal to achieve.

The importance of SPEs varies significantly among member states. Consequently, practices and efforts in identifying SPEs and the application of special treatments differ between countries. Potential asymmetries between national statistics respectively differences in data dissemination to international organisations should be avoided or properly be exposed.

The TF-FDI recommends the inclusion of transactions/positions of/with SPEs or SPE-like companies in b.o.p./i.i.p. reporting concerning the contributions to the euro area/EU aggregates.

*Notwithstanding all the practical and conceptual difficulties previously stated, the TF-FDI recommends that the possibility to collect separate statistics for SPEs continue being assessed by both working groups and in the framework of ad hoc workshops in the future. To this aim, coordination should be ensured with the related work cur*rently being developed in the OECD.

Additionally, chapter 5[9] recalled the decision of the IMF, in co-ordination with the ECB's WG-BP&ER and the OECD's Working Party on Financial Statistics (WPFS), concerning inter-company loans between affiliated MFIs. In particular, there is an explicit reference in the IMF resolution to SPEs principally engaged in financial intermediation for a group of related enterprises.

According to the IMF decision, SPEs principally engaged in financial intermediation for a group of related enterprises should be included in the category of affiliated financial intermediaries and, therefore, inter-company loans with any other institution included in this category should be excluded from direct investment and should be recorded in other investment[10].

9 See annex 1.
10 Permanent debt should still be recorded in direct investment.

ANNEX A: EXAMPLES OF SPE TRANSACTIONS THROUGH THE NETHERLANDS

Holding companies are one of the possible types of SPEs in the Netherlands. By order of their foreign parent company these SPEs not only manage participations but also distribute dividends gained from different participations. In general, the inward and outward equity capital transactions should be registered at their market value. Based on the reporting of an SPE, two examples of a fictive SPE are presented below. In the first example the purchase of the participation by Dutch SPE is booked at market value while in the second example the purchasing price is equal to the book value. The holding gains realised in the second case are extra ordinary high and should not be considered as Direct Investment income.

CASE A, REALISING GAIN ACCORDING TO COPC:

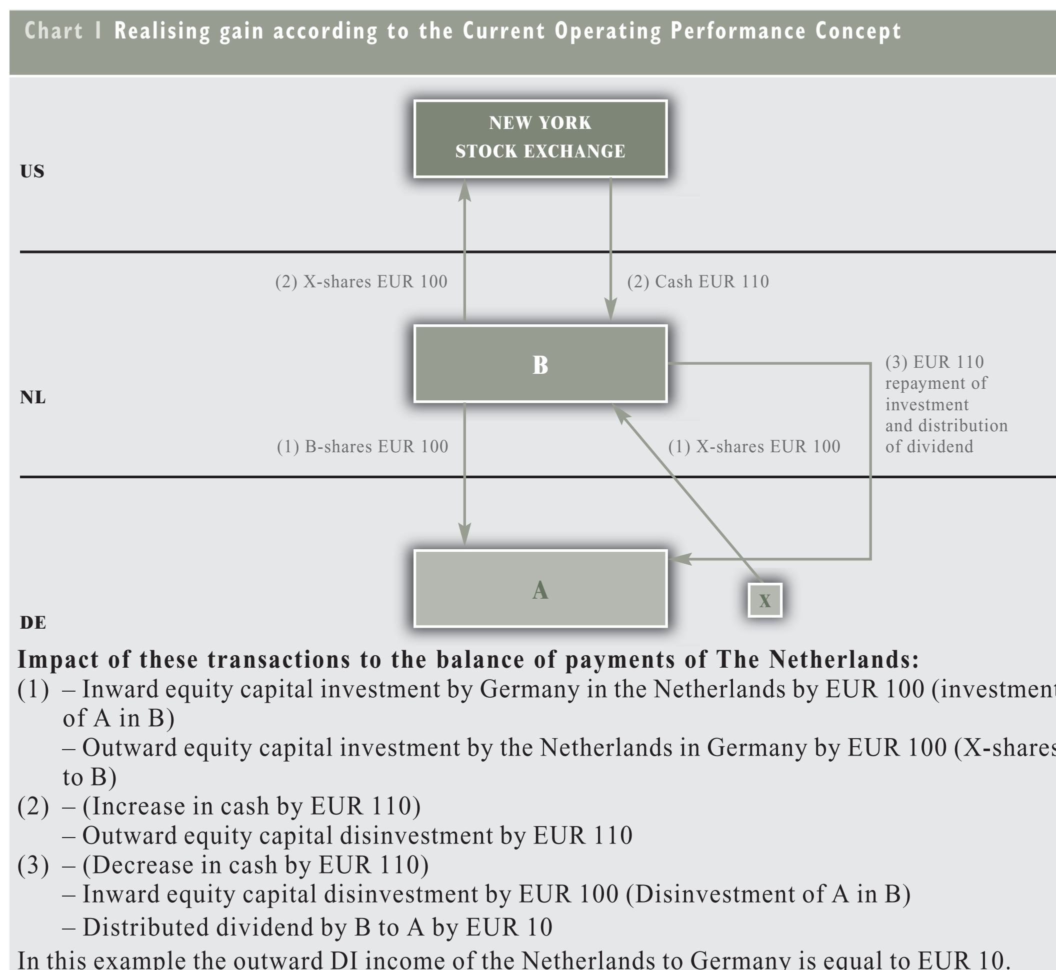
1. Holding company B is a Dutch SPE and for 100% owned by German multinational enterprise A. Company A has transferred its German subsidiary X (also German resident) to company B in for an amount of EUR 100 (market value). As a result of this transfer the equity capital of A in B has increased by the same amount.

2. After a year company B has sold the shares of the German subsidiary X via the New York stock exchange for EUR 110.

3. Company B has distributed the received amount including the realised earning to its parent company A. The EUR 10 realised gain can be considered as earning according to COPC.

These transactions are illustrated in Chart 1.

Chart 1 Realising gain according to the Current Operating Performance Concept



Impact of these transactions to the balance of payments of The Netherlands:

(1) – Inward equity capital investment by Germany in the Netherlands by EUR 100 (investment of A in B)
– Outward equity capital investment by the Netherlands in Germany by EUR 100 (X-shares to B)

(2) – (Increase in cash by EUR 110)
– Outward equity capital disinvestment by EUR 110

(3) – (Decrease in cash by EUR 110)
– Inward equity capital disinvestment by EUR 100 (Disinvestment of A in B)
– Distributed dividend by B to A by EUR 10

In this example the outward DI income of the Netherlands to Germany is equal to EUR 10.

CASE B, REALISING EXTRA ORDINARY HOLDING GAINS:

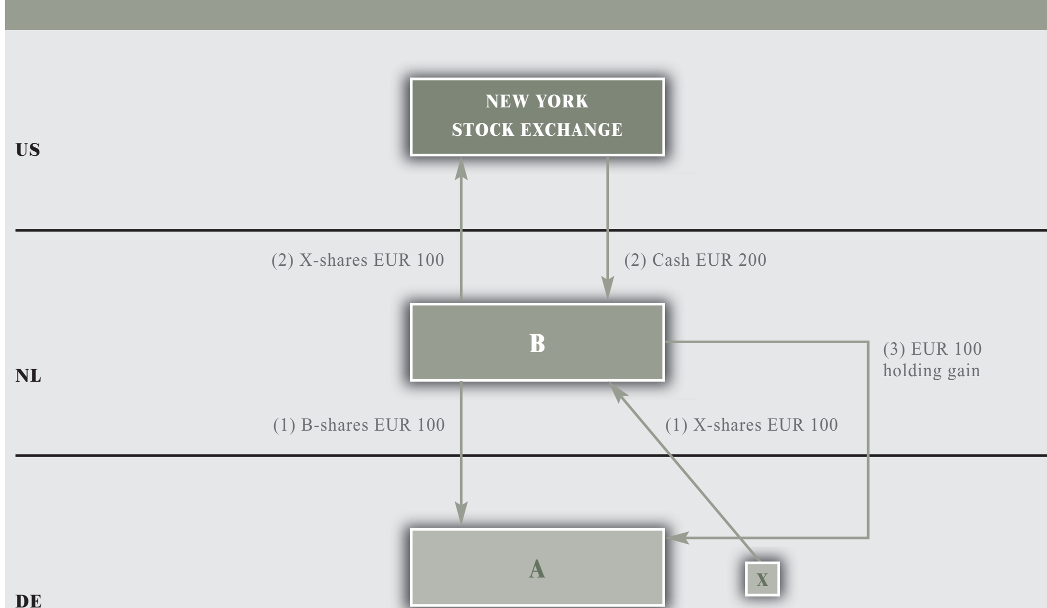
1. Holding company B is a Dutch SPE and for 100% owned by German multinational enterprise A. Company A has transferred its German subsidiary X (also German resident) to company B in for an amount of EUR 100 (book value). As a result of this transfer the equity capital of A in B has increased by the same amount.

2. After a year company B has sold the shares of the German subsidiary X via the New York stock exchange for EUR 200. This results in an extra ordinary holding gain of EUR 100.

3. Company B has distributed the received amount including the realised holding gain to its parent company A. The EUR 100 holding gain from the sale of X can not be considered as earning according to COPC and consequently not as FDI income.

These transactions are illustrated in Chart 2.

Chart 2 Realising extraordinary holding gains



Impact of these transactions to the balance of payments of The Netherlands:

(1) – Inward equity capital investment by Germany in the Netherlands by EUR 100 (investment of A in B)
– Outward equity capital investment by the Netherlands in Germany by EUR 100 (X-shares to B)

(2) – (Increase in cash by EUR 200)
– Outward equity capital disinvestment by the Netherlands in Germany by EUR 200 (X-shares to US)
– Adjustment (difference between market value and book value) of the inward equity capital investment by Germany in the Netherlands by EUR 100
– Adjustment (difference between market value and book value) of the outward equity capital investment by the Netherlands in Germany by EUR 100

(3) – (Decrease in cash by EUR 200)
– Inward equity capital disinvestment by Germany in the Netherlands by EUR 200 (Disinvestment of A in B)

ANNEX B: OVERVIEW OF THE DIFFERENT DEFINITIONS OF SPES AND OFFSHORE CENTRES IN INTERNATIONAL GUIDELINES

This annex presents the different definitions of SPEs and offshore financial centres, as they are literally expressed in international guidelines. Main international guidelines explored are the IMF 5th Manual, the IMF BOP textbook, the IMF Balance of Payment compilation guide, the OECD Benchmark definition of Foreign Direct Investment, The ESA95, and the International Financial Reporting Standards-2003 Edition (incorporating IAS and interpretations).

