OECD Benchmark Definition of Foreign Direct Investment

FOURTH EDITION 2008

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2008

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Foreword

Foreign direct investment (FDI) is a key driver of international economic integration. With the right policy framework, FDI can provide financial stability, promote economic development and enhance the well being of societies.

Reliable FDI statistics have always been essential for policy makers faced with the challenges of attracting and making the most of international investment. In the early 1980s, the OECD recognised that traditional reporting models could not account for the removal of regulatory barriers for cross-border investments, the evolution of multinational enterprises and the increasing complexity of their financing through offshore tax juridisctions and other arrangements. As a result, in 1983, the OECD adopted a new "Benchmark Definition of Foreign Direct Investment" which provided a comprehensive set of rules to improve statistical measures of foreign direct investment. However, the financing structures of multinational enterprises and other business combinations have continued to evolve in an increasingly globalised market. To adapt the statistical measures to changing economic and financial realities, the OECD adopted in 2008 the 4th edition of the Benchmark Definition of Foreign Direct Investment which sets the world standard for FDI statistics.

This 4th edition introduces new techniques in financial measures of direct investment. As examples, distinguishing financial flows via special purpose entities to reduce the effects of round-tripping of funds; distinguishing FDI by type of transaction (such as mergers and acquisitions); and identifying FDI according to the ultimate investor. This revised Benchmark Definition includes indicators on economic activities of multinational enterprises and a new section for users. The annexes elaborate further specific topics and include practical examples. The 4th editon of the Benchmark Definition will serve as a single point of reference for all that is related to FDI and its measurement.

This publication is the result of the work by the Working Group on International Investment Statistics, representing the international community of FDI statisticians [and chaired by Mr. Roger De Boeck]. The work was undertaken at the request of the OECD Investment Committee and in co-operation with the IMF and other partner international organisations. It was supported by material prepared by the Secretariat of the Working Group, Ayse Bertrand, Senior Statisician in the OECD Investment Division headed by Pierre Poret in the Directorate for Financial and Enterprise Affairs.

Table of Contents

Tables

Figures

 OECD BENCHMARK DEFINITION OF FOREIGN DIRECT INVESTMENT: FOURTH EDITION – ISBN 978-92-64-04573-6 – © OECD 2008

ACRONYMS

AMNE	Activities of Multinational Enterprises
ACP	African, Caribbean and Pacific Group of States
ASEAN	The Association of Southeast Asian Nations
Benchmark Definition	OECD Benchmark Definition of Foreign Direct Investment
BPM6	IMF Balance of Payments and International Investment Position Manual, 6th edition
COPC	Current Operating Performance Concept
DIIC	Direct Influence/Indirect Control Method
DP	Directional Principle
EFTA	European Free Trade Association
EU	European Union
EU MS	EU Member States
FATS	Foreign AffiliaTes Statistics
FDIR	Framework of direct investment relationships
FDI	Foreign Direct Investment
GFSM	Government Finance Sattistics Manual
Globalisation Handbook	OECD Handbook on Economic Globalisation Indicators
IC	Insurance Corporations
ICPF	Insurance Corporations and Pension Funds
IIC	Immediate Investing Country
IHC	Immediate Host Country
ISIC	International Standard Industry Classification
M&A	Mergers and Acquisitions
MAGHREB	Algeria, Mauritania, Morocco, Lybia and Tunisia
MASHREK	Turkey and Israel
MERCOSUR	Southern Common Market
MFSM	Monetary and Financial Statistics Manual
MNE	Multinational Enterprise
MMF	Money Market Funds
MSITS	Manual on Statistics of International Trade in Services
NACE	Nomenclature statistique des activités économiques (Statistical Classification of Economic Activities)
NAFTA	North American Free Trade Agreement
NICs	Newly Industrialised Countries
PF	Pension Funds
PMM	Participation Multiplication Method
RE	Reinvested Earnings

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SIMSDI	Survey of Implementation of Methodological Standards for Direct Investment
SME	Small and Medium-size Enterprise
SNA, 2008	System of National Accounts, 2008
SPE	Special Purpose Entity
UIC	Ultimate Investing Country
UHC	Ultimate Host Country
ECB	European Central Bank
EUROSTAT	Statistical Office of the European Communities
IMF	International Monetary Fund
OECD	Organisation for Economic Co-operation and Development
OPEC	Organisation of the Petroleum Exporting Countries
UNCTAD	United Nations Conference on Trade and Development

Recommendation of the Council on the OECD Benchmark Definition of Foreign Direct Investment

(Adopted by the Council at its 1175th session on 22 May 2008)

THE COUNCIL,

Having regard to Article 5 b) of the Convention on the Organisation for Economic Co-operation and Development of 14th December 1960;

Having regard to the Resolution of the Council on the Terms of Reference of the Investment Committee;

Having regard to the Recommendation of the Council of 27-28 July 1995 concerning the Third Edition of the Benchmark Definition of Foreign Direct Investment;

Considering that improvements have been achieved in the comparability of data collected on foreign direct investment since the first publication of the OECD Benchmark Definition of Foreign Direct Investment in 1983 but that however divergences still exist between the methodologies used by some Member countries and the methodology of the Benchmark;

Recognising the desirability of ensuring that the methodology of the Benchmark continues to reflect the reality of foreign direct investment transactions in a globalizing world economy;

On the proposal of the Investment Committee;

I. RECOMMENDS that Member countries continue to take steps to bring their statistical methodology into line with the OECD Benchmark Definition of Foreign Direct Investment and to consider 2010 as a target year for its full implementation, thereby providing a comparable and reliable basis for users of foreign direct investment statistics.

II. INSTRUCTS the Investment Committee, through its Working Group on International Investment Statistics, (i) to continue co-ordinating within OECD the collection of information on international direct investment and multinational enterprises; (ii) to collect and publish at regular intervals stock and flow data on inward and outward foreign direct investment; (iii) to prepare accompanying methodological notes in light of the results of the Survey of Implementation of Methodological Standards for Direct Investment; documenting areas where the methodology used by Member countries differs from the OECD Benchmark Definition; (iv) to take steps for the harmonization and integration of FDI statistics and the statistics on the activities of multinational enterprises to respond to the needs of the analysis of the global economy; and (v) to keep abreast of new developments impacting statistical methodologies, including issues indicated in annex 13 of the OECD Benchmark Definition.

III. DECIDES to repeal the Recommendation of the Council referred to above.

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Chapter 1

Introduction

1.1. Summary

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

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

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

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

1.2. Purpose of the *Benchmark Definition*

5. The *Benchmark Definition of Foreign Direct Investment* (*Benchmark Definition*)[3] sets the world standard for direct investment statistics. It is fully compatible with the underlying concepts

1. In this *Benchmark Definition* the term "country" is used as a substitute for "economy" which is the statistical concept (as some economies are not sovereign countries); it does not relate to the legal definition of country.
2. See also IMF Data Quality Assessment Framework *www.imf.org/*
3. *OECD Benchmark Definition of Foreign Direct Investment* was first issued in 1983.

and definitions of the *International Monetary Fund's (IMF) Balance of Payments and International Investment Position Manual 6th edition (BPM6)*. It also follows the general economic concepts set out by the *System of National Accounts, 2008(SNA, 2008)*.[4] Within this overall framework, it is important to stress that the main focus of the *Benchmark Definition* is FDI statistics encompassing direct investment positions and related direct investment financial and income transactions (flows). The *Benchmark Definition* also provides a brief overview of the methodology of statistics on the Activities of Multinational Enterprises (AMNE)[5] which are closely related to those on FDI. Moreover, the *Benchmark Definition,* in terms of detail and breakdowns, goes beyond the aggregate statistics of the functional category "direct investment" of the balance of payments financial account and of the international investment position.

6. To support these standards for FDI statistics, the *Benchmark Definition* provides guidance on how to compile comprehensive breakdowns by partner country and by industrial activity. By setting the world standard for FDI measurement, the *Benchmark Definition* also complements the *Organisation for Economic Co-operation and Development (OECD) Handbook on Economic Globalisation Indicators* (*Globalisation Handbook*). This Benchmark Definition also recommends new breakdowns such as:

- FDI presented on an asset/liability basis in accordance with the SNA and BPM;
- FDI presented according to the revised directional principle (the revision resulting from the inclusion of a new treatment of fellow enterprises) and providing for the following analyses – segregating some types of pass-through funds, segregating FDI corresponding to purchases/sales of existing shares in the form of mergers and acquisitions (M&A), identification of partner country for direct investment positions by ultimate investing country (UIC) for inward FDI.

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

i) a single point of reference for compilers and users of FDI statistics;

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

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

iv) an international standard that provides the basis for economic analysis, especially for international comparisons and for identifying national deviations from the standard that impact on the comparison;

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

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

8. Since publication of the first edition of the *Benchmark Definition*, compiling countries have made important progress in revising their FDI measurement systems towards greater

4. System of National Accounts by the Commission of the European Communities, International Monetary Fund, Organisation for Economic Co-operation and Development, United Nations, and World Bank.
References to SNA reflect its content as of April 2008. Should relevant texts be subject to further revisions, subsequent versions should apply as reference once they come into effect.

5. For a more detailed description see *Handbook on Economic Globalisation Indicators* , OECD 2005. AMNE statistics are also referred to as Foreign AffilaTe Statistics – FATS.

compliance with its requirements and definitions. To measure the extent to which statistical systems have implemented the recommendations on direct investment statistics, the IMF and the OECD have, since 1997, conducted the Survey of Implementation of Methodological Standards for Direct Investment (SIMSDI). This evaluation tool also provides standardised information on data sources and collection methods, and reporting practices for national direct investment statistics. SIMSDI serves as the metadata for statistics published in the OECD *International Direct Investment Statistics Yearbook*. Moreover, through its standardised information it supports the exchange of FDI data between reporting economies for bilateral comparisons.[6]

1.3. Revision of the *Benchmark Definition*

9. The removal of legal and regulatory restrictions on cross-border business operations in many countries has complicated the task of statistical systems that historically depended largely on data reported by national financial institutions and enterprises. As economic activities have become more global, investors have had continually increasing recourse to overseas financing. These investors may establish complex structures to obtain optimal benefits from their investments and for efficient management of the funds and related activities. These developments have had an adverse impact on the ability of statistics gathered through traditional methods to respond to user needs for adequate analytical information on FDI. They have also reinforced the need for adopting a harmonised analytical framework for constructing meaningful, comprehensive and internationally comparable statistics on cross-border investments. This latest edition of the *Benchmark Definition* sets out the standards and methodology to address the issues identified above.

10. The main features of the *Benchmark Definition, 4th edition* can be summarised as follows:

i) Full consistency with the BPM concepts and definitions relating to cross-border investment positions and corresponding international financial and income flows;

ii) Consistency with the broad definitions and accounting framework of the SNA;

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

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

v) Introduction of new concepts and breakdowns in response to user requirements to analyse direct investment in the context of globalisation;

vi) Providing new chapters devoted to uses of FDI statistics and to FDI globalisation indicators;

vii) Introduction of an FDI glossary;

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

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

1.4. An overview of foreign direct investment concepts

11. Direct investment is a category of cross-border investment made by a resident in one economy (the *direct investor*) with the objective of establishing a lasting interest in an enterprise (the *direct investment enterprise*) that is resident in an economy other than that of the direct investor. The motivation of the direct investor is a strategic long-term relationship with the direct investment enterprise to ensure a significant degree of influence by the direct investor in the management of the direct investment enterprise. The "lasting interest" is evidenced when the direct investor owns at least 10% of the voting power of the direct investment enterprise. Direct investment may also allow the direct investor to gain access to the economy of the direct investment enterprise which it might otherwise be unable to do. The objectives of direct investment are different from those of portfolio investment whereby investors do not generally expect to influence the management of the enterprise.

12. Direct investment enterprises are corporations, which may either be subsidiaries, in which over 50% of the voting power is held, or associates, in which between 10% and 50% of the voting power is held, or they may be quasi-corporations such as branches which are effectively 100% owned by their respective parents. The relationship between the direct investor and its direct investment enterprises may be complex and bear little or no relationship to management structures. Direct investment relationships are identified according to the criteria of the Framework for Direct Investment Relationships (FDIR)[7] including both direct and indirect direct investment relationships (see Chapter 3).

13. Direct investment statistics cover all cross-border transactions and positions between enterprises which are a part of the same group as defined in the FDIR. According to the standard (core) and supplemental presentations, FDI statistics include direct investment positions (equity and debt), direct investment income flows (distributed earnings, reinvested earnings, interest income) and direct investment financial flows (equity and debt). That part of the difference between closing and opening FDI positions in a particular reporting period that cannot be explained by financial transactions is referred to as "other changes". These "other changes" arise from price changes, movements in foreign currency and changes in volumes. Market value is the preferred conceptual basis to measure both direct investment positions and transactions (flows).

14. Direct investment statistics are presented on an aggregate basis in terms of assets and liabilities and also, separately, on a directional (both for inward/outward FDI) basis with a geographical and industry breakdown. For both inward and outward FDI on the directional basis the allocation by partner country uses the *debtor/creditor* principle. The directional data are also classified and analysed according to industrial activity. Directional data for both geographic and industry analysis should be derived from the basic information compiled on FDI assets and liabilities. It is recommended that the geographic and industrial allocation required for the FDI directional presentation should be made by the compiler excluding FDI transactions and positions effected through any resident Special Purpose Entity (SPE) (see Section 6.2).

15. Viewed from a reporting economy, cross-border positions/transactions involving pass-through capital (also referred to as "capital in transit") via non-resident SPEs distort the country and industry analysis. Therefore, where non-resident SPEs are involved in an FDI investment chain, compilers are strongly encouraged to provide further supplemental transactions and

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

positions data on the basis of the first non-SPE counterpart in the host or investing economy (in the outward or inward chain) as appropriate. Acknowledging that there is no single definition of SPEs, the *Benchmark Definition* recommends that data be developed based on national definitions of SPEs. A typology of SPEs based on features of these identified worldwide is provided in Annex 7 to assist compilers when identifying such entities.

16. Direct investment statistics are also disaggregated by major industry sectors based on the International Standard Industrial Classification (ISIC),[8] according to the principal activity of the direct investment enterprise (in the reporting economy for inward investments and in the host economy for outward investments).

17. Moreover, considering user needs for information by the type of FDI, which provides an important dimension for economic analysis, compilers are firstly encouraged to provide supplemental breakdowns for mergers and acquisitions as a sub-category of direct investment equity transactions classified by partner economy and industry. Secondly, they are encouraged to provide inward FDI position according to the ultimate investing country (UIC). Recommendations for other breakdowns are under study to complement these two supplemental FDI series recommended by this *Benchmark Definition*. These are for the geographical allocation and industry classification of outward FDI according to ultimate host country and FDI equity transactions by other types of FDI, namely greenfield investments, extension of capital and financial restructuring (see Annex 13 for more information on the research agenda).

1.5. Organisation of the *Benchmark Definition*

18. In providing guidance to national compilers and users of FDI statistics, the *Benchmark Definition* recommends harmonised standards to measure direct investment and proposes practical solutions to compilation problems. Where appropriate, more detailed information and guidance along with some concrete examples are provided in annexes to demonstrate or supplement the recommendations described in various sections of the main text. The section devoted to the use of statistics on direct investment supplements FDI statistics published regularly by the OECD in the *International Direct Investment Statistics Yearbook*, *International Investment Perspectives, Economic Globalisation Indicators* and quarterly statistical releases on the OECD web site. The FDI glossary, introduced for the first time in this edition of the *Benchmark Definition* is intended to assist both the compilers and users of direct investment statistics. The topics addressed in the remaining chapters are:

- Chapter 2. Uses of FDI Statistics
- Chapter 3. Main Concepts and Definitions of FDI
- Chapter 4. FDI Components, Accounts and Scope
- Chapter 5. Measuring FDI: Accounting Principles and Valuation
- Chapter 6. Special Entities
- Chapter 7. Country Attribution and Industry Classification
- Chapter 8. FDI and Globalisation

For both users and compilers of FDI further details are provided in the Annexes (as detailed in the Index), Bibliography, and Glossary to this edition of the *Benchmark Definition*.

8. The current version of ISIC is the fourth revision – ISIC4.

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Fourth Edition

Chapter 2

Uses of FDI Statistics

2.1. Summary

19. This edition of the *Benchmark Definition* includes for the first time a chapter devoted to the uses of foreign direct investment (FDI) statistics to assist users in their analysis of both the global and/or regional nature of FDI activity and the industry sectors that FDI affects. As economies become increasingly global, statistical methodologies need to be adapted to new realities, thereby maintaining the analytical quality of the statistics. Keeping in mind the complex nature of multinational enterprise (MNE) and hence FDI structures, this chapter on the uses of FDI statistics should prove valuable for a wide range of users.

20. In summary, the first section reviews the importance of measuring FDI and the role it plays in the global economy. It is followed by a brief description of the main features of FDI statistics and their interpretation. The last two sections of this chapter summarise firstly the main analytical presentations of FDI data proposed by this *Benchmark Definition* to meet user needs and secondly guidance on the interpretation of FDI series and globalisation indicators. The answers to questions frequently asked by users are also provided in Box 2.5 at the end of this chapter.

2.2. Why measure FDI?

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

22. By the very nature of its motivation, FDI promotes stable and long-lasting economic links between countries through direct access for direct investors in home economies to production units (businesses/enterprises) of the host economies (*i.e.* the countries in which they are resident). Within a proper policy framework, FDI assists host countries in developing local enterprises, promotes international trade through access to markets and contributes to the transfer of technology and know-how. In addition to its direct effects, FDI has an impact on the development of labour and financial markets, and influences other aspects of economic performance through its other spill-over effects.

23. Regular analysis of direct investment trends and developments is an integral part of most macro-economic and cross-border financial analysis. It is of prime interest to policy analysts to identify the source and destination of these investments. In other words, identifying partner countries and industries for inward and outward investments is central to most analysis. There is also increasing interest in identifying FDI by type, as different types of FDI – Mergers and Acquisitions (M&A) or Greenfield investments – are likely to impact to a varying extent, in particular, on the host economy.

24. Moreover, as explained in the latter part of this chapter a number of indicators based on direct investment statistics facilitate the measurement of the extent and impact of globalisation. To expand and refine the structural analysis, it is useful to go one step

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further and to complement this financial analysis of FDI by other economic indicators. These are mostly the statistics on the activities of multinational enterprises (AMNE – also known as Foreign AffiliaTe Statistics – FATS) discussed as well in Chapter 8 and elaborated in the OECD *Handbook on Economic Globalisation Indicators*. While FDI statistics provide the financial features of investment, the statistics on the activities of MNEs inform on the uses and impact of investment. It is, nevertheless, important to highlight the need for caution here and to draw the attention of those interested in globalisation indicators to the fact that there are current inconsistencies between FDI statistics and statistics on the AMNEs which limit the extent to which the two series are complementary. The main difference is in the coverage of the population of enterprises but there are also differences in some of the principles for recording geographical and industry sector allocation. The user should bear in mind as well that economic activity and assets of a direct investment enterprise might also be supported by sources of financing other than foreign direct investment. More work will be conducted as part of the *Benchmark Definition* research agenda to improve the reconciliation of the two sets of statistics (see Annex 13).

25. The measurement of FDI has to rely on clear and unambiguous rules. At the same time, statistics should reflect the changes and new developments implemented by market participants, even though they may result in some breaks in historical statistical series. At the centre of these changes are the complex structures put in place by MNEs for financing and managerial purposes and that are leading increasingly to the distortion of FDI data. These aspects need to be considered for the analytical presentations of FDI statistics. In addition, the borderline between different types of investments may be blurred whereby it is not always easy to differentiate FDI from other types of cross-border investments or services (see Annex 3).

26. Against this background, accelerated by the globalisation of economies, an in-depth review of existing concepts and definitions became necessary as traditional concepts applied to measure direct investment activity could no longer provide fully satisfactory results. As a part of the updating of globalisation statistics, this *Benchmark Definition* introduces new analytical breakdowns and develops new concepts to reflect more meaningful bilateral FDI statistics. Notwithstanding a number of significant improvements to the measurement of FDI introduced in this edition, all the research planned could not be completed on time to issue a more complete set of recommendations in the current edition of the *Benchmark Definition*. As a consequence, it was agreed to publish the forthcoming results of this further research in an addendum to the *Benchmark Definition* as soon as they are finalised (see Annex 13).

2.3. Understanding the main features of FDI

2.3.1. FDI in the context of economic accounts

27. It is useful to describe the relevance of direct investment within the overall economic accounts of a country, within the balance of payments and international investment positions framework and also, its complementary aspects with the statistics on the AMNEs.

- *National financial accounts and flows of funds accounts* (in the System of National Accounts 2008, SNA 2008) record the overall stocks of financing and the corresponding flows between the economic units of a country with the rest of the world, *i.e.* with non-resident units which enter into transactions with resident units or have economic links with them. FDI investment relates to one of the categories of cross-border financing of enterprises (see SNA 2008 for more details).

- Direct investment is one of the five functional categories of the financial account of the balance of payments and the corresponding international investment position statements. Direct investment income is a sub-item of investment income of the current account. Data for balance of payments and international investment positions are presented as broad aggregates for the main sub-components of these accounts; there are no further breakdowns by partner country or economic activity (see IMF Balance of Payments and International Investment Position, 6th edition Manual (BPM6) for more details).
- Conceptually, the population of enterprises covered by the statistics on the AMNEs is a sub-category of the enterprises covered by FDI statistics: the former relates to control, while the latter is based on ownership and influence (*i.e.* a larger population of FDI enterprises corresponding to the ownership criterion of 10%-100% of the voting power as opposed to the lower population of enterprises underlying MNE statistics for which more than 50% ownership is necessary for control). However, as indicated above the reconciliation of the two sets of statistics is not only limited to this theoretical description of control and influence. Further breakdowns of FDI and the reconciliation of other differences are necessary to achieve a sound analysis when using the two data sets (see also Chapter 8).

28. In response to analytical information needs, the preparation of the 4th edition of the *Benchmark Definition* was strongly influenced by two concerns:

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

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

2.3.2. FDI Equity ownership: The critical determinant

29. Direct investment is defined as "a category of cross-border investment made by a resident entity in one economy (the *direct investor*) with the objective of establishing a lasting interest[9] in an enterprise (the *direct investment enterprise*) that is resident in an economy other than that of the direct investor" (see Chapter 3). The main motivation of the direct investor is to exert some degree of influence over the management of its direct investment enterprise(s) whether or not this entails exercising a controlling interest. However, in many, if not most cases, the relationship is strong enough that the direct investor will control the direct investment enterprise. The motivation to significantly influence or control an enterprise is the underlying factor that differentiates direct investment from cross-border portfolio investments. For the latter, the investor's focus is mostly on earnings resulting from the acquisition and sales of shares and other securities

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

without expecting to control or influence the management of the assets underlying these investments. Direct investment relationships, by their very nature, may lead to long-term and steady financing and technological transfers with the objective of maximising production and the earnings of the MNE over time. Portfolio investors do not have as an objective any long-term relationship. Return on the assets is the main determinant for the purchase or sale of their securities.

30. On the other hand, the growing trend of individual primary investors investing into collective investment institutions (CII) and acquiring sufficient ownership of voting power to qualify as direct investment, as well as the increasing number of such institutions becoming direct investors in their own right, should also be taken into account. Both aspects, investments in CIIs and by CIIs, are included in FDI statistics as far as the basic FDI criteria are met. However, the nature and motivation of CIIs may differ from those of MNEs and there is a need to observe this phenomenon more closely in the coming years.

31. It has been argued that in practice there are several factors which may determine the influence a direct investor has over the direct investment enterprise. However, for the sake of consistency and cross-country comparability of the FDI statistics, a *strict application* of a numerical guideline is recommended to define direct investment. Accordingly, direct investment is considered evident when the direct investor owns directly or indirectly at least 10% of the voting power[10] of the direct investment enterprise. In other words, the 10% threshold is the criterion to determine whether (or not) an investor has influence over the management of an enterprise, and, therefore, whether the basis for a direct investment relationship exists or not.

2.3.2.1. FDI relationship

32. MNEs often have complex group structures including a number of direct investors and direct investment enterprises. For example, a direct investor could be the ultimate controlling parent (UCP) or the intermediate parent of an enterprise. In other words, a direct investor could be a parent of a non-resident enterprise and, at the same time, it could be a direct investment enterprise or a fellow enterprise of another non-resident enterprise. This implies that a direct investment enterprise may itself be a direct investor, and *vice versa*. However, there can only be one ultimate controlling enterprise, the UCP, which is at the top of the ownership chain, *i.e.* not controlled by any other entity.