IMF 5TH MANUAL

The Manual deals with SPEs issues, but no explicit definition can be found. SPEs issues are expressed in paragraphs 79, 365, 372 and 373 and 381.

§79

"Offshore enterprises engaged in manufacturing processes (including assembly of components manufactured elsewhere) are residents of the economies in which the offshore enterprises are located. This statement applies regardless of location in special zones of exemption from customs or other regulation concessions. The statement also applies to non-manufacturing operations (i.e. trading and financial enterprises), including so-called special purpose enterprises. (See paragraphs 365 and 381.)"

§381

"The residency of offshore enterprises, including those engaged in the assembly of components manufactured elsewhere and in trade and financial operations and those located in special zones, is attributed to the economy in which the enterprises are located. (See paragraph 79)"

§365

"This *Manual* recommends that so-called special purpose entities (SPEs) be included as direct investment enterprises if they meet the criteria stated in previous paragraphs. Whatever the structure (e.g., holding companies, base company, regional headquarters) or purpose (e.g., administration, management of foreign exchange risk, facilitation of financing of investments), SPEs are an integral part of the structure of the direct investment network as are, for the most part, SPE transactions with other members of the group. However, for SPEs with a sole purpose of serving in a financial intermediary capacity (as is the case for banks and other financial intermediaries such as security dealers), transactions recorded under *direct investment* are limited to those associated with permanent debt and equity. (See paragraph 372.) For both countries employing other treatments of SPEs and countries employing the recommended treatment (if it is feasible to do so), the value of SPE transactions as a group should be separately identified in terms of standards components to permit consistent international comparisons."

§372

"Intercompany transactions between affiliated banks (depository institutions) and affiliated financial intermediaries (e.g., security dealers) – including SPEs with the sole purpose of serving as financial intermediaries – recorded under direct investment capital are limited those transactions associated with permanent debt (loan capital representing a capital interest) and equity (share capital) investment or, in the case of branches, fixed assets. Deposits and other claims and liabilities related to usual banking transactions of depository institutions and claims and liabilities of other financial intermediaries are classified, as appropriate, under *portfolio investment or other investment*. The stock of foreign assets and liabilities of banks and other financial intermediaries (international investment position) should be treated in a parallel manner."

§373

"Transactions through SPEs (with the exceptions noted in paragraphs 365 and 372) are included in direct investment capital transactions, and the related stocks of assets and liabilities are covered in the direct investment position."

IMF BALANCE OF PAYMENTS TEXTBOOK

§542

"Special Purpose Entities (SPEs) are (1) generally organised or established in economies other than

those in which the parent companies are resident and (2) engaged primarily in international transactions but in few or no local operations. SPEs meeting the criteria presented in paragraphs 514-518 are included, with one exception, as direct investment enterprises. Excepted are SPEs with the sole purpose of serving as financial intermediaries; for these, investments recorded under *direct investment* are limited to equity capital and permanent debt."

§543 gives an example of typical SPEs' transactions

Two examples illustrate the BOP treatment of SPEs. An Australian enterprise sets up an enterprise in Bermuda with share capital of $2. The enterprise is

(1) To purchase and hold $2 million of portfolio equity investment in the United States;

(2) To purchase and hold $1 million of bonds issued by a German company;

(3) To purchase, for $5 million, and hold a 50% interest in a United Kingdom company.

Half of the $8 million required for the investment is provided by the Australian direct investor and half is provided by a bank in the Netherlands Antilles. Bermuda's balance of Payments would show the following transactions:

	Credit	Debit
1. Direct investment		
Direct investment in Bermuda		
Equity capital	$2 (AU)	
Other capital	$4,000,000 (AU)	
Direct investment abroad		
Equity capital		$5,000,000 (UK)
Other capital		
2. Portfolio Investment		
Assets		
Equity securities		$2,000,000 (US)
Debt securities		
Bonds and notes		$1,000,000 (DE)
3. Other investment		
Liabilities		
Loans		
Banks	$4,000,000 (NL Antilles)	

As the enterprise in Bermuda is not purely a financial intermediary, BOP transactions with related enterprises are recorded on the same basis as other direct investment transactions are-although the enterprise has no operations in Bermuda.

§544 gives an example of typical SPEs' acting as purely financial intermediary

"A New Zealand company wishes to borrow funds on the US capital market by issuing bonds valued at $3 million. Under US regulations, only resident companies are allowed to issue such securities on the US market. So the New Zealand company establishes "a $2 subsidiary" in Delaware (a US state) and the subsidiary issues bonds and lends the proceeds to its parent. As this SPE acts purely as a financial intermediary, only equity capital and any permanent debt provided by the direct investor are classified as direct investment. The following transactions would be recorded in New Zealand's balance of payments (all with the USA):

	Credit	Debit
1. Direct investment		
Direct investment abroad		
Equity capital		$2
2. Portfolio Investment		
Liabilities		
Debt securities		
Bonds and notes	$3,000,000	
3. Other investment		
4. Reserve assets (or other appropriate financial account item)		$2,999,998

IMF BALANCE OF PAYMENTS COMPILATION GUIDE

The IMF BOP compilation guide doesn't have explicit reference to SPEs, but deals with "Non-operating direct investment enterprises", a terminology that is likely to be close to SPEs. These entities are covered along paragraphs 705-711 of the guide. In addition, it seems that examples shown relate only to the ownership of shipping vessels.

§705

"While compilers should identify and collect information from all legal entities that fall

within the definition of direct investment enterprises, adequate data may be unavailable. Of particular concern are brass plate companies, such as those established to register ownership of shipping vessels or to raise capital through the issuance of securities."

§706
"To take advantage of various legislation, certain companies may register in a country but, for all practical purposes, have no operational presence in that country. (Some security markets – for example, those in the United States – permit securities to be issued only by locally registered companies.) That is, the company do not carry out production, have no employees, and do not pay income tax. Many companies established for the purpose of issuing securities may have no other presence in a host country. Brass plate companies may pay a fee to register in a host country and may share an office or directors with similar enterprises. However, books or accounts may be maintained elsewhere and, thus, be unavailable to the host country compiler."

§707
"Despite the difficulties caused by these arrangements, compilers should make every effort to compile complete sets of accounts for these enterprises. Countries that permit registration of these enterprises may also exempt them from supplying information that compilers require. However, some suitable data may be available from tax or other authorities. Alternatively, compilers may approach partner country compilers for information. In the country of the direct investor, the collection of data should be somewhat easier, and it is desirable that information on certain categories of enterprises be compiled separately so that relevant data can be provided (subject, of course, to any confidentiality constraints) to partner countries to assist them in compiling complete accounts."

§708
"According to the BPM, compilers should record the complete BOP entries of these enterprises. However, some compilers may prefer not to record transactions considered to be of no relevance to the domestic economy. Nevertheless, compilers should, for purposes of reporting to the IMF, prepare the gross entry as supplementary data."

§709
"The following example illustrates alternative methods of recording. A brass plate company is established in one country for the purpose of owning a shipping vessel operated by a non-resident parent enterprise located elsewhere. In the relevant period, the cost of registering the vessel is 25, and incidental expenses in the country are 5. The operator pay 110 to lease the vessel, and this amount is immediately remitted by the enterprise to the non-resident owner. If this brass plate enterprise is essentially ignored, BOP entries for the country of registrations would be:

	Credit	Debit
1. Current Account		
Services (incidental expenses)	5	
Transfer (registration fee)	25	
2. Financial Account		
Other investment		
Bank assets		30

§710
"However, the treatment required in the BPM requires the gathering of additional information. The value of the vessel at the time of acquisition by the brass plate company is 1,000, and the vessel depreciates by 75 during the period. According to recommendations of the BPM, BOP accounts for the country of registration should be:

	Credit	Debit
1. Current Account		
Goods		1,000
Services		
Leasing of vessel without crew	110	
Income		
Direct investment income		
Distributed income		5
2. Financial Account		
Direct investment in the reporting		
Equity capital	1,030	105
Other investment		
Bank assets		30

§711
"In this case, the direct investment inflow is 1,030, which is equal to the value of the vessel plus the cost of registration and incidental expenses. The operating profit of the enterprise is the difference between the revenue of 110 and expenses (registration, incidental, and depreciation) of 105. All of this is remitted to the direct investor. A further 105 is remitted and, as the enterprise has no retained profits from previous periods, this remittance

OECD BENCHMARK DEFINITION OF FOREIGN DIRECT INVESTMENT – 3RD EDITION

The OECD Benchmark definition deals with offshore centres in its paragraphs 67 and 68, with SPEs in paragraph 69. Annex 3 is also presented, given that this annex gives very detailed explanations or recommendations to identify SPEs.

Offshore Companies

§67.
"There are a number of companies incorporated in one country with their management office in another country which do not trade in their country of incorporation. The management office holds all the assets of the company and the only transaction with the country of incorporation is that the management office pays dividends on behalf of the company to any resident shareholder of the company in the country of incorporation. These companies may also have direct investment in third countries, the dividend and capital flows then being between the third countries and the country of the management office. The third country will probably assume in its statistics that these transactions are with the country of incorporation, while the management office's country will probably show the transactions as being between it and the third countries. An added complication is that the company owning the management office may itself be a subsidiary of an enterprise in another country."

§68.
"OECD recommends that where a company Z incorporated in Country A has its management office in another Country B, Country A in its outward direct investment statistics regard the foreign management office as direct investment by Country A in a branch in Country B. If company Z has any subsidiary and associate companies, these should be regarded as being directly owned by the foreign branch in Country B and thus only indirectly owned by company Z. The host countries of the subsidiary and associate companies should in their inward direct investment statistics regard the immediate investing country as being that of the management office, that is Country B, and regard the ultimate investing country either as Country A, the country of incorporation of company Z, or as Country C if company Z is itself a subsidiary with its ultimate parent in another Country C. Country B, the country of residency of the management office, should in its inward direct investment statistics regard the management office as an inward branch owned by Country A, with the ultimate investing country being Country C if company Z is a subsidiary with its ultimate parent in Country C. Country B in its outward direct investment statistics should regard the subsidiaries and associates of company Z that are not resident in Country B as part of Country B's outward direct investment."