33. Direct investment enterprises can take many different legal forms but they are all corporations (incorporated enterprises) or quasi-corporations (unincorporated enterprises operating separately from their owners and that have, or for which it is possible or meaningful to construct, a separate set of financial accounts). A direct investment enterprise is either a *subsidiary* (a controlled enterprise if it is more than 50% owned by its immediate direct investor), an *associate* (an influenced enterprise if it is owned between 10 and 50% by its immediate direct investor) or a *branch* (a quasi corporation). Moreover, enterprises that have no direct investment influence upon one another (*i.e.* the 10% voting power criterion is not met where there is either no equity ownership in one another or it is

10. While voting power is generally obtained through the purchase of equity, it is possible to have voting power that is not in the same proportion as the equity ownership (for example, 'golden shares' have greater voting power than other shares). It is also possible to obtain voting power without purchasing equity (for example, through derivative contracts and repurchase agreements). The implications of holding voting power without equity ownership are under investigation (see Annex 13).

insufficient for direct investment to exist) but are directly or indirectly influenced in the ownership hierarchy by the same enterprise (which must be a direct investor in at least one of them) are *fellow enterprises*. The relationship between enterprises is determined according to the *Framework for Direct Investment Relationships* (FDIR described in Chapter 3.

34. A direct investment enterprise may become an investor in its immediate direct investor or in a direct investor further up the investment chain. Such investment may consist of equity or debt but the extent to which voting power in the direct investor is acquired determines the appropriate treatment and recording basis for all the investment made. Where there is no voting power acquired in the direct investor or where less than 10% of the direct investor's voting power is obtained, all the investment made by the direct investment enterprise in its direct investor is referred to as *reverse investment*. The recording of such reverse investments under *equity* or *debt* has relevance for detailed standard FDI statistics presented on a directional basis (see also Chapter 4). Where a direct investment enterprise holds 10% or more of the voting power in its direct investor or in any other related enterprise resident in another economy, such investment and any associated or additional debt investment into the direct investor (or other enterprise) is regarded as separate direct investment in its own right and is recorded as appropriate under *equity* or *debt*.

35. Apart from the inclusion of small (less than 10%) equity investment, loans or other debt between *fellow enterprises* identified through the FDIR are also included in FDI statistics even if such enterprises are not related to each other by FDI equity investment *i.e.* where there is less than 10% ownership of the voting power but where they are related by having a common parent. In practice all transactions/positions between fellow enterprises relate to the funds circulating within multinational groups via shared service centres (*e.g.* providing treasury or cash pooling facilities) or to take advantage of the best financing opportunities. They may also represent *round-tripping* of capital. These funds may result in large amounts of FDI if recorded purely as assets/liabilities while the same funds circulate within the same group of enterprises (*i.e.* representing an overstatement of the FDI-other capital component). On the other hand, recording these transactions/positions according to the *directional principle* is based on the categorisation in the compiling economy of the relevant enterprises' ultimate controlling parent (UCP) as resident' or non-resident. Identifying whether the UCP is a resident or not determines the direction of direct or indirect FDI influence or control.

2.3.2.2. FDI accounts

36. Direct investment statistics embody three distinct statistical accounts: *i)* investment positions, *ii)* financial transactions, and *iii)* associated income flows between enterprises which are related through a direct investment relationship:

i) *Direct investment positions* (stocks of investment); provide information on the total stock of investment made abroad and received from abroad, broken down by instrument (equity, debt) for a given reference date. Yearly data are usually reported at the end of the calendar year which, in many countries, is the same as the fiscal year. More and more countries produce quarterly position data which allow the dissemination of more timely information. FDI position data allow a structural analysis of investments in the host economy or industry sector, and investment by the investing (home) country or industry sector. Due to the accumulation of earlier investments over time, in general, stock data allow the dissemination of more detailed estimates as they are less likely to be susceptible to statistical confidentiality constraints;

ii) *Direct investment financial transactions* show the net inward and outward investments with assets (acquisitions less disposals/redemptions) and liabilities (incurrence less discharges) presented separately by instrument (equity, debt) in any given reference period (yearly, quarterly or monthly). FDI inward flows provide a useful indicator in relation to the attractiveness of economies but such interpretations require additional information on which to base sound conclusions;

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

37. Direct investment financial transactions (flows) and positions comprise mainly three types of financing: *i)* acquisition or disposal of equity capital; *ii)* reinvestment of earnings which are not distributed as dividends; and *iii)* inter-company debt (payables and receivables, loans, debt securities). Analysing FDI by looking separately at equity *versus* debt reflects the relative stability of equity and the greater volatility of debt. As compared to equity, the debt component (and consequently the country breakdown of FDI) is more influenced by the location of, for example, treasury centres.

38. Changes in FDI positions other than those due to transactions, such as changes due to exchange rate movements as well as other price changes resulting from holding gains or losses and other changes in volume are included in FDI positions. In addition, reclassifications from portfolio investment to direct investment are reflected in FDI positions and categorised as appropriate to *equity* or *debt* (*e.g.* when a direct investor acquires additional equity in an enterprise bringing the overall investment to 10% or more of its voting power, equity stocks investment is reclassified from portfolio investment to direct investment as described in Chapter 4).

2.3.2.3. Valuation

39. As a matter of principle, direct investment assets and liabilities should be measured according to market value. Where direct investment enterprises are not listed on a stock exchange, their value is, in principle, estimated as a proxy to market value. There are various methods for making such estimates, *e.g.* the use of net asset value, own funds at book value. These are described in Chapter 5 and further elaborated in Annex 5. In practice, harmonisation of the methods estimating market value still remains an area for improvement for international consistency of FDI statistics.

2.4. Analytical FDI breakdowns[11]

40. While direct investment statistics described in this *Benchmark Definition* should be compiled using the same basic criteria as the BPM6, the two standards offer analytically complementary products. The *Benchmark Definition* recommends two analytical approaches to presenting FDI data:

- for aggregated FDI assets/liabilities data; and
- for detailed FDI data on a directional basis analysed separately by partner country and by economic activity.

41. While the asset/liability series are identical to balance of payments and international investment position statistics, the detailed directional data present a number of new features as compared to presentations recommended in the previous edition of the *Benchmark Definition* (see Annex 2).

42. There are two types of presentations of FDI data series: *standard* and *supplemental*. The standard (or core) type refers to regularly compiled and disseminated core data, recommended by the *Benchmark Definition*. The compilation and dissemination of the supplemental type of FDI data are strongly encouraged to be reported on a voluntary basis, left at the discretion of each reporting economy. The principle of having presentations of FDI statistics on both standard and supplemental FDI bases was guided by the increasingly diversified user needs for the analysis of direct investment activity.

43. The two *standard presentations* which serve different analytical purposes are described below. Both of these data sets represent historical breaks from the series compiled according to the recommendations of the *Benchmark Definition 3rd edition*. The new standard presentations are:

i) aggregate FDI data compiled using the *asset/liability* principle which, in addition, provides information separately on resident Special Purpose Entities (SPEs) (see Chapter 4 and Annex 2); and

ii) detailed FDI statistics by partner country and/or by industry sector compiled using the *directional principle* (see Chapter 4 and Annex 2). Within these the core directional data distinguish the involvement of resident SPEs in the investment chain, excluding them from the FDI statistics. However, the resident SPE data are presented separately in an accompanying analysis with the same level of detail, as the information on transactions /positions of resident SPEs could also be of interest to users. This presentation also provides the framework for bilateral consistency across national statistics.

44. FDI data presented using the asset/liability principle or the directional principle can be derived from one another using the component building blocks described in Chapter 4 provided that the various building block elements are all available. Given the degree of the detail required in some instances, confidentiality concerns may limit the dissemination of some items. However, national compilers, having access to confidential information, can provide the results of these building blocks at more aggregate levels, if such information is deemed useful (see Box 2.1 concerning identification and suppression of confidential data).

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

Box 2.1. **Confidentiality**

In compiling and presenting FDI statistics, compilers in many countries may encounter the possibility of confidential data occurring in the results to be disseminated. Such information generally does not directly identify the entity, *e.g.* the name and address of an enterprise, to which the data relate. However, the particular context in which the data are presented *e.g.* classification by: country of counterpart, activity of enterprise, type of financial instrument as well as cross-classifications of these attributes, may allow users to determine the identity of the entity in question and the value of its activity from the information provided (as well as other information they may have independently available to them). In general, the greater the level of detail in the analyses, as well as the degree of concentration of particular types of enterprises and their activities in a compiling country, the greater the likelihood of confidential data arising. For many countries, national statistical legislation prohibits the direct or indirect disclosure of information relating to a particular individual or entity. Many international organisations also operate statistical confidentiality regimes to ensure that confidential statistical information is not disseminated.

FDI information can be regarded as being confidential in a primary sense for a number of reasons:

i) if a compiler declares it to be confidential,

ii) if there is only one or at most two entities giving rise to the information, or

iii) if the contribution of a particular enterprise (or even two enterprises) dominate(s) the contributions of all other entities.

In the latter two cases, the usual confidentiality rules specify that where there are less than three contributors to a particular statistical value then this information is regarded as being confidential. The reason for this is that, for example, where there are two contributors then either of them can potentially determine the contribution of the other. Clearly where there is only one contributor then any user with sufficient knowledge can potentially identify the entity involved as well as the value of its activity. In the case of statistical dominance, the confidentiality disclosure rules applied may vary between compiling countries. For some countries, if an entity contributes at least 75% of the value of the information to be disseminated then it is declared confidential. For other countries a dominance threshold of 80% (or similar percentage) may be used. Alternatively, where two entities contribute, say, 90% or more of the value of the information being disseminated it is declared confidential.

Whatever disclosure rules individual countries adopt, compilers in these countries have to suppress this confidential information in their dissemination of statistical results. However, suppression of primary confidential data is not sufficient to prevent identification and disclosure of such confidential data. It is necessary for compilers to suppress additional data – secondary confidential data – in the results disseminated in order to prevent derivation of the primary confidential data. This operation is necessary within a single dissemination item *e.g.* a single table of data, but it often has to be extended where multiple dissemination items exist, *e.g.* multi-tabular data which include data overlaps. As a result, a significant amount of data may need to be suppressed by compilers to cover both primary and secondary confidential data. It is important to stress that such suppression generally applies on a 'bottom-up' basis *i.e.* firstly at the greatest level of detail and proceeding to increasing levels of aggregation where necessary. It is important to stress that, in general, where confidentiality suppression exists in data disseminated, higher aggregates in the results are not affected, and where the contribution of the entities whose data are suppressed at the more detailed levels are included in the higher aggregates.

45. Supplemental series all relating to FDI data analysed under the directional principle are:

i) Transactions/positions excluding resident SPEs and looking through non-resident SPEs by partner country and by industry classification.

ii) Where considered necessary, transactions/positions including all SPEs (according to the *Benchmark Definition* 3rd edition at least once a year).

iii) FDI equity transactions by type – purchase and sale of existing equity in the form of M&As.

iv) Inward FDI positions according to the country of the ultimate investing country (UIC) (and the corresponding industry sector).

2.4.1. Standard (core) FDI series

2.4.1.1. FDI according to the asset/liability principle

46. FDI aggregates as a part of national macro-economic statistics are based on the asset/liability principle. They are consistent with balance of payments statistics and international investment positions as well as the components of national accounts statistics. These data provide for an economy the aggregate totals of FDI *assets* and *liabilities* (Box 2.2) by type of instrument (equity, debt). They are based on reports from either a sample or a census of an economy's enterprises and the results cover the full population of such enterprises. The data are recorded on an immediate (first) counterpart basis regardless of the nature of the enterprise and the counterpart or of the direction of influence and control. These FDI statistics include all the funds that pass through SPEs as well as capital transiting through operating subsidiaries of MNEs on behalf of the parent companies. In consequence, while the data presented using the asset/liability principle provide an overall aggregate measure of FDI, they do not provide an appropriate basis for an analysis by partner country and/or by industry, as these data do not reflect the direction of influence or control. In addition, the asset/liability data can present two major problems:

i) Overstatement of FDI amounts for individual economies as well as for regional and global totals. Countries where SPEs are located record FDI figures that are overstated by pass-through funds which are indistinguishably aggregated with economically relevant investments. In addition, global amounts are also overstated while funds are transferred through intermediaries and accounted for more than once by compilers in different economies. To overcome this problem, transactions/positions of resident SPEs[12] are shown separately. This presentation provides useful information on the role of the reporting economy on the global routing of funds

ii) The real origin and destination of FDI are distorted if funds are passing through non-resident SPEs or other types of subsidiaries. In other words, the immediate non-resident counterpart may not be the real direct investor or the real direct

12. SPEs are not the only entities via which capital may be passed through. Nonetheless, the identification of resident SPEs should be considered as a minimum to allow for more meaningful FDI figures, also because in some countries they account for the major part of pass-through financing.

investment enterprise. This may be a problem for any country, whether it hosts SPEs itself or not (*i.e.* presenting transactions /positions of resident SPEs separately does not resolve the problems caused by non-resident SPEs).