Special Purpose Entities

§69.
"As multinational enterprises mature, they diversify their investments geographically, through adequate organizational structures. These include certain Special Purpose Entities (SPEs) which facilitate financing of investments for the group from sources both internal and external to the multinational enterprises. Additionally, such SPEs also serve other functions such as sale and regional administration including management of foreign exchange risks and other activities aimed at profit maximization. Special Purpose Entity is a generic label applicable to such organizational

structures which are also variously referred to as financing subsidiaries, conduits, holding companies, base companies and regional headquarters. In some instances, multinational enterprises use existing operational companies to perform functions usually associated with SPEs. Since these SPEs are an integral part of the organizational structure of a multinational enterprise, their transactions that arise from direct investment relationships (except as noted in paras [38] and [39 c]) should be reflected in the statistics and, if possible, shown as a sub-component. In some instances, these transactions may give rise to negative direct investment positions. For a more detailed description of the SPEs or of transactions that exhibit the characteristics of functions carried out through these entities, refer to Annex 3."

INTERNATIONAL ACCOUNTING STANDARDS (IAS)

Information about SPEs can be found in the 2003 edition of the International Financial Reporting Standards (IFRS) manual: IAS27 deals with the issue of Consolidated Financial Statements and Accounting for Investment in subsidiaries, and interpretations-SIC12 of IFRS relates to how/when/which SPE should be consolidated.

INTERPRETATIONS: SIC 12-1: CONSOLIDATION – SPECIAL PURPOSE ENTITIES

ISSUE

1. An entity may be created to accomplish a narrow and well-defined objective (e.g., to effect a lease, research & development activities or a securitisation of financial assets). Such a special purpose entity ("SPE") may take the form of a corporation, trust, partnership or unincorporated entity. SPEs often are created with legal arrangements that impose strict and sometimes permanent limits on the decision-making powers of their governing board, trustee or management over the operations on the SPE. Frequently, these provisions specify that the policy guiding the ongoing activity of the SPE cannot be modified, other than perhaps by its creator or sponsor (i.e., they operate on so-called "autopilot").

2. The sponsor (or enterprise on whose behalf the SPE was created) frequently transfers assets to the SPE, obtains the right to use assets held by the SPE or performs services for the SPE, while other parties ("capital providers") may provide the funding to the SPE. An enterprise that engages in transactions with an SPE (frequently the creator or sponsor) may in substance control the SPE.

3. A beneficial interest in an SPE may, for example, take the form of a debt instrument, an equity instrument, a participation right, a residual interest or a lease. Some beneficial interests may simply provide the holder with a fixed or stated rate of return, while others give the holder rights or access to other future economic benefits of the SPE's activities. In most cases, the creator or sponsor (or the enterprise on whose behalf the SPE was created) retains a significant beneficial interest in the SPE's activities, even though it may own little or none of the SPE's equity.

4. IAS 27 requires the consolidation of entities that are controlled by the reporting enterprise. However, the Standard does not provide explicit guidance on the consolidation of SPEs.

5. The issue is under what circumstances an enterprise should consolidate an SPE.

6. This interpretation does not apply to post-employment benefit plans or equity compensation plans.

7. A transfer of assets from an enterprise to an SPE may qualify as a sale by that enterprise. Even if the transfer does qualify as a sale, the provision of IAS 27 and this Interpretation may mean that the enterprise should consolidate an SPE. This Interpretation does not address the circumstances in which sale treatment should apply for the enterprise or the elimination of the consequences of such a sale upon consolidation.

CONSENSUS

8. An SPE should be consolidated when the substance of the relationship between an enterprise and the SPE indicates that the SPE is controlled by that enterprise.

9. In the context of an SPE, control may arise through the predetermination of the activities of the SPE (operating on "autopilot") or otherwise. IAS 27.12 indicates several circumstances which result in control even in cases where an enterprise owns one half or less of the voting power of another enterprise. Similarly, control may exist even in cases where an enterprise owns little or none of the SPE's equity. The application of the control concept requires, in each case, judgement in the context of all relevant factors.

10. In addition to the situations described in IAS 27.12, the following circumstances, for example, may indicate, a relationship in which an enterprise controls an SPE and consequently should consolidate the SPE (additional guidance is provided in the Appendix to this Interpretation).

(a) in substance, the activities of the SPE are being conducted on behalf of the enterprise according to its specific business needs so that the enterprise obtains benefits from the SPE's operation;

(b) in substance, the enterprise has the decision-making powers to obtain the majority of the benefits of the activities of the SPE or, by setting up an "autopilot" mechanism, the enterprise has delegated these decision-making powers;

(c) in substance, the enterprise has rights to obtain the majority of the benefits of the SPE and therefore may be exposed to risks incident to the activities of the SPE; or

(d) in substance, the enterprise retains the majority of the residual or ownership risks related to the SPE or its assets in order to obtain benefits from its activities.

11. Predetermination of the ongoing activities of an SPE by an enterprise (the sponsor or other party with a beneficial interest) would not represent the type of restrictions referred to in IAS 27.13(b).

BASIS FOR CONCLUSIONS

12. IAS 27.11 states that "a parent which issues consolidated financial statements should consolidate all subsidiaries". IAS 27.06 defines a parent as "an enterprise that has one or more subsidiaries", a subsidiary as " an enterprise that is controlled by another enterprise (known as the parent)", and control as "the power to govern the financial and operating policies of an enterprise so as to obtain benefits from its activities". Paragraph 35 of the Framework and IAS 1.20(b)(ii) (revised 1997) require that transactions and other events are accounted for in accordance with their substance and economic reality, and not merely their legal form.

13. Control over another entity requires having the ability to direct or dominate its decision-making, regardless of whether this power is actually exercised. Under the definitions of IAS 27.06, the ability to govern decision-making alone, however, is not sufficient to establish control. The ability to govern decision-making must be accompanied by the objective of obtaining benefits from the entity's activities.

14. SPEs frequently operate in a predetermined way so that no enterprise has explicit decision-making authority over the SPE's ongoing activities after its formation (i.e., they operate on "autopilot"). Virtually all rights, obligations, and aspects of activities that could be controlled are predefined and limited by contractual provisions specified or scheduled at inception. In these circumstances, control may exist for the sponsoring party or others with a beneficial interest, even though it may be particularly difficult to assess, because virtually all

activities are predetermined. However, the predetermination of the activities of the SPE through an "autopilot" mechanism often provides evidence that the ability to control has been exercised by the party making the predetermination for its own benefit at the formation of the SPE and is being perpetuated.

15. IAS 27.13(b) indicates that a subsidiary should be excluded from consolidation when it "operates under severe long-term restrictions which significantly impair its ability to transfer funds to the parent." Predetermination of the activities of an SPE by an enterprise (the sponsor or other party with a beneficial interest) is often a demonstration of control over ongoing activities as determined by that enterprise and would not represent the type of restrictions referred to in IAS 27.13(b).

Date of Consensus: June 1998

Effective Date: This interpretation becomes effective for annual financial periods beginning on or after 1 July 1999; earlier application is encouraged. Changes in accounting policies should be accounted for according to the transition requirements of IAS 8.46.

APPENDIX

The purpose of the appendix is to illustrate the application of the Interpretation to assist in clarifying its meaning.

Indicators of control over an SPE

The examples in paragraph 10 of this Interpretation are intended to indicate types of circumstances that should be considered in evaluating a particular arrangement in light of the substance-over-form principle. The guidance provided in the Interpretation and in this Appendix is not intended to be used as "a comprehensive checklist" of conditions that must be met cumulatively in order to require consolidation of an SPE.

(a) *Activities*

The activities of the SPE, in substance, are being conducted on behalf of the enterprise, which directly or indirectly created the SPE according to its specific business needs.

Examples are:

– the SPE is principally engaged in providing a source of long-term capital to an enterprise or funding to support an enterprise's ongoing major or central operations; or

– the SPE provides a supply of goods or services that is consistent with an enterprise's ongoing major or central operations which, without the existence of the SPE, would have to be provided by the enterprise itself.

Economic dependence of an entity on the reporting enterprise (such as relations of suppliers to a significant customer) does not, by itself, lead to control.

(b) *Decision-making*

The reporting enterprise, in substance, has the decision-making powers to control or to obtain control of the SPE or its assets, including certain decision-making powers coming into existence after the formation of the SPE. Such decision-making powers may have been delegated by establishing an "autopilot" mechanism.

Examples are:

– power to unilaterally dissolve an SPE;
– power to change the SPE's charter or bylaws; or
– power to veto proposed changes of the SPE's charter or bylaws.

(c) *Benefits*

The reported enterprise, in substance, has rights to obtain the majority of the benefits of the SPE's activities through a statute, contract,

agreement, or trust deed, or any other scheme, arrangement or device. Such rights to benefits in the SPE may be indicators of control when they are specified in favour of an enterprise that is engaged in transactions with an SPE and that enterprise stands to gain those benefits from the financial performance of the SPE.

Examples are:

– rights to a majority of any economic benefits distributed by an entity in the form of future net cash flows, earnings, net assets, or other economic benefits; or
– rights to majority residual interests in scheduled residual distributions or in a liquidation of the SPE.

(d) *Risks*

An indication of control may be obtained by evaluating the risks of each party engaging in transactions with an SPE. Frequently, the reporting enterprise guarantees a return or credit protection directly or indirectly through the SPE to outside investors who provide substantially all of the capital to the SPE. As a result of the guarantee, the enterprise retains residual or ownership risks and the investors are, in substance, only lenders because their exposure to gain and losses is limited.

Examples are:

– the capital providers do not have a significant interest in the underlying net assets of the SPE;
– the capital providers do not have rights to the future economic benefits of the SPE;
– the capital providers are not substantively exposed to the inherent risks of the underlying net assets or operations of the SPE; or
– in substance, the capital providers receive mainly consideration equivalent to a lender's return through a debt or equity interest.

ANNEX C: IMPORTANCE OF OFFSHORE COUNTRIES IN US DATA

From Table C-1, few geographic zones published by the BEA to obtain independent regional groups of countries and a "closed" regional distribution of US external FDI liabilities (i.e. the sum of individual countries and the new defined groups matches the total US FDI liabilities) have been selected/ modified.

In Table C-2, the presence of foreign countries in the US economy, measured in term of FDI capital invested, is evaluated according to the applicatione of both first shot and UBO[11] criterion (column 1 and 2 respectively). For each partner country, a relative change in FDI liabilities is calculated, resulting from the move towards UBO criteria. Column 3 presents a ranking of US partners according to percentages changes. Nine offshore centre countries and one group of offshore countries (Other OWH[12]) have been selected from the US distribution list, with available data on both first shot and UBO criteria.

With US$ 55 bn (€59 bn[13]), offshore centres ranked altogether at the 8th position (fifth position if we merge EU countries), in the "first shot" classification list. With US$ 66 bn (€71 bn), they ranked all together at the 7th position (or fourth position behind EU, Japan and Canada), in the UBO distribution list.

11 US definition of UBO: "The ultimate beneficial owner is that person, proceeding up a US affiliate's ownership chain, beginning with and including the foreign parent, that is not owned more than 50% by another person.".
12 Other OWH = Other Western Hemisphere = Anguilla, Antigua & Barbuda, Aruba, Barbados, Cuba, Dominica, Dominican Rep., French Islands-Caribbean, Grenada, Haiti, Jamaica, St Lucia, St Vincent & Grenadines, Trinidad&Tobago, UK Islands.
13 1€ = 0.9305 US$, at end 2000.

Table C-1 Foreign Direct investment positions in the United States, end

(US$ million)

Partner country	First shot	UBO
World Total	**1,214,254**	**1,214,254**
Canada	114,599	127,864
Europe	**835,137**	**781,462**
Austria	3,174	2,439
Belgium	14,585	10,881
Luxembourg	53,794	1,832
Finland	9,107	9,281
France	131,484	130,346
Germany	124,839	135,693
Ireland	23,528	6,744
Italy	5,994	13,401
Netherlands	146,493	121,635
Spain	5,459	6,754
Greece	952	
Portugal	-68	
Sweden	22,427	23,791
Denmark	4,428	3,014
United Kingdom	213,820	252,397
Norway	2,241	2,627
Liechtenstein	202	268
Switzerland	69,240	59,108
Iceland		
Other Europe [1]	3,325	254
South and Central America	**13,682**	**17,649**
Brazil	886	1,616
Mexico	7,832	10,271
Panama	3,726	410
Venezuela	802	4,042
Other S. & C. America	435	1,310
Argentina	362	
Chile	24	
Colombia	2	
Uruguay	40	
Other Western Hemisphere (OWH)	**40,782**	**44,282**
Bahamas	1,268	78
Bermuda	18,502	38,378
Netherlands Antilles	3,940	1,193
United Kingdom Islands, Caribbean	15,353	4,591
Other OWH	1,718	42
Anguilla	1	
Antigua and Barbuda	20	
Aruba	14	
Barbados	1,560	
Cuba	0	
Dominica	0	
Dominican Republic	79	
French Islands, Caribbean	3	
Grenada	5	
Haiti	-1	
Jamaica	-5	
St. Lucia	0	
St. Vincent and the Grenadines	3	
Trinidad and Tobago	40	
UK Islands, Atlantic (OWH)	0	
Africa	**2,756**	**2,971**
South Africa	1,218	2,075
Other Africa	1,538	896
Liberia	1,549	
Middle East	**6,189**	**11,722**
Israel	2,690	2,773
Kuwait	908	1,155
Lebanon	1	635
Saudi Arabia		4,721
United Arab Emirates	64	1,592
Other Middle East		845
Bahrain		
Iran	1	
Jordan	-3	
Oman	-11	
Qatar	37	
Syria	1	
Yemen	-9	
Asia and Pacific	**201,110**	**218,791**
Australia	20,701	20,437
Hong Kong	1,544	12,825
Japan	163,577	165,812
Korea, Republic of	3,287	3,401
Malaysia	92	731
New Zealand	385	430
Philippines	50	103
Singapore	7,751	7,846
Taiwan	3,131	5,250
Other Asia and Pacific	593	1,956
China	296	
India	96	
Indonesia	39	
Thailand	116	
Back to US	**0**	**9,512**
Offshore centres [1]	**55,353**	**65,998**

Source: Bureau of Economic Analysis – US
1) Eurostat estimates.

However, if we analyse individually the ten identified offshore countries, the role played by each of them is drastically affected by the UBO country reallocation:

– This reallocation lead to a doubling of FDI assets held by Bermuda in the USA, from US$19 to US$38 bn, boosting this country within the top 8 major partners. The situation of Hong Kong is even more spectacular, with an increase of its positions in the USA by more than 700%. Lebanon, who has almost no presence on the US market, appears as non-negligible in the "UBO" distribution's list.

– Apart from Singapore, UBO reallocation has

sharply reduced the importance of the six other offshore countries. As an example, the Bahamas and "Other OWH" islands have almost disappeared from the UBO list (less than US$ 80 Mio). Offshore countries are more "sensitive" to criteria change. In column 3, offshore countries can be found either in the top or in the bottom countries' list

Table C-2: Classification of US FDI partners, according to first shot, UBO and %

	First shot	UBO	Percentage change (from First shot to UBO)	
1	United Kingdom	United Kingdom	Back to US (by definition)	nc
2	Japan	Japan	**Lebanon**	63400
3	Netherlands	Germany	United Arab Emirates	2388
4	France	France	**Hong Kong**	731
5	Germany	Canada	Malaysia	695
6	Canada	Netherlands	Venezuela	404
7	Switzerland	Switzerland	Other Asia and Pacific	230
8	Luxembourg	**Bermuda**	Other S. & C. America [2]	201
9	Ireland	Sweden	Italy	124
10	Sweden	Australia	O. Middle East & Saoudi Arabia [1]	120
11	Australia	Italy	**Bermuda**	107
12	**Bermuda**	**Hong Kong**	Philippines	106
13	**UK Islands, Caribbean**	Belgium	Brazil	82
14	Belgium	Mexico	South Africa	70
15	Finland	Back to US	Taiwan	68
16	Mexico	Finland	Liechtenstein	33
17	**Singapore**	**Singapore**	Mexico	31
18	Italy	Spain	Kuwait	27
19	Spain	Ireland	Spain	24
20	Denmark	O. Middle East & Saoudi Arabia [1]	United Kingdom	18
21	**Netherlands Antilles**	Taiwan	Norway	17
22	**Panama**	**UK Islands, Caribbean**	New Zealand	12
23	**Other Europe** [1]	Venezuela	Canada	12
24	Korea, Republic of	Korea, Republic of	Germany	9
25	Austria	Denmark	Sweden	6
26	Taiwan	Israel	Korea, Republic of	3
27	Israel	Norway	Israel	3
28	O. Middle East & Saoudi Arabia [1]	Austria	Finland	2
29	Norway	South Africa	Japan	1
30	**Other OWH** [3]	Other Asia and Pacific	**Singapore**	1
31	**Hong Kong**	Luxembourg	France	-1
32	**Other Africa** [4]	Brazil	Australia	-1
33	**Bahamas**	United Arab Emirates	Switzerland	-15
34	South Africa	Other S. & C. America [2]	Netherlands	-17
35	Greece	**Netherlands Antilles**	Austria	-23
36	Kuwait	Kuwait	Belgium	-25
37	Brazil	Greece	Denmark	-32
38	Venezuela	**Other Africa** [4]	**Other Africa** [4]	-42
39	Other Asia and Pacific	Malaysia	**Netherlands Antilles**	-70
40	Other S. & C. America [2]	**Lebanon**	**UK Islands, Caribbean**	-70
41	New Zealand	New Zealand	Ireland	-71
42	Liechtenstein	**Panama**	**Panama**	-89
43	Malaysia	Liechtenstein	**Other Europe** [1]	-92
44	United Arab Emirates	**Other Europe** [1]	**Bahamas**	-94
45	Philippines	Philippines	Luxembourg	-97
46	**Lebanon**	**Bahamas**	**Other OWH** [3]	-98
47	Back to US	**Other OWH** [3]	Greece	nc
48	Portugal	Portugal	Portugal	nc

1) Eurostat estimates.
2) Mainly Argentina.
3) Mainly Caribbean offshore centres of Eurostat list.
4) Mainly Liberia (also member of the offshore list).

(nothing in between, except Singapore). At the bottom, they all have a percentage change below "-70%", like Ireland, Luxembourg and "Other European" country group.

The ranking of Hong Kong at the top UBO list makes sense, since Hong Kong enterprises might also be "real" investors/invested regarding the economic position of Hong Kong. The ranking of Bermuda is more questionable.

ANNEX D: DATA ON THE IMPORTANCE OF SPEs IN EU MEMBER STATES

COUNTRY: BELGIUM

TF-FDI – SUBGROUP ON SPEs

Table D 1 – Impact of SPEs in FDI statistics

(EUR millions)

B.O.P. data for the year 2001

	Euro area		European Union		National
	Intra	Extra	Intra	Extra	
FDI abroad	31,229	81,199	54,239	58,189	112,428
Equity capital	19,758	50,126	40,927	28,957	69,884
of which SPEs or assimilated cies	961	2,483	1,129	2,315	3,444
Other capital	11,471	31,073	13,312	29,232	42,544
of which SPEs or assimilated cies	34,031	-18,966	24,839	-9,775	15,065
FDI in the reporting economy	33,835	60,820	53,929	40,726	94,655
Equity capital	39,329	48,269	58,791	28,807	87,598
of which SPEs	5,759	2,478	7,214	1,023	8,237
Other capital	-5,494	12,551	-4,862	11,919	7,057
of which SPEs or assimilated cies	1,722	4,486	1,498	4,709	6,208
Net	65,064	142,019	108,168	98,915	207,083

I.I.P. data at end-December 2000

	Euro area		European Union		National
	Intra	Extra	Intra	Extra	
FDI abroad	115,233	49,288	128,977	35,545	164,521
Equity capital	57,984	15,891	60,984	12,892	73,875
of which SPEs or assimilated cies	0	0	0	0	0
Other capital	57,249	33,397	67,993	22,653	90,646
of which SPEs or assimilated cies	52,862	30,918	63,258	20,522	83,780
FDI in the reporting economy	134,251	75,419	160,016	49,655	209,670
Equity capital	102,233	55,328	124,324	33,238	157,561
of which SPEs or assimilated cies	24,271	17,909	25,358	16,822	42,180
Other capital	32,018	20,091	35,692	16,417	52,109
of which SPEs or assimilated cies	14,251	17,293	16,665	14,879	31,544
Net	-19,018	-26,131	-31,039	-14,110	-45,149

Remarks on the SPE data of Belgium

Coordination Centers in Belgium are included under the category SPE's. The same list of enterprises is used to prepare the figure in both tables but there are some other differences mentioned below.