Box 2.2. **FDI according to the asset/liability principle**

For the reporting country (RC), FDI is summarised as follows:

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

plus

Reverse investments by direct investment enterprises in the RC in their direct investors abroad

plus

Investments by fellow enterprises in the RC in other fellow enterprises abroad

Liabilities = Investment by direct investors from abroad in direct investment enterprises in the RC

plus

Reverse investments by direct investment enterprises abroad in their direct investors in the RC

plus

Investments by fellow enterprises abroad in fellow enterprises in the RC.

2.4.1.2. FDI according to the directional principle

47. Massive investment flows into and out of a country may not be of primary interest to analysts of direct investment if they reflect merely a pass-through or round-tripping of direct investment funds. Therefore, users seeking to analyse the economic impact of FDI from the perspective of the direction of influence/control (inward/outward FDI) would rather focus on investments recorded according to the *directional principle* both for transactions and positions.

48. FDI statistics compiled according to the *directional principle* show outward investments and inward investments taking into account reverse investments as recommended in the previous edition of the *Benchmark Definition* (*i.e.* reverse investments of the reporting country are recorded as negative inward investments) as well as investment into fellow enterprises – the direction in the latter case depending on whether the ultimate controlling parent of the resident fellow enterprise is a resident or a non-resident of the compiling economy (Box 2.3). Statistics are presented (equity, debt) at the level of partner country by instrument and by industry sector (see Annex 2).

49. Partner country or industry allocation is recorded in the directional presentation of FDI statistics as that of the immediate counterparty involved in the investment chain for both inward and outward investments but excluding resident SPEs (as opposed to the inclusion of all SPEs under the asset/liability principle described above). A direct investor in country A may wish to invest in country C but may do so through its holding company in country B. This simple example demonstrates how source and destination of investment

through indirect routing may distort the data and influence the relevant economic analysis. Also under the directional principle information for resident SPEs is also shown separately in the core accounts with the full geographic and industry breakdown.

Box 2.3. **FDI according to the directional principle**

For the reporting country (RC), FDI is summarised as follows:

Outward investment =

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

minus

Reverse investments by direct investment enterprises abroad in their direct investors in the RC

plus

Investments by resident fellow enterprises in fellow enterprises abroad where the ultimate controlling parent of the resident fellow enterprise is resident in the RC

minus

Investments by fellow enterprises abroad in resident fellow enterprises where the ultimate controlling parent of the resident fellow enterprise is resident in the RC

Inward investment =

Investments by direct investors abroad in direct investment enterprises in the RC

minus

Reverse investments by direct investment enterprises in the RC in their direct investors abroad

plus

Investments by fellow enterprises abroad in resident fellow enterprises where the ultimate controlling parent of the resident fellow enterprise is non-resident in the RC

minus

Investments by resident fellow enterprises in fellow enterprises abroad where the ultimate controlling parent of the resident fellow enterprise is non-resident in the RC.

50. Unlike the recommendation in the former *Benchmark Definition,* small (less than 10%) equity investment, loans and other debt between fellow enterprises identified according to the Framework for Direct Investment Relationships (FDIR) are no longer treated according to the asset/liability approach but in line with the direction of influence/control, so as to obtain the headline FDI transactions/position data by partner country or by sector of industry. As the related fellow enterprises, by definition, do not have sufficient FDI equity investment in each other to determine the direction of investment *a priori,* their investments in one another are recorded as outward or inward depending on whether their ultimate controlling parent is a resident or a non-resident of the compiling economy. Most of these transactions might represent short-term loans and may inflate the FDI data when presented on a purely asset/liability principle.

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Box 2.4. **Fellow enterprises**

Identifying fellow enterprises

Fellow enterprises are enterprises, in the same or in different economies, related through the FDIR without either being a direct investor in the other, but through being directly or indirectly influenced by the same enterprise in the ownership hierarchy. The common parent must be a direct investor in at least one of the enterprises in question. Such enterprises can be considered to be related through a ‘horizontal’ linkage within the FDIR – not involving FDI equity of 10% or more – and are called fellow enterprises.

Determining the direction of transactions/positions between fellow enterprises

The direction of direct investment between fellow enterprises (where they are covered by the FDIR) is determined according to the residency of the *ultimate controlling parent* of the fellow enterprises involved in the specific transaction/position. If the *ultimate controlling parent* is a non-resident in either of the economies of the fellow enterprises, all transactions and positions between these fellow enterprises are classified as inward FDI in both countries. If the *ultimate controlling parent* is resident in the economy of one of the fellow enterprises, all transactions and positions between that fellow enterprise and a non-resident fellow enterprise are classified as outward FDI for the economy of the resident enterprise and as inward for the economy of the non-resident fellow enterprise.

Recording transactions/positions between fellow enterprises according to the directional presentation

Once the direction of the transaction/position between fellow enterprises resident in different economies is determined, the geographical (and industry) allocation should be made on the basis of the location of the immediate counterparts excluding resident SPEs (and looking through all non-resident SPE on a supplemental basis).

2.4.2. Supplemental FDI series

51. Firstly on a supplemental basis, the *Benchmark Definition* encourages the supply of further FDI data under the directional principle on transactions, positions and income reallocated to the countries and industries of the first non-SPE counterparty encountered in an investment chain. These data complement standard FDI series excluding resident SPEs and giving geographical and industrial detail as discussed above.

52. Secondly *FDI by type* as a subset of standard FDI statistics under the directional principle is an altogether new dimension of FDI statistics. Such a subset of FDI data will allow refinement of the qualitative analysis of FDI in home and host countries. As a first step, identifying the purchase/sale of existing shares in the form of M&As would be useful. Generally speaking M&As relate to existing company structures taken over fully or partially by other entities. In the context of public debate, a sharp distinction is often drawn between “greenfield” investment, providing fresh capital and additional jobs, and M&As that are perceived to include only a change of ownership in an existing corporate entity. This theoretical distinction between the types of FDI however may differ in practice and in a number of instances the acquisition of existing enterprises can provide important additional economic benefits. The separate treatment of M&A is part of a political reality to which investment analysts have to respond and, in light of the present debate about “strategic sectors”, “national champions”, etc., the need is likely to grow.

53. Users should be cautious when using the *FDI data* distinguishing *M&A type transactions,* described in this *Benchmark Definition,* which are different to what is generally referred to as M&A statistics produced by commercial and other sources. The former corresponds only to equity transactions that qualify as FDI (covering 10%-100% of ownership of voting power) while the latter represents the total capital of companies (see Annex 9). At the present time, the *Benchmark Definition* recommends that supplemental series be produced only for FDI equity flows for M&A type activity. Further research is planned for Greenfield investments, extension of capital and financial restructuring, all of which are also part of FDI. Similar analysis of FDI positions would not be meaningful as such data relate indistinguishably to the stock of all types of investment accumulated over time.

54. A third set of supplemental data series are *inward FDI positions according to ultimate investing country*. There is ample interest by policy makers in political, economic and structural analysis to identify the locations of the ultimate owners of direct investment enterprises. The *Benchmark Definition* recommends that supplemental data be produced for inward FDI positions by geographical and by industry – allocation according to the ultimate owner (investor).

55. *Inward FDI position according to ultimate investing country* reallocates investments to various non-resident parents of the enterprise in proportion to the equity held disregarding the capital that transits through related operational or other enterprises. These data show the countries that have effective economic interest in the host economy. They relate to the control of investment positions by non-resident enterprises rather than to the ultimate control of the total assets of the direct investment enterprise.

56. An objective analysis of outward direct investment using similar concepts is more complicated. FDI according to ultimate investing host country is subject to further research[13] (see Annex 13).

2.5. Interpreting FDI series and globalisation indicators

2.5.1. FDI series

57. FDI series are very informative and useful for both short and long-term analysis. Timely estimates of the direct investment activity allow the monitoring of recent economic developments. On the other hand, longer series contribute to the measurement of the attractiveness of the reporting economy within the global market and the competitiveness of the economic agents, *i.e.* foreign direct investors and FDI enterprises.

58. An increase in inward investments by foreign direct investors implies additional capital injected into the economy (the domestic market) and, thus, is likely to have an impact on its economic performance. On the other hand, the size of outward investment transactions indicates the extent of penetration of the resident direct investor in other markets. FDI transactions (FDI financial flows and FDI income flows) provide information for FDI activity within a given time period while FDI positions data indicate the levels of investment at a given point in time. The trends obtained from FDI financial transactions and FDI positions may be quite different. In addition, attention is drawn to the point concerning the interpretation of headline FDI statistics in the context of the impact of reverse investment and of investment between fellow enterprises. In this context, for

13. Further research will be conducted on FDI according to ultimate investing/host country.

example, a low headline figure for total inward FDI into an economy may result from a general low level of FDI investment under different instruments and across different FDI relationships. Alternatively, it could result from a high level of such investment (under particular instruments and relationships) into the economy being partially or completely offset – or even exceeded – by outflows of investment by foreign-owned enterprises to their related direct investors or fellow enterprises abroad. Similar effects apply to outward direct investment.

59. Analysing inward and outward *FDI by its sub-components* namely *equity* , *reinvestment of earnings* (combined with equity for positions data) and *debt* allows further refinement of FDI trends and the nature of investments. Even if the analysis of equity investment is at the core of direct investment, intercompany loans play an important role in financing FDI related enterprises. However, trends in equity and debt components could be very different and may reflect different patterns. Reimbursements of intercompany loans need to be interpreted correctly but not as divestment. This interpretation is possible when we look at sub-components of FDI. A further reading of FDI sub-component statistics divided by claims and liabilities will provide additional information on capital movements.

60. *FDI by partner country :* The first classification specified by the *Benchmark Definition* requires that direct investment statistics be classified geographically on a directional basis *i.e.* for inward and outward investments, and including the associated income data. These series provide the geographical distribution of investment, *i.e.* country of source and destination. This information is very useful in any comparative analysis on the attractiveness of a country or a group of countries and for constructing analytical indicators such as globalisation indicators described in Chapter 8.

61. *FDI by industry sector*: Direct investment statistics should be classified according to industrial activity (based on the ISIC Classification) of the direct investment enterprise for both inward and outward investment. In other words, for outward investment, data are recorded according to the industry of the direct investment enterprise abroad and for inward investment they reflect the industry of the direct investment enterprise in the reporting country. Allocation of the industry sector should be based on the principle activity of the enterprise when it is involved in more than one activity. Deviations from these principles distort international comparison of industries that are recipients of direct investment. These data offer interesting indicators on the globalisation of markets. As a secondary series, it is also recommended that the data according to the industry of the direct investor be provided on a supplemental basis for inward FDI (see Chapter 7).

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

63. The *treatment of SPEs* will affect the results of the analysis. The problems raised by SPEs are twofold: *i)* the inclusion of resident SPEs may lead to an overstatement of FDI to and/or from the reporting country and; *ii)* investments via non-resident SPEs may lead to the distortion of information on the origin and destination of FDI. Core FDI series by country and by industry breakdown excluding resident SPEs resolve the first problem but not the second one which may be solved by supplemental data series acquired by looking through non-resident SPEs. The usefulness of these supplemental data for international

comparisons will increase as more countries report such data and when a standardised definition of SPEs can be implemented in all or most countries.

64. It was indicated earlier that detailed FDI statistics are required on a directional basis. The direction of the investment is determined by reference to the FDI relationships involved:

i) Firstly, there is a cross-border flow from one economy to another, *i.e.* from the economy of the investor into the economy of the direct investment enterprise (subsidiary or associate or branch) receiving the investment.

ii) Secondly, the treatment of *reverse investment i.e.* the investment of the direct investment enterprise back into its direct investor but where the acquisition of equity is less than 10% (not sufficient to qualify as direct investment in its own right).

iii) Thirdly, the treatment of equity and debt between fellow enterprises, which are identified as being in FDI relationship according to the FDIR, *i.e.* because they have a common parent but they have insufficient or no FDI equity influence in one another other.

2.5.2. Globalisation indicators related to FDI

65. Globalisation indicators related to FDI are discussed in Chapter 8 where a list of reference and supplemental indicators are provided. This section provides the analytical description of those indicators.