The BOP data in the first table contains the figures of Belgium and Luxemburg together. Until end 2001, Belgium collected and published figures for the BLEU (Belgian-Luxembourg Economic Union). Only since 2002 there are figures of Belgium seperately available.

In the second table, stock data of the annual survey are used and not the figures of IIP because that are stocks calculated on accumulated flows. The data of the survey are only covering Belgium.

In other capital, in the first table short term payments are included whereas in the second table only the payments > 14 days are included in the figures.

COUNTRY: FINLAND

TF-FDI – SUBGROUP ON SPEs

Table D 2 – Impact of SPEs in FDI statistics

(EUR millions)

B.O.P. data for the year 2001

	Euro area		European Union		National
	Intra	Extra	Intra	Extra	
FDI abroad	-3,345	-6,009	-7,745	-1,609	-9,354
Equity capital	-259	-3,239	-1,656	-1,842	-3,498
of which SPEs or assimilated cies	NA	NA	NA	NA	NA
Other capital	-3,086	-2,770	-6,089	233	-5,856
of which SPEs or assimilated cies	NA	NA	NA	NA	NA
FDI in the reporting economy	144	4,026	4,556	-386	4,170
Equity capital	258	4,056	4,036	278	4,314
of which SPEs	NA	NA	NA	NA	NA
Other capital	-114	-30	520	-664	-144
of which SPEs or assimilated cies	NA	NA	NA	NA	NA
Net	-3,201	-1,983	-3,189	-1,995	-5,184

I.I.P. data at end-December 2000

	Euro area		European Union		National
	Intra	Extra	Intra	Extra	
FDI abroad	20,271	35,730	36,013	19,988	56,001
Equity capital	16,923	22,245	30,381	8,787	39,168
of which SPEs or assimilated cies	NA	NA	NA	NA	NA
Other capital	3,348	13,485	5,632	11,201	16,833
of which SPEs or assimilated cies	NA	NA	NA	NA	NA
FDI in the reporting economy	6,438	19,647	22,842	3,243	26,085
Equity capital	4,036	14,917	17,018	1,935	18,953
of which SPEs or assimilated cies	NA	NA	NA	NA	NA
Other capital	2,402	4,730	5,824	1,308	7,132
of which SPEs or assimilated cies	NA	NA	NA	NA	NA
Net	13,833	16,083	13,171	16,745	29,916

In the case of Finland it was not possible to identify SPEs among the resident direct investors/direct investment enterprises and thus no separate FDI data related to resident SPEs, can be ??ovided.

In the attached table, the equity figures include reinvested earnings.

COUNTRY: FRANCE

TF-FDI – SUBGROUP ON SPEs

Table D 3 – Impact of SPEs in FDI statistics

(EUR millions)

B.O.P. data for the year 2001

	Euro area		European Union		National
	Intra	Extra	Intra	Extra	
FDI abroad	-47,572	-44,973	-59,336	-33,209	-92,545
Equity capital	-31,175	-20,990	-34,585	-17,580	-52,165
of which SPEs or assimilated cies	-11,366	-12,665	-14,545	-9,486	-24,031
Other capital	-12,125	-22,005	-20,203	-13,927	-34,130
of which SPEs or assimilated cies	-2,731	-7,110	-5,520	-4,321	-9,841
FDI in the reporting economy	36,501	22,305	51,278	7,528	58,806
Equity capital	13,551	6,653	15,548	4,656	20,204
of which SPEs	5,069	2,851	7,374	546	7,920
Other capital	22,218	13,276	34,290	1,204	35,494
of which SPEs or assimilated cies	6,877	3,248	9,874	251	10,125
Net	-11,071	-22,668	-8,058	-25,681	-33,739

I.I.P. data at end-December 2000

	Euro area		European Union		National
	Intra	Extra	Intra	Extra	
FDI abroad	169,080	295,897	232,162	232,815	464,977
Equity capital	122,810	216,980	166,058	173,732	339,790
of which SPEs or assimilated cies	20,466	39,136	29,098	30,504	59,602
Other capital	46,271	78,917	66,105	59,083	125,188
of which SPEs or assimilated cies	12,514	21,342	17,878	15,978	33,856
FDI in the reporting economy	150,394	126,668	197,309	79,753	277,062
Equity capital	102,568	90,565	135,751	57,382	193,133
of which SPEs or assimilated cies	35,964	32,797	47,691	21,070	68,761
Other capital	47,826	36,103	61,559	22,370	83,929
of which SPEs or assimilated cies	11,997	9,057	15,442	5,612	21,054
Net	18,686	169,229	34,853	153,062	187,915

Since SPEs are not identified as such in French statistics (no official definition), a category has been created for the purpose of this assessment including all companies with NACE 74.15 ("Management of companies").

COUNTRY: GERMANY

TF-FDI – SUBGROUP ON SPEs

Table D 4 – Impact on SPEs in FDI statistics

(EUR millions)

B.O.P. data for the year 2001

	Euro area		European Union		National
	Intra	Extra	Intra	Extra	
FDI abroad					
(resident SPEs = Investors)	28,507	-73,765	15,273	-60,531	-45,258
Equity capital	-5,175	-56,443	-16,246	-45,372	-61,618
of which SPEs or assimilated cies	7,058	-8,769	-2,123	412	-1,711
Other capital	33,682	-17,322	31,519	-15,159	16,360
of which SPEs or assimilated cies	12,006	321	14,477	-2,150	12,327
FDI in the reporting economy	29,996	11,650	30,972	10,674	41,646
(resident SPEs = Investees)					
Equity capital	18,325	11,764	27,620	2,469	30,089
of which SPEs	17,692	212	22,954	-5,050	17,904
Other capital	11,671	-114	3,352	8,205	11,557
of which SPEs or assimilated cies	7,585	5,179	2,683	10,081	12,764
Net	58,503	-62,115	46,245	-49,857	-3,612

I.I.P. data at end-December 2000

	Euro area		European Union		National
	Intra	Extra	Intra	Extra	
FDI abroad					
(resident SPEs=Investors)	160,003	299,592	220,494	239,101	459,595
Equity capital	159,845	243,034	208,918	193,961	402,879
of which SPEs or assimilated cies	86,737	115,651	120,086	82,302	202,388
Other capital	158	56,558	11,576	45,140	56,716
of which SPEs or assimilated cies	23	14,114	3,988	10,149	14,137
FDI in the reporting economy	301,476	167,953	347,208	122,221	469,429
(resident SPEs=Investees)					
Equity capital	167,944	77,061	193,916	51,089	245,005
of which SPEs or assimilated cies	140,493	54,333	163,447	31,379	194,826
Other capital	133,532	90,892	153,292	71,132	224,424
of which SPEs or assimilated cies	107,845	61,336	121,861	47,320	169,181
Net	-141,473	131,639	-126,714	116,880	-9,834

APPROXIMATION OF SPE ACTIVITIES IN GERMAN FDI STATISTICS

In accordance with the international standards, activities of SPEs established in Germany by non-residents are generally included in the direct investment data. Contrary to the international standards, in the case of SPEs established in Germany by non-residents that have the sole purpose of financial intermediation, transactions with affiliated banks and affiliated financial intermediaries, except transactions in equity capital and permanent debt, are not excluded from the data. Furthermore, there is no special definition, identification and treatment of SPEs in German FDI statistics.

However, a sector breakdown allows the identification of "holding companies" (NACE code 6523), management holding companies (NACE code 7415) and "other services for enterprises". These sectors are regarded as a best approximation for domestic SPEs. Certainly not all companies within these sectors can be regarded as SPEs, but more specific information are not available for the time being. Financial and management holding companies cover about 50% of German direct investment assets abroad and more than 75% of German direct investment liabilities held abroad. This illustrates the dominant role holding and shell companies are playing in conducting FDI activities. A case by case study showed that about 60% of German holding companies owned by foreign direct investors have participations mainly in domestic enterprises, whereas about 40% hold exclusively foreign subsidiaries. In the case of German direct investment abroad about 39% of German holding companies do also hold German subsidiaries. However, the increasing complexity of transactions related to financial vehicles challenges the compilers' possibilities in analysing the whole extent of SPE activities.

The sector "other services for enterprises" comprises among other business asset management and fiscal advice. SPEs involved in financial leasing activities are not classified in "other services for enterprises" but in various other sectors related to the business in which they are actively mitigating financial leases. Financial auxiliaries dealing with asset backed securities are not at all included in FDI statistics.

COUNTRY: GREECE

TF-FDI – SUBGROUP ON SPEs

Table D 5 – Impact of SPEs in FDI statistics

(EUR millions)

B.O.P. data for the year 2001

	Euro area		European Union		National
	Intra	Extra	Intra	Extra	
FDI abroad	0	0	0	0	0
Equity capital					
of which SPEs or assimilated cies					
Other capital					
of which SPEs or assimilated cies					
FDI in the reporting economy	0	0	0	0	0
Equity capital					
of which SPEs					
Other capital					
of which SPEs or assimilated cies					
Net	0	0	0	0	0

I.I.P. data at end-December 2000

	Euro area		European Union		National
	Intra	Extra	Intra	Extra	
FDI abroad	635	5,654	1,750	4,539	6,289
Equity capital	565	5,458	1,669	4,354	6,023
of which SPEs or assimilated cies	337	2,814	1,046	2,105	3,151
Other capital	70	196	81	185	266
of which SPEs or assimilated cies	22	25	24	23	47
FDI in the reporting economy	8,977	4,435	10,178	3,234	13,412
Equity capital	8,168	4,176	9,312	3,032	12,344
of which SPEs or assimilated cies	383	478	383	478	861
Other capital	809	259	866	202	1,068
of which SPEs or assimilated cies	0	0	0	0	0
Net	-8,342	1,219	-8,428	1,305	-7,123

The data refer only to Holding Companies as they were reported by the respondents to the annual questionnaire on FDI positions data.

ANNEX E: SPEs IN THE EUROSTAT CLASSIFICATION BY SECTOR (NACE REV 1)

Because of their involvement in various economic activities of services sector, SPEs cannot be identified along the Eurostat classification by sector. Furthermore, not all the Member States are able to identify SPEs' in their surveyed population of enterprises.

The OECD benchmark and the IMF fifth Manual (§365 and 372) give some examples of possible SPEs, defined either according to their structure or the purpose of their activity. From these examples, Eurostat has tried to identify the localisation of these activities in the official NACE rev 1 nomenclature, either in the financial intermediation (6895) or the "Real estate and business activity" (7395) sectors.

SPEs defined according to	Nace rev1 code	Included in Eurostat code
The company's structure:		
Holding companies	74.15	7415 -> 7410 ->7400 -> **7395**
Regional headquarters	74.15	7415 -> 7410 ->7400 -> **7395**
The purpose of the activity		
Management of foreign exchange risk	67.11 or 67.13	6890 -> **6895**
Facilitation of financing of investment	65.23	6520 -> **6895**
Dealing for own account by security dealers	65.23	6520 -> **6895**
Security dealing on behalf of the others	67.12	6890 -> **6895**

Eurostat does not process estimates at class level of the NACE (65.23, 67.11, 67.12, 67.13, 74.15), as few Member States are able to provide such details, at the moment.

Eurostat makes regular estimates for NACE group 65.2 (Eurostat code 6520), NACE division 74 (Eurostat code 7400), and for the miscellaneous activities of the financial intermediation sector (Eurostat code 6890), as indicated below.

Table E-1 Importance of some "potentially" hosting SPEs sectors, in Extra EU FDI positions data[1)]

(EUR millions)

	Assets (2000)	Liabilities (2000)
Total (All sectors)	**1,517,186**	**890,709**
Total services	**792,494**	**547,207**
Financial intermediation (6895)	**295,180**	**189,831**
Monetary intermediation (6510)	97,077	45,417
Other financial intermediation (6520) [2)]	102,347	110,283
Financial holding companies (6524)	:	:
Insurance & activities auxiliary to insurance (6730)	83,348	30,679
Miscellaneous Financial intermediation (6890) [2)]	12,408	3,452
Real estate & business activities (7395)	**273,718**	**218,793**
Real estate (7000)	23,396	20,612
Computer activities (7200)	18,857	7,714
Research and development (7300)	1,385	1,453
Other business activities (7400) [2)]	217,057	182,162
Management holding companies (7415)	:	:
Miscellaneous Real estate & business activities	13,012	6,849
Total "6520, 6890 and 7400" 2), in % of Total services	**42**	**54**
Total "6520, 6890 and 7400" 2), in % of All sectors	**22**	**33**

1) Excluding Dutch SPEs.
2) Sectors "potentially" hosting SPEs.

On the basis of EU available data, the relative importance of assumed "SPEs sectors" is appreciated relatively to the services sector and the total sectors.

The analysis of Table E-1 indicates that:

1. 42% of EU FDI assets held by the services sector could be under the effective control of resident SPEs, that is E332 bn or 22% of total EU external FDI assets.

2. 54% of FDI assets invested by the rest of the world in resident enterprises of the services sector could have been, in fact, addressed to resident SPEs: around E296 bn or one third of Extra EU liabilities.

Apart from the Extra EU zone, EU FDI estimates by activity are processed by Eurostat with partners "total EFTA", the USA, Canada and Japan. Therefore, an rough idea about the potentiality of the link between the main hosting SPEs sectors" and offshore countries could be given in the narrowed geographic space "Extra EU – EFTA – USA – Canada – Japan".

The analysis of Table E-2 shows that:

1. At end 2000, resident SPEs might have held abroad up to 15% (€80 bn) of EU external FDI assets located in the "Extra EU-EFTA-USA-CA-JP" area. This amount is of the same magnitude than the total EU FDI assets located in offshore centres (€77 bn, section 3.1-table 3 of the report).

2. 25% of FDI capital (€28 bn) held in the EU by foreign companies located in the "Extra EU-EFTA-USA-CA-JP" zone, were probably routed to EU based SPEs. A large part of these €28 bn could have been generated in the offshore countries area. But if we compare this amount with the €66 bn hold by offshore countries in the EU market (see section3.1-table 3 of the report), it could be an indication that offshore centres might not have invested essentially in EU based SPEs. In principle, there are no fiscal/tax incentives for establishing an EU based SPE in the chain between an offshore SPE and the target company in the EU. At the European level, the existence (on a large scale) of a direct relationship between the so-called "EU based SPE" and the offshore countries cannot be established in the absence of FDI information with offshore countries broken down by activity.

Table E-2 Importance of some "potentially" hosting SPEs[1] sectors, in the restricted space "Extra EU – EFTA c. – USA – Canada – Japan"

(EUR millions)

	Assets (2000)	Liabilities (2000)
Total (All sectors)	**525,805**	**107,528**
Total services	**275,987**	**75,621**
Financial intermediation (6895)	**106,994**	**29,295**
Other financial & misc. intermediation (6520+6890)[2]	39,170	13,882
In % of Total Financial intermediation	37	47
In % of Total services	14	18
Real estate & business activities (7395)	**58,913**	**20,434**
Other business activities (7400)[2]	41,358	13,508
In % of Total Real estate & business act.	70	66
In % of Total services	15	18
Total "6520, 6890 and 7400"2), in % of Total services	**29**	**36**
Total "6520, 6890 and 7400"2), in % of All sectors	**15**	**25**

1) Excluding Dutch SPEs.
2) Sectors "potentially" hosting SPEs.

Table E-3 Correspondence table between EUROSTAT classification of services activities and the NACE (summary)

Economic activity	Activity code in Eurostat Questionnaires	NACE Rev. 1
Agriculture and fishing	0595	sec A, B
Mining and quarrying	1495	sec C
Manufacturing	3995	sec D
Electricity, gas and water	4195	sec E
Construction	4500	sec F
Total services	5095	sec G, H, I, J, K, L, M, N, O, P, Q
Trade and repairs	5295	sec G
Hotels and restaurants	5500	sec H
Transports, communication	6495	sec I
Financial intermediation	6895	sec J
Monetary intermediation	6510	Group 65.1
Other financial intermediation	6520	Group 65.2
Financial holding companies	6524	part of class 65.23
Insurance & activities auxiliary	6730	div 66 & group 67.2
Total Other fin. intermed & insurance	6795	
Real estate & business act	7395	sec K
Real estate	7000	div 70
Computer activities	7200	div 72
Research and development	7300	div 73
Other business activities	7400	div 74
Business & manag. Consultancy	7410	Group 74.1
Manag. holding companies	7415	class 74.15
Advertising	7440	Group 74.4
Total Computer, Research & Other bus.	7495	
Misc. real estate & business activities	7390	div 71
Other services	9995	sec L, M, N, O, P, Q
Not allocated economic activity	9996	
Sub-total	9997	sec A,B,C,D,E,F,G,H,I,J,K,L,M,N,O,P,Q
Priv. purchases & sales of real estate	9998	
Total	9999	

Financial holding companies-Eurostat definition of class 65.23

This class includes other financial intermediation primarily concerned with distributing funds other than making loans:

– Investment in securities, e.g. shares, bonds, bills, unit trust units, etc.
– Dealing for own account by security dealers
– Investment in property where this is carried out primarily for other financial intermediaries (e.g. property unit trusts)
– Writing of swaps, options and other hedging arrangements

This class excludes:

– Financial leasing
– Security dealing on behalf of others
– Trade, leasing and renting of property
– Operational leasing

Management activities of holding companies-Eurostat definition of class 74.15

No additional description is made for this class.

ANNEX F: SPECIAL TREATMENTS OF SPEs IN MEMBER STATES

F.1 TREATMENT OF SPEs AND OFF-SHORE ENTERPRISES IN DK

BACKGROUND

The number and importance of offshore enterprises and specifically of SPEs established in Denmark have grown rapidly during the last years. Especially, the importance of SPEs has grown rapidly since 1999, where the Danish tax legislation was changed in favour of this type of enterprises.

SPEs influence statistical data very drastically on a gross basis, especially data for in- and outgoing transfers of equity capital and other capital, and for dividends, reinvested earnings and interest income, even though they do not contribute to the local economy. On a net basis the effect on the current account is insignificant. Most of these enterprises are established as holding companies for tax reasons or legislation reasons. There is not legal obligation to register as an SPE, and because the transactions of the companies are typically without "real" payments it is very difficult to identify the companies for statistical purposes.

Definition and identification of SPEs and offshore enterprises

In Denmark we define an SPE as a holding company, which has no interact with the local economy and hardly any employees. In many cases, these enterprises do not have any employees at all, but are managed by lawyers or auditors. The company is not established for a kind of physical activity in Denmark. The inward FDI transactions and positions correspond to the outward FDI transactions and positions and are typically made simultaneously. The compound of the FDI-elements may differ in the inward and outward site, but the total assets and liabilities in each individual enterprise do not. We have so far identified about fifty enterprises in the statistics as SPEs according to our own definition.

When it comes to offshore enterprises things are more complicated. We have no special definition on offshore enterprises. One of the reasons being that the offshore enterprises are difficult to identify. Our temporary definition on offshore enterprises is that it is not an SPE, but the enterprise does not contribute to the local economy. The enterprise may be established as an inter-company bank for a group of companies. None of these enterprises are situated in Denmark and the group of companies have no logical relation to Denmark.

We have only identified one enterprise as an offshore enterprise.

Treatment of SPEs and offshore enterprises in DK

Flow – stock

We identify the SPEs in the statistics according to the mentioned above criteria. In one or two cases the enterprises have fulfilled criteria except that the inward FDI and the outward FDI were not balanced. In this case we have made an individual judgement of the transactions as a whole and have decided to balance the figures, so the transactions/positions do not change the net position. We include the SPEs in our data for both stock and flow.

Profit/loss and reinvested earnings

When it comes to calculation of profit/loss, we look at interest of inter-company loans, profit/loss, and dividend as a whole. Also in this case the assets and the liabilities must balance.

Offshore companies are treated individually.

Future treatment of SPEs and offshore enterprises in DK

It is still under consideration whether to include or the exclude the SPEs from our FDI-data. On the one hand, the international manuals (and the international reporting requirements) define SPEs as an ordinary FDI transaction on a par with other FDI transactions, to be included in

the statistics. On the other hand, the SPEs have a significant influence on the national data, even if the SPEs do not contribute to the local economy. SPEs disturbs the analytical use of data and for this reason alone it could be considered to exclude them from the statistics.