2.5.2.1. Reference indicators[14]

i) Extent of globalisation through FDI

66. This set of indicators is the most commonly used measurement of the globalisation of an economy. It measures the extent of cross-border investments realised with the objective of a lasting interest to and from an economy. It also allows cross-country comparisons based on the relative importance of FDI, *i.e.i)* financial flows; or *ii)* income flows; or *iii)* FDI positions expressed as a per cent of Gross Domestic Product (GDP). Each ratio indicates the relative importance of globalisation for the reporting economy either for total investments or for investments by economic sector. An increase of the ratio implies a greater share of foreign investment, thus an increase in the relative impact of globalisation. It is, however, to be noted that FDI flows and FDI positions when referenced against GDP are not fully compatible measures of globalisation. Nevertheless, in the absence of other more meaningful cross-country comparisons of the relative size of globalisation, GDP remains the best common reference. In addition, comprehensive and timely GDP statistics are available in most countries.

67. FDI financial flows (inward and outward) expressed as a per cent of GDP indicate the degree of globalisation of an economy based on the economic climate for a given time period, *i.e.* the changes over that time period. This indicator provides early information on the relative attractiveness of economies (both domestic and foreign) and industries for new investments after allowing for the withdrawal of investments (disinvestment) during that

14. Globalisation indicators are based on standard FDI statistics according to directional principle unless the underlying data are only available on a supplemental basis.

same time period. FDI flows are compiled in many countries on a quarterly basis or on a monthly basis, with a view to allowing a timely monitoring of their FDI activities.

68. FDI income flows (inward and outward) as a per cent of GDP provide information on the relative importance of the earnings of direct investment enterprises both in the reporting economy and abroad.

69. FDI positions (inward and outward) as a per cent of GDP indicate the extent of globalisation at a given point in time. These structural indicators designate the interdependence of economies. The ratio for inward FDI positions indicates the extent of foreign ownership (or foreign presence) in an economy. The ratio for outward investment indicates the degree of ownership (or presence abroad) of economic agents in other markets. They also illustrate, respectively, the level of dependence of the domestic economy on foreign economies and its level of penetration in foreign markets. A comparison of the results obtained for inward and outward FDI will indicate the comparative importance of the country as an exporter or recipient of FDI.

ii) Contribution of investing (home) and host economies and of economic sectors to globalisation

70. Expressed as ratios (as percentage of totals for both inward and outward FDI), the results reflect the process of globalisation of the economies by their level of financial expansion abroad and their dependence on financing from abroad. The indicator related to investing (home) and host economies shows the evolution of the share of individual economies as origin of direct investment (outward investment by reporting economy) or as host of direct investment (inward investment by non-residents to the reporting economy). The ratio based on FDI flows allows an analysis of the changes between two periods while the ratio based on positions indicates the structural developments over time. The geographical analysis can be further deepened by measuring the share of the sub-component FDI equity capital in such investments by partner country. Changes in these ratios will indicate a greater/lesser contribution to globalisation by the host or investing economy.

71. The indicator based on economic sectors is similar to the previous indicator (by partner country) but the focus this time is on the economic sector for both inward and outward investments. This indicator describes the relative contribution of different economic sectors to the international economic system by the measurement of the share of FDI positions by economic sector abroad or by the measurement of the dependence of the home economic sectors on investments from abroad. Changes in these ratios indicate a greater/lesser contribution to globalisation by individual economic sectors. Furthermore, the analysis can be refined by examining the statistics by partner country and economic sector of the reporting country. However, such statistics, although of analytical interest, remain quite scarce in many countries.

iii) Return on FDI

72. The indicator, based on FDI equity income, provides information regarding the profitability of the direct investment enterprises. For example, when the rate of return of inward FDI [FDI equity income debits – *i.e.* debits for *a)* dividends and distributed branch profits, plus *b)* reinvested earnings and undistributed branch profits – as a per cent of total inward FDI positions] increases, it implies that the resident direct investment enterprises are more profitable and are more and more competitive for investors. However,

observations based purely on the results of the statistical ratios are not sufficient to draw conclusions on the competitiveness of enterprises (or an economy). Many other factors should also be taken into account such as cyclical or structural factors, developments in that sector of economic activity as well as other factors related to the global strategy of the investing enterprise(s).

2.5.2.2. Supplemental indicators

iv) Degree of concentration of FDI

73. This indicator is based on the Herfindahl index to measure the geographical concentration of FDI or the concentration of FDI by economic sector. It is "obtained by squaring the market share of the various players, and then summing those squares".[15] It measures the extent of diversification of the investments *a)* by home and host countries; and *b)* by economic sectors. A decrease in the ratio implies a higher degree of globalisation. In other words, the more investments are diversified geographically the greater is the extent of globalisation.

v) Dynamics of FDI in reporting economy

74. This indicator measures the share of foreign capital in the reporting economy. First of all it compares, at a specific point in time, the positions of FDI enterprises (inward FDI) to the overall liabilities (balance sheet totals) of the domestic sector as reported in the national financial accounts. Likewise, it also compares the positions of direct investors (outward FDI) to total assets (balance sheet totals) of the reporting economy. In the first case, an increase of the ratio implies a higher foreign presence through FDI, thus a higher attractiveness of the reporting economy. In the latter indicator, an increase implies the opposite, *i.e.* an increasing presence by the home economy in foreign markets (which may be more attractive).

vi) Dynamics of FDI by category: cross-country and sectoral analysis

75. This indicator provides detailed information on the relative share of categories of FDI flows and positions for both inward and outward investment. The information is based on aggregate data by sub-components of FDI (equity capital, reinvested earnings and other capital) and by geographical distribution or by economic sector. The focus is specific markets or economies. The patterns of contribution to the market, in its broad definition, will vary across the countries or economic sectors depending on the degree of globalisation and the competitiveness of economies or economic sectors. As the ratio increases, the contribution to globalisation will be more important.

vii) Share of FDI by type

76. Analysing the share of FDI by type is part of the information needed to analyse the impact of FDI particularly in the host economy. Spill-over effects of the investment will vary depending on the type of investment (*e.g.* M&As) and its relative share over total investments of an economy. The ratio if analysed by country and by sector could provide valuable information. However, confidentiality may prohibit the general availability of such detailed information.

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15. Herfindahl Index – Measuring industry concentration by Suresh Krishanmurty.

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Box 2.5. **Frequently asked user questions**

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

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

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

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

Negative outward investments resulting from the directional principle applied to fellow enterprises relates to disinvestment by the resident ultimate controlling parent who receives funds from non-resident subsidiaries. Negative inward investments represent net claims of a resident subsidiary (who has a non-resident ultimate controlling parent) on non-resident fellow enterprises.

The changes in FDI positions are affected by the accumulated flows and hence may also result in negative values, but mainly for other capital (*e.g.* when the loans from the direct investment enterprise to the parent exceed the loans – or even the original capital – given by the parent to the direct investment enterprise. It could be the case where conduits or treasury companies are involved). This is particularly important when FDI statistics are presented on a directional basis given the significance of inter-affiliate transactions and positions in debt.

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

In order to serve users requiring timely data, the compilers of FDI statistics make initial estimates for some components on preliminary information available at that time. It is especially difficult to have timely and at the same time complete data on the accrued income when the results are first published, as these values are only known once the direct investment enterprise has closed its books and the current operating income and earnings distributions have been determined for the reference period.

Consequently, when more complete data are provided for the reference period, data compilers revise the estimates for the previous periods. However, compilers are recommended to provide to the public at large a description of the revisions.

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

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

Box 2.5. **Frequently asked user questions** *(cont.)*

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

Multinational enterprises frequently have recourse to SPEs for their inward and outward direct investments, including the large amounts of capital in transit, passing through entities in jurisdictions which may offer advantages, *e.g.* for tax purposes. Even though transactions/positions with SPEs are included in assets and liabilities of direct investment enterprise, they are no longer included in FDI statistics by partner country or by industry classification. In other words, detailed FDI statistics exclude resident SPEs and look through non-resident SPEs in the analysis of source/destination of FDI. The purpose of looking-through SPEs is to reduce the overstatement of FDI statistics and to provide more realistic analysis and hence estimates of real source/destination of FDI.

However, on a supplemental basis, countries are encouraged to report separately tables on global amounts for outward/inward investments of each compiling country to/from their resident SPEs. Such data will allow users to have a more complete view on the financing of FDI.

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

The statistics on direct investment include cross-border investments made with the objective of establishing a lasting interest to exercise an influence in the management of the direct investment enterprise (the target entity) which is evidenced by the ownership of at least 10% of the voting power by the direct investor. Control by the direct investor of the direct investment enterprise is not necessary to qualify as FDI. The Framework for Direct Investment Relationship establishes the chains of relationships between direct investors and their direct investment enterprises and includes qualifying cross-chain relationships between direct investment enterprises. As such, FDI statistics compiled using the FDIR include certain transactions and positions between fellow enterprises which are not linked through a direct 10% or more ownership of voting power. FDI statistics only record the financial value of the investments. The geographical allocation is based on the debtor/creditor principle excluding resident SPEs.

The statistics on AMNE (also referred to as FATS) cover affiliates which are *controlled* by an enterprise resident in another economy. The *OECD Handbook on Economic Globalisation Indicators* recommends that AMNE statistics cover the majority owned affiliates. In principle, AMNE data cover a sub-set of the entities involved in FDI. The AMNE present detailed data on the foreign affiliates, *e.g.* on the employment, turnover, value added, etc. Nevertheless, the geographical attribution of the units is based on the ultimate controlling (investing) country (for inward investment) or the ultimate hosting country (for the outward data). (See Chapter 8 for more details.)

In theory, FDI and AMNE statistics are very closely related and, therefore, complementary. However, methodologies applied to current FDI and AMNE statistics are not consistent and render difficult the analysis of financial and income flows and positions along with the economic impact of the AMNEs. Introduction of new supplemental FDI inward positions allocated to the ultimate controlling parent is expected to reduce these discrepancies to the extent that samples of enterprises are also harmonised.

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

Several International organisations compile and disseminate FDI data. These include the OECD, Eurostat, the European Central Bank (ECB), IMF, and UNCTAD. FDI statistics of the OECD and Eurostat are essentially based on a common framework for reporting detailed FDI statistics. IMF and ECB compile and disseminate FDI as a functional category of balance of payments.. The data released by the OECD and Eurostat are generally very consistent, as the same data framework is used. Data regarding the Euro-zone is consistent between Eurostat and the ECB. OECD and IMF research demonstrated that the main differences between their aggregate FDI statistics are largely due to the timing of revisions. UNCTAD data are in a number of cases different due to adjustments.

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Chapter 3

Main Concepts and Definitions of Foreign Direct Investment

3.1. Summary

77. This chapter provides an overview of statistical units and the *Framework for Direct Investment Relationships* (FDIR). Rigorous application of these fundamental aspects is central to the implementation of the Foreign Direct Investment (FDI) concepts and recommendations described in this *Benchmark Definition*. It is also important both for the interpretation and use of FDI statistics. Definitions of statistical units which underpin the concepts and treatment of FDI are in line with the general principles adopted in the System of National Accounts (SNA) and the Balance of Payments Manual (BPM) and, therefore, consistent with the concepts and definitions underlying most macro-economic statistics.

78. The first section which describes the statistical units has two main purposes. Firstly it identifies the economic territory to be covered by the FDI statistics and highlights its main features. Secondly, it describes the economic agents that are involved in direct investment, and stresses the importance of the institutional sectors making up the economy even though classification by institutional sector is not used in any of the presentations called for by this *Benchmark Definition*.

79. Thereafter, the FDI universe is described more specifically on the basis of statistical units. The concept of direct investment, direct investor, direct investment enterprise and the relationships between the various units based on the Framework for Direct Investment Relationships are described in detail. The recommended treatment of fellow enterprises is a new feature of the edition of the Benchmark Definition and this section includes details of their definition and treatment.

80. In addition, three principles underpinning the compilation and presentation of FDI statistics are described. They are:

- the debtor/creditor principle
- the *asset/liability* principle, and,
- the *directional* principle.

3.2. Statistical units

3.2.1. Economic territory and the concept of residence [16]

81. The concept of residence is a fundamental factor for direct investment statistics which measure cross-border investments between residents of two or more economic territories. Foreign direct investment includes transactions /positions between a resident and a non-resident institutional unit but excludes all transactions/positions between units that are residents of the same economy.

82. The concept of residence in the *Benchmark Definition* is identical to that adopted by the SNA and the BPM. The residence of an economic entity (or an *institutional unit*) is attributed to the *economic territory* with which it has the strongest connection, in other words its *centre*

16. For a more detailed discussion of these broad statistical concepts, see IMF BPM6.

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of predominant economic interest . Each institutional unit is a resident of one and only one economic territory. While some units, mostly households, may have connections with more than one economy, for statistical consistency, there is a need to attribute a single economic territory to each based on objective and comprehensive criteria.