One solution considered is to compile FDI from the SPEs and the offshore enterprises and create two separate datasets, one including the SPEs used for international reporting and one excluding the SPEs used for national reporting.

No decision has been taken yet.

F.2 BRIEF DESCRIPTION OF THE DUBLIN INTERNATIONAL FINANCIAL SERVICES CENTRE IN THE CONTEXT OF BOP/IIP STATISTICS FOR IRELAND

The purpose of this note is to clarify the role of the International Financial Services Centre (IFSC) in Dublin and its significance in the BOP statistics for Ireland, in particular, as they relate to the CPIS and to the BOP concept of residency.

At the meeting of CPIS to discuss the 1997 results some countries seemed to misunderstand the nature of activity at the IFSC considering it to be primarily Direct Investment, this note will show the range of activities at the IFSC which include Direct Investment, Portfolio investment, Other Investment activities and Financial Derivatives.

The note is structured as follows, it begins with a general overview of the IFSC, which is followed by a description of the various activities at IFSC and then concludes with a profile of BOP financial account positions and transactions that are relevant to each activity.

OVERVIEW

The IFSC (International Financial Services Centre, Dublin) was set up in 1987 offering a range of tax and other incentives approved by the European Union. In constructing a regulatory regime for financial services entities, the Irish Government adopted an innovative stance, both in devising new legislation designed to facilitate operators in international financial services and implementing EU single market Directives.

The establishment of the IFSC was against a backdrop of high unemployment, mass emigration and a very difficult economic situation. Its objective was to help remedy this situation by providing sustainable employment in an active and substantive international financial services industry for well the educated and highly motivated workforce which was readily available in this country at that time. The legal and regulatory environment underpinning the IFSC, while being rigorous, in line with EU and International standards, is regarded as ‘user-friendly’ by the operations setting up.

The IFSC is regarded as an example of an ‘onshore’ financial services centre offering the opportunity to the global financial services industry to conduct and expand its international business. Apart from insurance and certain other financial services, many of the operations set up within IFSC and their activities are supervised by the Central Bank of Ireland. The Department of Enterprise and Employment exercises the supervisory role in respect of insurance operations. The IFSC is subject to all EU legislation applicable to financial services. A central attraction for companies locating in the IFSC has been the reduced 10 per cent corporation tax rate that applies to such companies.

However, in July 1998 the Irish Government announced that it had reached agreement with the European Commission on the phasing out of the existing preferential 10 per cent corporate tax rate regime for certain sectors of the economy, including the IFSC and its replacement with a general across-the-board 12.5 per cent single corporation tax rate. The new framework will see the application of a new

corporation tax rate of 12.5 per cent on trading income from January 1st 2003 to financial services activities which previously would have been established in the Dublin IFSC. *This country-wide rate will apply to trading income of all corporations in Ireland, no matter what their business activity or where they are located.*

LICENSING

The IFSC licensing process starts with contact between the prospective Applicant Company and the IDA (Industrial Development Authority) who market the Centre on behalf of the Government and who facilitate the application process. All license applications are channelled through the IDA and then reviewed by the Certification Advisory Committee (CAC) which includes interests representing the official regulatory bodies i.e. Departments of Finance and Trade, Enterprise & Employment, the Central Bank and the IDA. The licence lists the activities the company can undertake and specifies the employment criteria to be met to qualify for the incentives offered. As regards employment, this can be directly within the company licensed or designated to the Management Company servicing the licensed company or collective investment undertaking.

Subsequent ongoing supervision is carried out by the Central Bank, which is responsible for the prudential and other regulatory functions of IFSC operations under its remit. The Department of Trade, Enterprise & Employment supervise insurance operations. Corporate treasury and asset financing activities by entities that are not subsidiaries of overseas banks are monitored by the Central Bank.

IFSC ACTIVITIES

The activities undertaken in the IFSC which consist principally of Mutual Funds and Banking activities are described below in more detail under the relevant headings shown. In this context an implicit activity within IFSC is the establishment by 'management' companies of various types of special purpose companies or SPCs through which investments are made or services provided (e.g. captive insurance or reinsurance companies, agency reinsurance companies, captive finance companies, agency treasury companies).

Initially all activity of the IFSC entities was with non-residents, thus all transactions were BOP relevant. However, since its inception there has been a trend towards greater integration with the domestic economy which will be complete once changes in the taxation regime come into being on 1 January 2003.

Banking & Asset Finance – lending, deposits, corporate finance

This refers to conventional banking activities including lending and deposit taking and also structured finance. Corporate finance and other financial engineering services are also included under this activity, either on or off balance sheet to the IFSC Company or its parent. Asset finance refers to the financing of operations secured on particular assets. Aviation finance is an example, but other types of assets are included e.g. ships, computer hardware, railway stock etc.

Collective investment schemes (CISs) and Special purpose investment companies (SPICs)

CISs cover activities such as unit trusts, mutual funds, UCITS (units for collective investment in transferable securities) entities. Investors are non-resident and the bulk of the investments are into non-resident portfolio securities. SPICs are inward direct investment entities whose assets consist of non-resident issued portfolio securities.

Insurance/re-insurance

Conventional insurance and re-insurance business is covered here including the activities of captive companies.

Corporate treasury management

This includes the corporate treasury activity of banks providing risk-management services directly to customers. Individual corporates have established stand-alone and agency companies for activities such as international netting, cash management etc. carried out on behalf of affiliates.

Financial Services Providers
This principally covers administrative/trustee and custodial management as well as servicing for international fund managers and promoters of funds. Management in administrative services provided to insurance or treasury captive companies is included here.

Money markets/securities dealing/broking
This refers to trading in equities, bonds, and other instruments either on own account or on behalf of clients.

Other activities
There are a number of specialist activities, which are not categorised under a generic heading. Some examples are: factoring/invoice discounting, bond/note issuance facilities, receivables securitisation, purchasing, managing and collecting trade account receivables, balance sheet structuring, granting of financial rights in the entertainment industry (e.g. world-wide tours, concert performances, merchandising etc.).

BALANCE OF PAYMENTS TREATMENT OF IFSC ENTITIES

All entities operating at IFSC are deemed to be Residents for Balance of Payments purposes apart from non-resident funds (registered in other jurisdictions both off shore and on shore). These resident entities are registered in Ireland and pay tax to the Irish Government on trading income. The funds are listed on the Irish Stock Exchange. Therefore, comprehensive reporting of Balance of Payments statistics is required (an example of the data required for a collective investment scheme is attached).

A review of the relevant transactions of IFSC entities already discussed above with an indication of the appropriate *BOP Financial Account* statistics required is set out below:

Banking & Asset Finance – lending, deposits, corporate finance
These are direct investment entities with non-resident owners.

Financial Account Transactions/Positions:
Most if not all of these companies are financial intermediaries or MFIs therefore only transactions in permanent debt and equity are considered as *direct investment* transactions.

They may also be involved in *Portfolio Investment* – buying and selling of Bonds & Notes and Money Market Instruments.

Most activity will occur in the *Other Investment* account with transactions in loans and deposits, and trade credits and other assets/liabilities.

There are also some transactions in all *derivative* types i.e. swaps, options, futures and forward contracts.

Insurance/re-insurance
In general, these companies are inward Direct Investment enterprises and some are subsidiaries of Irish resident parents.

Financial Account Transactions/Positions:
Equity investment into these companies is *direct investment*.

However the bulk of the activity is the investment of policyholders funds into traded securities, which is classified as *Portfolio Investment*.

Changes in Technical /Actuarial reserves are recorded under *Other investment* – other liabilities

Corporate treasury management
In general, these companies are inward Direct Investment enterprises and some are subsidiaries of Irish resident parents.

Financial Account Transactions/Positions:
The majority of transactions in this sector are included in *Direct Investment – Other capital* which captures inter-company loans/deposits and other transactions with related companies.

Where third parties are involved we record transactions in loans/deposits and other assets/ liabilities under *Other Investment*. If Bonds or other traded securities are involved these transactions are recorded in *Portfolio Investment*.

Collective Investment Schemes and SPICS
CIS enterprises are primarily involved in portfolio investment both inwards and outwards, while SPICs are inward Direct Investment enterprises engaged in outward Portfolio investment.

Financial Account Transactions/Positions:
The main activity is in Portfolio investment, transactions by investors into a fund being recorded under Portfolio investment liabilities – equities

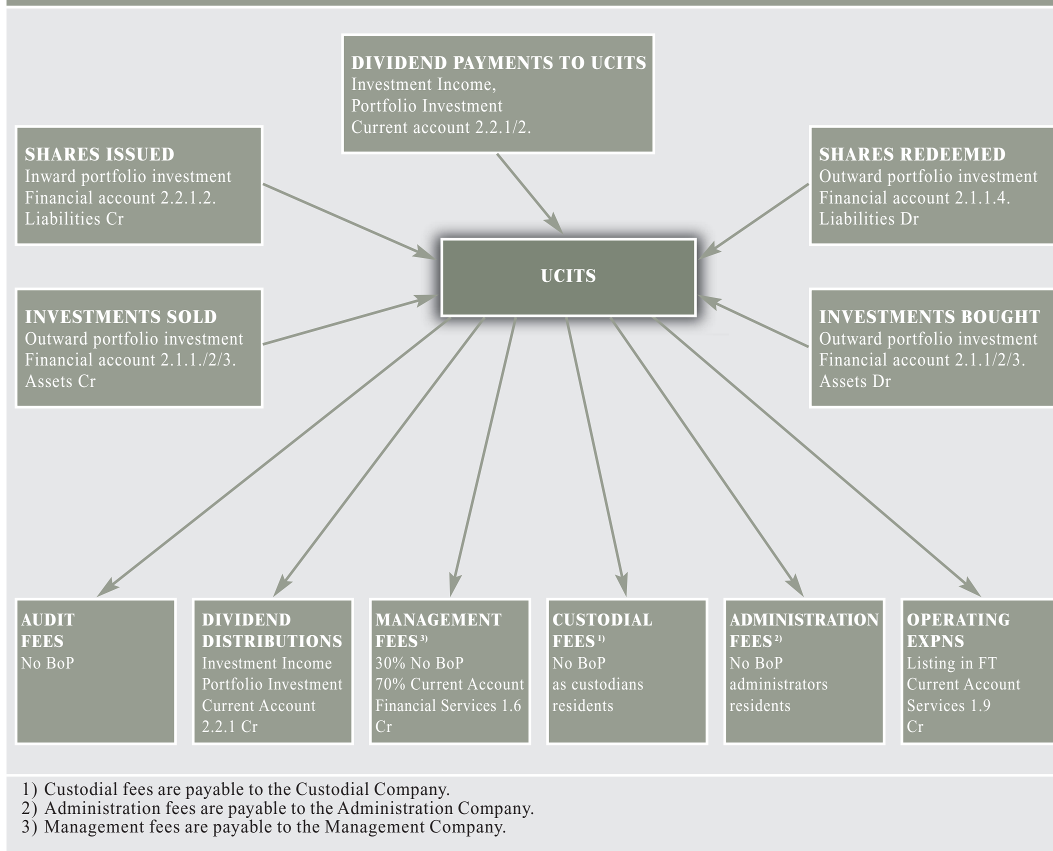
The investment activity of the fund is recorded under portfolio investment assets – Equities, Bonds and MMIs.