3.2.1.1. Economic territory

83. An *economy* consists of all the institutional units that are resident in its territory. Most entities have strong links with only one economy, so their residence is clear, but with increasing international economic openness, there is a growing number of institutional units that have connections to more than one economy.

Box 3.1. **The *economic territory***[17]

The *economic territory* includes the following:

i) Land area, airspace, territorial waters, including jurisdiction over fishing rights and rights to fuel or minerals. In a maritime territory the economic territory includes islands that belong to the territory (BPM6 4.5).

ii) Clearly demarcated territorial enclaves that are located in the rest of the world such as embassies, consulates, military bases, scientific stations, information or immigration offices, aid agencies, central bank representative offices, etc. They are established with the formal political agreement of governments of the territories where the land areas are physically located. Such enclaves are used by governments that own or rent them for diplomatic military, scientific or other purposes.

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

iv) When a territory has a separate physical or legal zone that is under its control, but to which, to some degree, separate laws are applied (*e.g.* off-shore financial centres), these special zones should be included in the economic statistics of the territory.

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

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

Source: BPM6: Chapter 4.

84. Even though there is often close correspondence, the statistical definition of the *economic territory* (or the *economy* – see Box 3.1) is not identical to the concept of a country or to any other legal definition (such as nationality). In many cases, but not always, a country indeed constitutes the economic territory. The existence of an institutional unit and the economic territory in which it is resident are determined by a number of criteria including physical presence and being subject to the jurisdiction of the government of the territory.

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

In this *Benchmark Definition*, the term "country" is alternately used as a substitute to "economic territory (and economy)" but not according to any legal framework.

85. Most commonly, an economic territory has the dimensions of physical location as well as legal jurisdiction and is under the economic control of a single government. Economic and currency unions constitute another type of economic territory which is discussed at more length in Annex 11.

3.2.1.2. Centre of predominant economic interest

86. Economic interests[18] include current production, consumption, acquisition of assets and incurrence of liabilities, asset-holding, place of incorporation or registration, and the origin of applicable taxation and regulation.

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

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

ii) if the location, even if it is not fixed, remains within the economic territory;

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

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

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

3.2.2. Institutional units

90. An institutional unit is an economic entity that is capable, in its own right, of owning assets, incurring liabilities and engaging in economic activities and in transactions with other entities (*SNA, 2008, § 4.2*) (see Box 3.2).

91. Institutional units of an economy are classified by the SNA under two main categories: *i)* households (formed by persons or group of persons); *ii)* legal and social entities – corporations (including quasi-corporations), non-profit institutions, and government units – whose existence is recognized by law or society independently of the persons, or other

18. Citizenship and plans for future location are non-economic connections.

Box 3.2. **SNA: Classification of institutional units**[19]

The definition of institutional units covered in this *Benchmark Definition* is fully in line with the concept of the SNA (1993 and subsequent updates) whereby an institutional unit *is an economic entity that is capable, in its own right, of owning assets, incurring liabilities and engaging in economic activities and in transactions with other entitie* [SNA, 2008, Chapter 4].

The main attributes of an institutional unit are:

a) it is entitled to own goods or assets in its own right; it is, therefore, able to exchange the ownership of goods or assets through transactions with other institutional units;

b) it is able to take economic decisions and engage in economic activities for which it is itself held to be directly responsible and accountable at law;

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

d) either a complete set of accounts, including a balance sheet, exists for the unit, or it would be possible and meaningful, from an economic viewpoint, to compile a complete set of accounts if they were to be required.

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

a) ***Households*** are defined in the *SNA* as a small group of persons who share the same living accommodation, who pool some, or all, of their income and wealth and who consume certain types of goods and services collectively, mainly housing and food… (*SNA, 2008,* §4.4) A person who pools income with the household in one economic territory, but is resident of another economic territory, is not classified as a member of that household. Households can be direct investors but not direct investment enterprises.

b) ***Legal and social entities*** are recognised by law or society independently of the persons or other entities that may own or control them. (*SNA, 2008*, §4.6) Such entities include *corporations*, *non-profit institutions* and *government* units. Some unincorporated enterprises belonging to households or government units may behave in much the same way as corporations, and such enterprises are treated as quasi-corporations when they have complete sets of accounts, or such a set of accounts can be constructed (*SNA, 2008,* §4.6). Only business enterprises can be both direct investors and direct investment enterprises; governments and non-profit enterprises can be direct investors but not direct investment enterprises.

entities, that may own or control them. While the *Benchmark Definition* follows the general principles of the SNA to identify institutional units, the treatment of some specific issues concerning cross-border direct investment transactions/positions also need to be addressed.

92. Institutional units are defined by the SNA in the context of a single economy and to identify the residents of that economy. However, a legal entity may have to be split into separate institutional units, resident in different economies, to address the statistical treatment of entities which have strong links with more than one economy. As a result, some arrangements that are not legal entities in their own right may be recognised as being institutional units, *i.e.* quasi-corporations.

19. Only a summary of SNA and BPM concepts are included in this section. For a more detailed discussion of the items therein, the reader should refer to SNA, 2008 and BPM6.

93. A ***quasi-corporation*** is an unincorporated business that operates as if it was an entity separate from its owners. Examples are *branches*, *land ownership*, *partnerships* (both of limited and unlimited liability), *trusts*, and resident portions of *multi-territory enterprises*. These quasi-corporations are treated as if they were corporations, *i.e.* as separate institutional units from the units to which they legally belong. For example, quasi-corporations owned by households or government units are grouped with corporations in the non-financial or financial corporate sectors. The purpose of this treatment is to separate from their owners those unincorporated enterprises which are sufficiently self-contained and independent that they behave in the same way as corporations (*SNA*, 2008, § 4.42-48).

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

95. An *ancillary* corporation is a wholly-owned subsidiary whose productive activities are ancillary in nature: that is, confined to providing services to the parent corporation and/or other ancillary enterprises owned by the same parent corporation. The kinds of services which may be produced by an ancillary unit are transportation, purchasing, sales and marketing, various kinds of financial or business services, computing and communications, security, maintenance, and cleaning. In some cases, the ancillary unit is located in a different economy from the companies it serves. An ancillary corporation is recognized as a separate institutional unit when it is resident in a different economy from that of any of its owners, even if it is not, in practice, autonomous.

3.2.2.1. Enterprises

96. An ***enterprise*** is a sub-group of the broad SNA category *legal and social entities*. It is defined as an institutional unit engaged in production. An enterprise may be *a corporation* (including *quasi-corporations)*, *a non-profit institution*, or an *unincorporated enterprise*. Incorporated enterprises and non-profit institutions are complete institutional units. An unincorporated enterprise, however, refers to an institutional unit – a household or government unit – only in its capacity as a producer of goods and services. It covers only those activities of the unit which are directed towards the production of goods or services (*SNA*, 2008, §5.1).

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

3.2.2.2. Quasi-corporations

98. An unincorporated enterprise is a producer unit which is not a legal entity separate from the owner (household, government or foreign resident); the fixed and other assets used in unincorporated enterprises do not belong to the enterprises but to their owners, the enterprises as such cannot engage in transactions with other economic units nor can

Box 3.3. **Structures related to enterprises**

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

There are two concepts of enterprise groups:

- A multinational enterprise group consists of all the enterprises located in different economies and under the control or influence of the same owner wherever located.
- An economy-specific enterprise group consists of all the enterprises located in the same economy and under the control or the influence of the same owner also located in the same economy. Ownership links that are external to the economy are not recognised in the formation of local enterprise groups.

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

they enter into contractual relationships with other units nor incur liabilities on their own behalf. In addition, their owners are personally liable, often without limit,[20] for any debts or obligations incurred in the course of production. (*SNA, 2008, §4.42, 4.48)* An unincorporated enterprise attached to a non resident is always considered as a quasi corporation.

99. Even though a ***branch*** is not a separate legal entity, it is statistically identified as a quasi-corporation if it operates in an economy separate from that of its owner and has operations over a significant period in that economic territory.[21]

100. To avoid the multiplication of artificial units, the definition of branches requires several indicators of substantial economic activity and separate accounts.

101. The identification of branches has implications for the statistical reporting of both the branch and the legal entity from which the branch has been created. The operations of

20. However, some unincorporated enterprises may have limited liability such as a limited liability partnership.
21. The common usage of the term branch is broader, where a "branch" may also mean establishments, incorporated subsidiaries, or industrial classification group.

the branch should be excluded from the institutional unit of its head office in its home territory and its activities should be reported consistently in both of the economies to which it is connected. Each branch is a direct investment enterprise if the FDI criteria are satisfied.

102. Construction of major specific projects (bridges, dams, power stations, etc.) may take several years to complete and be carried out and managed by non-resident enterprises through site offices in the territory of location. In most instances, the operations managed from the site office satisfy the criteria to be a branch. In other cases, for example, for a short-term project (less than one year) or one based from the home territory rather than a local office, the work provided to customers resident in the territory of those operations is classified as international trade in construction (*i.e.*, an import to the territory of operations).

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

104. Similarly to mobile equipment, a multi-territory pipeline that passes through a territory, but is not operated by a separate legal entity in that territory would be recognized as constituting a branch or not, depending on whether there is substantial presence, availability of separate accounts, etc. Where such operations are not separate entities, there may be a multi-territory enterprise as described below.

105. When a branch is identified, there are direct investment flows to and from the territory of its location, but the provision of goods or services to customers in that territory are resident-to-resident transactions. In contrast, if the operations are not substantial enough to qualify as a branch, the provision of goods or services to customers in that territory are imports of that territory.

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

107. A resident ***notional unit*** (a kind of a quasi-corporation) is identified for statistical purposes for direct non-resident ownership of immobile non-financial assets such as land and buildings. Land and buildings can only be used for production in the territory in which

they are located. Therefore, the land and buildings and other structures owned by a non-resident are always treated as being owned by a resident notional institutional unit that is in turn owned by a non-resident unit(s) holding the legal title.

108. Consistent with this treatment, a notional unit is imputed for the ownership by non-residents of natural resources such as subsoil assets, non-cultivated biological resources, and water, and long-term rights to use these assets. The notional unit is nearly always a direct investment enterprise.[22]

109. ***Multi-territory enterprises*** operate as a seamless operation over more than one economic territory. Such an enterprise, even though it has substantial activity in more than one economic territory, cannot be separated into a parent and branch(es) because it is run as a seamless operation and cannot supply separate accounts for each territory. Multi-territory enterprises are typically involved in cross-border activities and include shipping lines, airlines, hydroelectric schemes on border rivers, pipelines, bridges, tunnels, and undersea cables.[23] Some non-profit institutions serving households (NPISH) may also operate in this way.

110. It is preferable that a parent and branch(es) be identified separately in the case of a multi-territory enterprise. If possible, enterprises should be identified in each territory according to the principles for identification of branches. If that is not feasible because the operation is so seamless that separate accounts could not be developed, it is necessary to prorate the total operations of the enterprise into the individual economic territories. The factor used for prorating should be based on available information that reflects the contributions to actual operations. The prorating of the enterprise implies that every transaction needs to be split into each component economic territory, a process which may be difficult to implement by compilers. Hence, for the country of residence, each apparently/ostensibly domestic transaction would be split into resident and non-resident components. Equally, non-resident entities of those economies outside the territories of the multi-territory enterprises that have transactions and positions with such entities need to make the same split, so as to capture the counterparty claims in a consistent manner. Bilateral agreements between compilers will help to minimise possible asymmetries.[24] This treatment has implications for other macroeconomic statistics and its implementation should always be co-ordinated with other statistical interests for consistency. Compilers in each of the territories involved are encouraged to co-operate in order to develop consistent data, avoid gaps, and minimize respondent and compilation burden.

111. Analogous treatments can be applied to enterprises operating in zones of joint jurisdiction – the enterprise will need to be split into entities that are resident in each economy having jurisdiction over the zone, with flows into and out of the enterprise pro-rated between these entities. Positions and flows between the entities may also need to be developed.

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

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

24. The identification and allocation of income flows within a multi-territory enterprise, and the treatment of changing the identification of the "parent" over time are on the research agenda.

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

113. *Special corporate structures*, such as those with little or no physical presence, holding companies, nominees, etc., are discussed more in detail in Chapter 6.

3.2.3. Institutional sectors

114. The *Benchmark Definition* does not require as part of the standard data components a classification of direct investment statistics by institutional sectors: the emphasis is given instead to industry classification.[25] However, identifying the institutional sector of the resident party and the non-resident counterparty is important information for the compiler in determining whether or not a transaction/position should be included in direct investment statistics. Classification principles for resident and non-resident institutional sectors are based on the enterprise's primary activity, which is determined by its principal product or group of products produced or distributed, or services rendered.

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

116. Annex 3 Box A.3.1 provides further information on institutional sectors and, in particular, the subsectors of the financial corporation sector. For the purposes of collecting and compiling FDI statistics, it is important to collect and compile information from local enterprise groups, for those parts of the local enterprise group that are classified to the financial intermediaries subsectors separately from those parts that are not classified to the financial intermediaries subsectors. Box 3.3 provides further information for compilers for structures related to enterprises such as enterprise groups and joint ventures.

3.3. Foreign direct investment

117. *Foreign direct investment* reflects the objective of establishing a lasting interest by a resident enterprise in one economy (*direct investor*) in an enterprise (*direct investment enterprise*) that is resident in an economy other than that of the direct investor. The lasting interest implies the existence of a long-term relationship between the direct investor and the direct investment enterprise and a significant degree of influence on the management of the enterprise. The direct or indirect ownership of 10% or more of the voting power [26] of

25. In contrast, the *Balance of Payments and International Investment Position Manual* uses sector classification, rather than industry breakdowns, as the primary disaggregation of an economy's structure for all its functional categories.

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

an enterprise resident in one economy by an investor resident in another economy is evidence of such a relationship. Some compilers may argue that in some cases an ownership of as little as 10% of the voting power may not lead to the exercise of any significant influence while on the other hand, an investor may own less than 10% but have an effective voice in the management. Nevertheless, the recommended methodology does *not* allow any qualification of the 10% threshold and recommends its strict application to ensure statistical consistency across countries.

118. Direct investment includes the initial equity transaction that meets the 10% threshold and all subsequent financial transactions and positions between the direct investor and the direct investment enterprise, as well as qualifying FDI transactions and positions between incorporated and unincorporated fellow enterprises included under the FDIR (see Section 3.4). Direct investment is not solely limited to equity investment but also relates to reinvested earnings and inter-company debt (see Chapter 4).

119. Direct investment includes inward and outward financial transactions/positions between directly and indirectly owned incorporated and unincorporated enterprises.[27] The extent of the direct investment relationship is determined according to the Framework for Direct Investment Relationships (see Section 3.4.3).

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

3.4. The direct investment relationship

121. The classification of financial positions and flows to direct investment requires that the two institutional units directly involved be resident in different economies and that they be in a direct investment relationship. This section presents the framework that has been developed to establish when two or more institutional units are in a direct investment relationship. While direct investment measures a wide variety of instruments as described in Chapter 4, direct investment relationships are determined using the voting power criterion only.

3.4.1. Foreign direct investor

122. A foreign direct investor is an entity (an institutional unit) resident in one economy that has acquired, either directly or indirectly, at least 10% of the voting power of a corporation (enterprise), or equivalent for an unincorporated enterprise, resident in another economy. A direct investor could be classified to any sector of the economy and could be any of the following:

- *i)* an individual;
- *ii)* a group of related individuals;
- *iii)* an incorporated or unincorporated enterprise;
- *iv)* a public or private enterprise;
- *v)* a group of related enterprises;

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

vi) a government body;

vii) an estate, trust or other societal organisation; or

viii) any combination of the above.

123. In the case where two enterprises each own 10% or more of each other's voting power, each is a direct investor in the other.

3.4.2. Foreign direct investment enterprise

124. A direct investment enterprise is an enterprise resident in one economy and in which an investor resident in another economy owns, either directly or indirectly 10% or more of its voting power if it is incorporated or the equivalent for an unincorporated enterprise.

125. The numerical threshold of ownership of 10% of the voting power determines the existence of a direct investment relationship between the direct investor and the direct investment enterprise. An ownership of at least 10% of the voting power of the enterprise is regarded as the necessary evidence that the investor has sufficient influence to have an effective voice in its management. In contrast to some other statistical measures such as those on the Activities of MNEs, direct investment does not require control by the investor (*i.e.* more than 50% owned by the investor and/or its related enterprises). Direct investors may have direct investment enterprises in one economy or in several economies.

126. To facilitate international comparisons and to achieve global consistency of FDI statistics, the *Benchmark Definition* recommends a strict application of the 10% rule. Therefore, compilers should not qualify the 10% threshold further by applying other criteria. The *Benchmark Definition* does not recommend the use of other considerations such as representation on the board of directors; participation in policy-making processes; material inter-company transactions; interchange of managerial personnel; provision of technical information; and provision of long-term loans at lower than existing market rates.

3.4.3. Framework for direct investment relationships (FDIR)

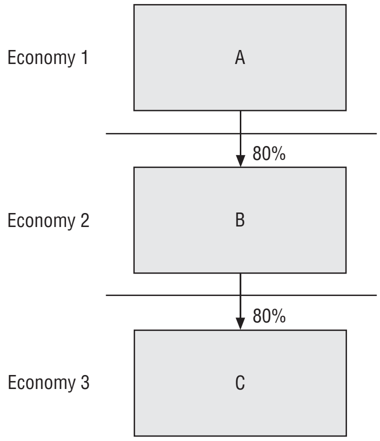
127. The definitions of direct investors and direct investment enterprises above highlight the immediate relationship between two enterprises. As noted earlier, the legal structures of related enterprises can consist of many enterprises linked through complex ownership chains.

128. The Framework for Direct Investment Relationships (FDIR) is a generalised methodology for identifying and determining the extent and type of direct investment relationships. In other words, the FDIR allows compilers to determine the population of direct investors and direct investment enterprises to be included in FDI statistics.

129. For a compiling economy, the FDIR identifies all enterprises related to a particular enterprise whether it is a direct investor or a direct investment enterprise or both. For example, within a group, it is possible that a direct investment enterprise itself owns 10% or more of the voting power of another non-resident enterprise, in which case the direct investment enterprise is itself a direct investor in a further direct investment enterprise. The question is therefore whether there is a direct investment relationship between the further enterprise and the original enterprise.

130. In Figure 3.1, enterprises A, B and C are in different economies. Enterprise A owns 80% of the voting power in enterprise B and is a direct investor in B. Enterprise B, in turn,

Figure 3.1. **Continuation of Control**

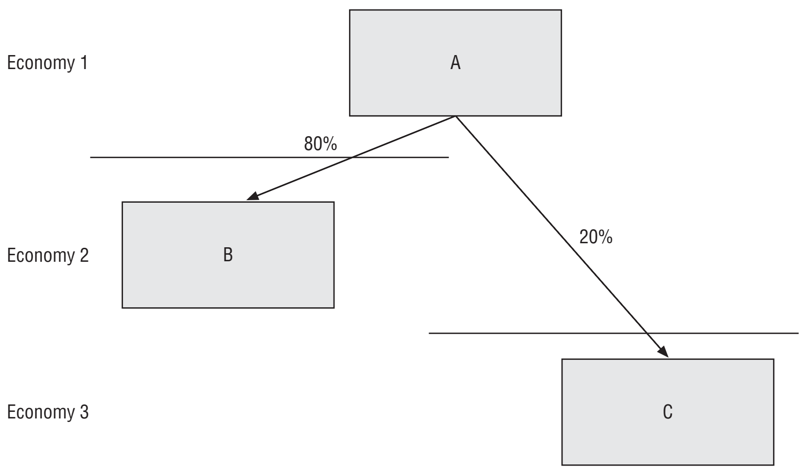


owns 80% of the voting power in enterprise C and is a direct investor in C. A has control over B, and through its control over B, has indirect control over C. As a result, financial transactions between A and C are also relevant to FDI, even though A directly holds no equity in C, and A and C are therefore considered to be in the direct investment relationship which embraces A, B and C. Financial transactions and positions as well as associated income flows between A, B and C should be included in direct investment statistics.

131. In relatively simple cases such as that in Figure 3.1, where each link in the ownership chain is a single equity holding and there is majority ownership (control) at each stage, it is clear that the direct investment relationship continues down the chain of ownership. However, when some links are non-controlling links and voting power of an enterprise is held by more than one member of a direct investment relationship, the extent of the relationship may be less obvious.

132. It is not uncommon for an entity to be a direct investor in more than one direct investment enterprise. In Figure 3.2, enterprises A, B and C are each in different economies. Enterprise A owns 80% of the voting power in enterprise B and is a direct investor in B.

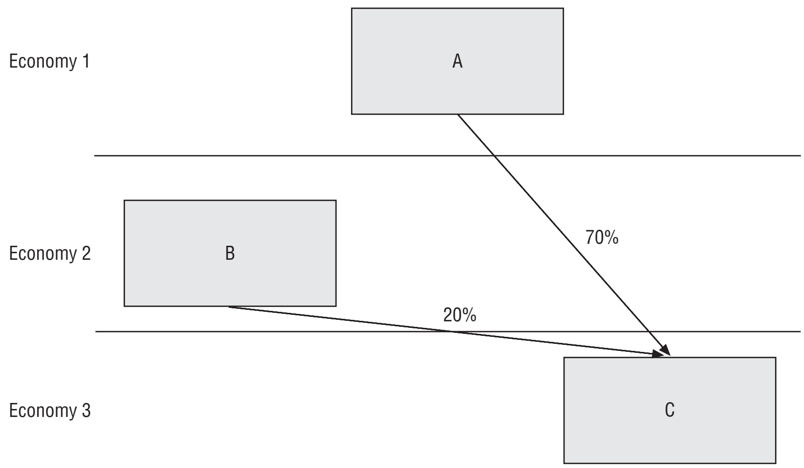
Figure 3.2. **Fellow enterprises**



Enterprise A also owns 20% of the voting power in enterprise C and is a direct investor in C. Enterprise A controls B and has significant influence over C. As a result, financial transactions and positions between B and C are also relevant to FDI statistics even though there is no equity participation between them. For example, B may raise capital which it lends to C at a concessional rate due to the control by A. It is reasonable to consider A, B and C to be in the same direct investment relationship – B and C are considered "fellow enterprises" of one another.

133. In Figure 3.3, there are two overlapping direct investment relationships, one with enterprise A as the direct investor and the other with enterprise B as the direct investor. The direct investment enterprise, C, is in a direct investment relationship with both A and B. Enterprise C is controlled by direct investor A, which owns 70% of the voting power of C, and C is significantly influenced by direct investor B, which owns 20% of the voting power of C. Despite their common ownership of C, enterprises A and B are not in a direct investment relationship with each other.

Figure 3.3. **Multiple direct investors**



134. The FDIR aims at identifying all enterprises over which the investor has significant influence under the 10% voting power criterion for FDI. In this determination, it is necessary to establish whether each enterprise under consideration is a *subsidiary*, an *associate*, or is *not relevant in FDI* – all three categories when combined being exhaustive and individually mutually exclusive. Those enterprises which are subsidiaries or associates are included in the direct investment relationship, while those categorised as *not influenced* are not included.

3.4.3.1. Subsidiaries in FDI

135. Subsidiaries in FDI are described as follows:

i) A subsidiary is an enterprise in which an investor owns more than 50% of its voting power *i.e.* it is controlled by the investor;

ii) Where an investor and its subsidiaries combined own more than 50% of the voting power of another enterprise, this enterprise is also regarded as a subsidiary of the investor for FDI purposes;

iii) In determining the scope of a direct investment relationship, the degree of influence that may be exercised through controlling links (more than 50% of voting power) is not diminished by the existence of multiple links in an ownership chain.

- ❖ An enterprise controlled by a subsidiary of an investor or by a group of subsidiaries (which may also include the investor) is itself regarded as a subsidiary for FDI purposes.
- ❖ However, for clarification, it should be stressed that an enterprise controlled by an associate or any group including an associate is regarded as an associate in the context of FDI.

3.4.3.2. Associates in FDI

136. Associates in FDI are described as follows:

i) An associate is an enterprise in which an investor owns directly at least 10% of the voting power and no more than 50%;

ii) Where an investor and its subsidiaries combined own at least 10% of the voting power of an enterprise but no more than 50%, the enterprise is regarded as an associate of the investor for FDI purposes;

iii) Where an associate, either as an individual or in combination with its subsidiaries, own more than 50% of an enterprise, this enterprise is regarded for FDI purposes as an associate of the higher level investor;

iv) In determining the scope of a direct investment relationship involving associates, the degree of influence that may be exercised through a single or cumulative influencing link (from 10% to 50%) along an ownership chain is diminished by one degree. Thus, an enterprise which is an associate of a subsidiary – or of a group of the investor's subsidiaries (which may include the investor) is regarded as an associate of the investor for FDI purposes.