Any non-resident transactions in cash are recorded under Other Investment, and financial derivatives are recorded under Financial derivatives.

Table F-1 UBO Summary statistics on IFSC activities (end 1998)

Financial Account	EUR millions
Direct Investment net	-34,947
Portfolio Investment Assets	120,859
Portfolio Investment Liabilities	97,380
Other Investment Assets	99,886
Other Investment Liabilities	73,863
Total net	14,555

Table F-2 Units for collective investment in transferable securities (UCITS)



F.3 SPECIAL PURPOSE ENTITIES – THE CASE OF THE NETHERLANDS

1 BACKGROUND

According to the OECD Report on Special Purpose Entities and Offshore Enterprises {DAFFE/MC/STAT(2003)4}, the Netherlands seems to be the only OECD country with a legal definition of Special Purpose Entities (SPEs) or, as they are called in the Netherlands, Special Financial Institutions (SFIs). Conversely, in Dutch statistical regulations the offshore enterprises are not defined. This means that the concept of offshore is unknown and that cross-border transactions of these enterprises are not treated differently in the compiled statistics. All SFIs established in the Netherlands are considered as residents.

From April 2003 the Statistical Information and Reporting Department of DNB will implement a Direct Reporting system (DRA). In the new reporting system SFIs will have different reporting obligations than non-SFIs. Non-SFIs are obligated to send in on a monthly basis, a fully reconciled statement of stocks and flows for each BoP-item separately. SFIs only have to report transactions on a monthly basis. A fully reconciled statement including stocks is reported by the SFIs only on an annual basis. For the *monthly and annual reporting obligations* about 1,200 SFIs, with a coverage of about 95% of the figures of all SFIs, have been selected as *direct reporters*. In addition, DNB foresees an annual benchmark reporting, in which registered SFIs not being selected as direct reporters, will report once a year their

annual positions only. This benchmark will serve firstly as a basis for updating the population of *direct reporters* and secondly as a source for levelling up the SFI-statistics compiled on the basis of the figures reported by *direct reporters*.

2 DEFINITION AND IDENTIFICATION

2.1 DEFINITION

Dutch SFIs are defined as:

> *in the Netherlands established companies or institutions, regardless their legal form, whose shares are directly or indirectly held by non-residents and are mainly dealing with receiving funds from non-residents and channelling them to non-residents.*

2.2 IDENTIFICATION AND REGISTRATION

According to article 9 paragraph 1 of the *"Reporting Instructions for External Payments 2003"*[14], which are founded on the *"External Financial Relations Act 1994"*, SFIs are obliged to register at DNB within three weeks after their establishment. On the basis of the information provided through the registration form DNB will take a decision about whether or not to appoint the SFI as a *direct reporter*.

There are three conditions that should be met by an entity to be considered an SFI: firstly, the company should be a resident; secondly, the shares should be directly or indirectly in hands of non-residents and, finally, the money flows should be mainly raised from non-residents and handed over to non-residents.

Beside the legal obligation of SFIs to register at DNB, *trust companies,* as the representatives of over 75% of the total population of the SFIs, play an important role in identification and registration of these entities. Maintenance of an up to date SFI-register is a necessary condition to produce reliable statistics. In the case of SFIs this is a challenging task, because a significant part of these registered SFIs are not operating regularly. In some cases they are established to carry out just a limited number of transactions in a short period of time. By the end of 2002 over 12,500 SFIs were registered at DNB.

3 TREATMENT

3.1 INCLUSION IN STATISTICS

With regard to SFIs the Netherlands can be considered as a transit country for their money flows. The net outcome of the incoming and outgoing flows should be close to zero. This should be the case for each individual SFI as well as for the total of the money flows of the whole population of SFIs. In practice, however, a small net outcome may result for limited periods of time, mainly due to time differences.

The net effect of the SFI-transactions is included in the published data of the Dutch Balance of Payments within *Other Investment-Liabilities- Other Liabilities- Other Sectors*. There are two reasons to include only the net effect of these transactions in the BoP and to exclude them from the International Investment Position (IIP) statistics. Firstly, the gross money flows are irrelevant for the Dutch economy; secondly, including the gross money flows would blow up the statistics, thereby hampering the analysis of the development of the external sector. For the same reasons SFI-transactions are also not included in the National Accounts compiled by Statistics Netherlands.

The exclusion of gross flows results in the so-called cleaning of the Dutch BoP from SFI-transactions. As other countries do include SFI money flows from and to the Netherlands in their BoPs as, respectively, inward and outward *Direct Investment (or Portfolio Investment),* the regularly published data by DNB of bilateral investment flows from and to the Netherlands can not be compared with the investment statistics compiled in other countries.

14 Rapportagevoorschriften Buitenlandse Betalingsverkeer (RV) 2003.

For the compilation of the BoP for the Euro-area, DNB reports BoP data including gross transactions of SFIs to the ECB. These BoP-data contain a geographical split between intra-EMU and extra-EMU countries. If the ECB would not have the gross figures for the Netherlands (divided by intra-EMU and extra-EMU countries) in order to eliminate the intra-EMU transactions it would, ceteris paribus, result in *errors & omissions* for the BoP of the Euro-area. DNB also reports its IIP including the positions of SFIs to the ECB, thereby enabling the ECB to compile internationally consistent IIP statistics for the Euro-area.

3.2 TYPES

Depending on their activities, four types of SFIs can be distinguished. Considering the magnitude of their cross-border transactions the financing companies followed by holding companies are the largest types of SFIs.

Financing companies

This type of SFIs are engaged in taking up and on-lending funds within their own group company outside the Netherlands. These companies can also raise funds from non-residents to lend on within their own group or raise funds within the group to lend on outside their own group to non-residents. The relative share of financing companies in total turnover of SFIs in 2002 was about 71%.

Holding companies

These SFIs invest within the group company, manage the participations and distribute dividends gained from the participations to the parent company. About 2% of total transactions of SFIs in 2002 were realised by SFI *holding companies*. The relative share of these enterprises in the IIP-statistics in much higher than in the gross transactions. In 2001 the participations of SFIs outside the Netherlands was about 43% of all foreign assets of Dutch SFIs.

Royalty and Film right companies

This group concerns a limited number of SFIs with a small share in the total turnover of SFIs. They exploit the licences, patents and film rights for their parent companies. The measured relative share of these companies in 2002 came to less than 1% of the total SFI transactions.

Rebilling companies

These SFIs mainly deal with rebilling activities of their parent company on behalf of the cross-border sales in goods. *Rebilling companies* are set up not only to gain from the tax regulations for these companies but also to minimise exchange rate risks.

Beside these four types, different varieties of SFIs can arise from a combination of two or more of the above mentioned types.

3.3 PROBLEMS

Although there are some practical difficulties in the treatment of SFIs and their figures in the BoP, these problems can be solved. A short description of the problems faced and the possible solution for each difficulty is presented below.

Non-response

In spite of their obligations SFIs do not always report their establishment and consequently their activities to DNB. This problem may well occur in the case of newly established SFIs, which may not have been informed about their registration obligations to DNB. There are some methods to identify those unknown, i.e. newly established SFIs, and to point out to them their obligations towards DNB. One method is the awareness of trust companies about the registration and reporting obligations of their clients to DNB. Regular and intensive contacts with these trust companies has shown to be an effective instrument in covering the SFI activities in statistics.

Some of the reporting delays of SFIs stem from the fact that their administration is located outside the Netherlands. To deal with

the non-response and delay problem, DNB has the disposal of the instrument of *fines or ceases and desist orders under penalty*, which is based on the *External Financial Relations Act.* Increasing the awareness of SFIs about their reporting obligations, also by periodically sending reminders, combined with the legal instrument of *fines and ceases* has proven to be very successful in the data collection process.

Asymmetry

A large (short-term) difference between the incoming and outgoing money flows is called an *asymmetry*. As mentioned before all incoming money flows through SFIs should be transferred to other countries again. In the majority of cases the transactions will be carried out at the same time or within a short period of time. To enable SFIs to pay their expenditures in the Netherlands, however, the incoming money flows could be higher than the outgoing flows. Compared to the gross flows the total expenditures of SFIs or the net effect of the money flows, however, is negligible. In the new reporting system DRA the asymmetries caused by each individual reporter can be easier identified and solved.

Multistage SFIs

Some multinationals own more than one SFI, each used for different purposes. These SFIs are considered multistage SFIs if they are financially related to each other, for example through loans or participations. In this case money flows may enter the Netherlands through one of the related SFIs and leave the country through another. Multistage SFIs can usually be recognised by their (almost) identical names, which usually include the name of the multinational parent company. The reports of the interrelated SFIs are managed by the same account manager at DNB in order to be alert on the interrelationship between the individual SFIs of a multistage SFI.

Change of activities of SFIs

A company can also perform a mixture of SFI and non-SFI activities. At the moment of registration a company not fully fulfilling the criteria of an SFI will not be considered an SFI. It sometimes becomes more difficult, if SFIs take on board domestic activities. As soon as this is recognised the status as an SFI will be reconsidered and, if necessary, withdrawn.

4 SUMMARY

Although the process of identifying SFIs and processing their data in some aspects is more complicated than that of non-SFIs, there are practical solutions for the problems being faced within this process. This allows DNB to compile reliable statistics about the activities of SFIs. In the new reporting system, that is to be implemented in April 2003, SFIs will continue to be treated separately from non-SFIs in the national BoP.