3.4.3.3. Not relevant in FDI

137. The following are not relevant in FDI:

i) An enterprise in which an investor owns less than 10% of its voting power is regarded as not influenced by the investor and is therefore out of the scope of the FDIR. However, it should be stressed that a particular investor in a chain of ownership within the FDIR may indirectly hold less than 10% (but more than 0%) of an enterprise's voting power; this enterprise should be included in the FDIR as a subsidiary or an associate of the investor if the relevant criteria described earlier in sub-section 3.4.3 are fulfilled *e.g.* as in the description of associates in the preceding section;

ii) It should be also noted that an enterprise which is an associate of an enterprise associated to an investor is not influenced by this investor in the context of FDI, *i.e.* it is not regarded as an associate of the investor within the FDIR.

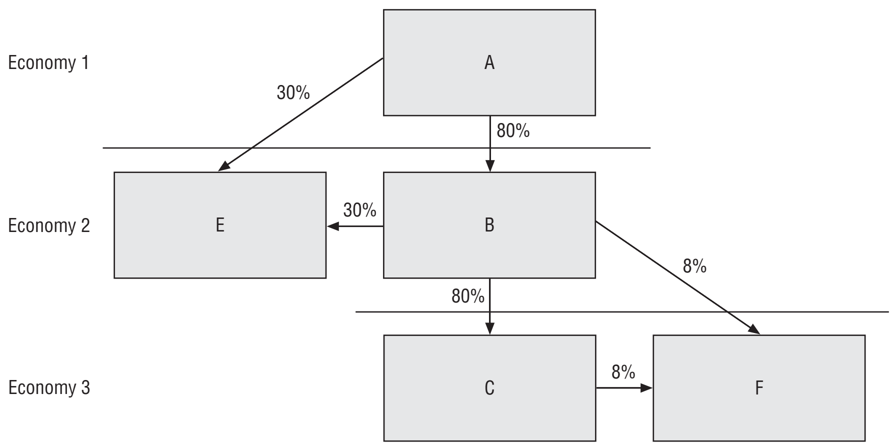
3.4.3.4. Fellow enterprises in FDI

138. The coverage of subsidiaries and associates within the FDIR along what might be termed vertical FDI ownership chains is generally relatively straightforward. However, an enterprise in one economy may be related through the FDIR to another enterprise in the

same economy, or in a different economy, without either being a direct investor in the other, but through both being directly or indirectly influenced by the same enterprise in the ownership hierarchy. This "common parent" must be a direct investor in at least one of enterprises in question. Such enterprises can be considered to be related through a horizontal' linkage within the FDIR – not involving FDI equity of 10% or more – and are called fellow enterprises. It should be noted, however, that for FDI statistics, only cross-border transactions and positions between FDI-related enterprises should be recorded. Where there is no voting power acquired in a fellow enterprise, or where less than 10% of the enterprise's voting power is obtained, all the investment made by one fellow enterprise in one economy in its fellow in another economy is included in FDI statistics but needs to be distinguished in compiling the data to facilitate the preparation of FDI data on both the asset/liability and directional presentational bases referred to in Section 2.4. Therefore, for a particular compiler, fellow enterprises may be considered as those resident and non-resident enterprises related within the FDIR other than those which have a direct investor-direct investment enterprise relationship (*i.e.* under the 10% or more voting power criterion) with one another. It is likely that many fellow enterprises will be direct investment enterprises in their own right but, clearly, some will not. For example, if a resident direct investor, A, has a direct investment enterprise abroad, B, as well as a resident subsidiary, C, then C, by definition, is not a direct investment enterprise of A, but B and C are fellow enterprises within the FDIR covering A, B and C.

139. Therefore, the direct investment relationship extends in both directions along an ownership chain from an enterprise to cover all of its subsidiaries and associates and all of the investors within the FDIR for which the enterprise is a subsidiary or an associate. It also covers "across chain" relationships as described below and in Figure 3.4 (see also Annex 4).

Figure 3.4. **Joint ownership**



140. It should be noted that identifying the extent of a direct investment relationship from an investor, B, which is an associate of another investor, A, may identify enterprises in a direct investment relationship with enterprise B that are not in a direct investment relationship with enterprise A. Determining the existence of one or more direct investment relationships under the FDIR depends largely on whether a common parent exists for enterprises in different ownership chains.

141. It must be stressed that direct investment is only recorded when there is a financial transaction or position between entities in different economies that are in a direct investment relationship (including fellow enterprises). However, it should also be noted that the residence of units is not a feature of the definition of subsidiaries and associates for FDI purposes. The FDIR may include within the relationship enterprises that are resident in the same economy.

142. Figure 3.4 also highlights that equity positions within one economy may be important in determining the extent of a direct investment relationship. Despite being resident-to-resident positions, the equity positions between enterprises B and E and between enterprises C and F are part of the equity determining the relationship between enterprises A and E and between enterprises A and F.

143. Box 3.4 below summarises the principles and norms that determine the extent of a direct investment relationship.

Box 3.4. **Direct investment relationships**

Basic types of enterprises:

- A *subsidiary* is an enterprise in which the investor has control of more than 50% of the voting power;
- An *associate* is an enterprise in which the investor has control of at least 10% of the voting power and no more than 50%;
- *Fellow enterprises* are enterprises which do not have enough (or any) voting power in each other to constitute FDI influence but have a common parent.

Principles for extending the relationship through indirect ownership:

- A series of subsidiaries can continue as long as control exists at each stage in the ownership chain – a chain such as that in Figure 3.1 can continue indefinitely;
- Any subsidiary can extend the FDI relationship to an associate by owning from 10% to 50% of the voting power of that enterprise;
- An associate can extend the FDI relationship to another associate of the higher level investor only by owning more than 50% of the voting power of that enterprise. Such a chain of associates can be extended as long as majority ownership of voting power exists at each stage.

Basis for extending the relationship through joint ownership:

- Where the investor and its subsidiaries combined own more than 50% of the voting power of an enterprise, this enterprise is a subsidiary of the investor;
- Where the investor and its subsidiaries combined own at least 10% of the voting power of an enterprise but no more than 50%, this enterprise is an associate of the investor;
- Where an investor's associate and the associate's subsidiaries combined own more than 50% of the voting power of an enterprise, the enterprise is an associate of the investor.

144. Recognising practical difficulties compilers may encounter in fully applying the FDIR, two alternative methods may be applied: the "participation multiplication" method, and the "direct influence/indirect control" method. Should compilers choose to apply either of

these alternative methods due to practical difficulties in implementing the FDIR, they should include this information in their metadata. However, such countries should endeavour to move towards applying the FDIR over time.

145. Annex 4 provides more information and further examples concerning the determination of the extent of the direct investment relationship under the FDIR along with the two alternative methods. It also describes the practical implementation of the FDIR for measuring investment income credits and debits, and for classifying financial account transactions and international investment positions.

3.4.4. The debtor/creditor principle

146. In compiling and presenting FDI statistics, account must be taken that information on the funding received or provided or on the associated FDI income flows may be collected by different means and from different sources. The geographical allocation of the amounts involved, firstly determining whether they are between residents and non-residents and then, for the latter, determining the specific economy involved, depends on the allocation method used. This *Benchmark Definition* strongly recommends the use of the *debtor/creditor* principle. A *debtor* is a person or an entity which has a financial obligation to another person or entity. Conversely, a *creditor* is a person or entity which has a financial claim on another person or entity. Therefore, a debtor has a financial liability to a creditor and a creditor has a financial claim (an asset) on a debtor. For FDI statistical purposes, under the debtor/creditor principle, the FDI assets (both transactions and positions) of the compiling economy are allocated to the economies of residence of the non-resident debtors; its FDI liabilities are allocated to the economies of residence of the non-resident creditors allocated on the basis of the debtor/creditor principle. Therefore, adherence to this principle – although in some cases it may be difficult to implement – results in a complete and conceptually consistent set of flows and stocks data at a country or regional level. Use of other allocation approaches (such as the economy of the transactor) can lead to incorrect results between transactions and positions at bilateral (country or regional) level.

3.4.5. The asset/liability principle and the directional principle

147. This *Benchmark Definition* recommends that FDI data be presented in two ways: on a straightforward asset/liability basis (*i.e.* under the *asset/liability* principle) and reflecting the direction of direct investment influence within the context of the FDIR (*i.e.* under the *directional* principle). The two principles are described as follows:

- ***Asset/Liability principle.*** Under this approach, a compiling economy reports for resident institutional units classified under the FDIR as direct investors, direct investment enterprises or as fellow enterprises, all FDI financial claims on and obligations to non-residents using the normal balance sheet data showing gross assets and liabilities for positions, and net transactions for each category. The data presented on this basis, while compiled distinguishing the nature of the relationship between the FDIR counterparts, do not incorporate any offsetting of reverse direct investment transactions or positions in equity or debt between a direct investment enterprise and its direct investor. Similarly, the asset/liability presentation does not incorporate any offsetting of any transactions or positions between fellow enterprises (see *directional principle*).
- ***Directional principle.*** Presentation of the FDI data on a directional basis is designed to provide users with information reflecting the direction of influence underlying

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the direct investment. This requires a compiling economy to determine whether the investment was *inward* (labelled as *inward foreign direct investment*) *i.e.* that the influence giving rise to it originated abroad, and that it resulted in the establishment by a non-resident direct investor of a direct investment enterprise resident in that economy; or that it was *outward* (labelled as *outward foreign direct investment*) *i.e.* that the influence giving rise to it originated within the compiling economy, and that it resulted in the establishment by a resident direct investor of a direct investment enterprise abroad. This was also the recommendation in the previous edition of the *Benchmark Definition*. In the latest edition, the application of the directional principle has been extended to cover transactions and positions between fellow enterprises covered by the FDIR. In this context, the determination by a compiling economy of the direction of the investment (inward or outward) transactions and positions between a resident fellow enterprise and a non-resident fellow enterprise is made by reference to the broad residency of the ultimate controlling parent (*i.e.* whether it is resident or non-resident) of the fellow enterprises. If the ultimate controlling parent is a resident of the compiling economy, then the transactions and positions between the two fellow enterprises are categorised as *outward foreign direct investment*; if the ultimate controlling parent is not a resident of the compiling economy, then the transactions and positions between the two fellow enterprises are categorised as *inward foreign direct investment*. Where reverse investment exists or where investment occurs between fellow enterprises, this treatment is very likely to result in the overall inward direct investment position for an economy being lower in magnitude than the overall direct investment liability position presented on an asset/liability basis. The equivalent outcome to that for overall inward direct investment will also result for the overall outward direct investment position data compared to the overall direct investment assets. Depending on the particular investment circumstances which may exist in a reference period, similar, or indeed opposite, effects may arise when comparing the two presentations for FDI transactions data.

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Chapter 4

FDI Components, Accounts and Scope

4.1. Summary

148. This chapter describes the components, accounts and scope of foreign direct investment (FDI).

149. Chapters 2and 3 both emphasized how it is only voting power, usually derived from owning voting equity, which is used to determine whether a direct investment relationship exists. However, once the relationship exists, measures of the direct investment between enterprises resident in different economies covered in the Framework for Direct Investment Relationship (FDIR) include all immediate equity and debt positions and transactions between the related parties.

150. The first part of this chapter discusses the components of FDI which cover the types of financial instruments involved in direct investment transactions/positions. This is followed by a discussion of the accounts which represent the three measures concerning FDI, *i.e.* foreign direct investment positions, FDI financial transactions and FDI income. Each of these three measures includes detailed accounts that serve as building blocks for FDI. These building blocks can be arranged in different presentations that will be explained in this chapter. A fourth account referred as the "other changes" account provides the link between the financial transactions and the positions.

151. The third part of this chapter discusses the scope of FDI in terms of the presentation of aggregated *versus* detailed FDI statistics and the differences concerning their coverage, inclusions and exclusions.

4.2. FDI components

152. The main financial instrument components of FDI are *equity* and *debt instruments* (see Box 4.1). *Equity* includes *common and preferred shares* (exclusive of non-participating preference shares which should be included under debt), *reserves*, capital contributions and *reinvestment of earnings*. All cross-border positions and transactions in equity between FDI-related enterprises (see Chapter 3) are included in FDI. *Dividends*, distributed branch earnings, *reinvested earnings* and *undistributed branch earnings* are components of FDI income on equity.

153. Debt instruments include marketable securities such as bonds, debentures, commercial paper, promissory notes, non-participating preference shares and other tradable non-equity securities as well as loans, deposits, trade credit and other accounts payable/ receivable. All cross-border positions and transactions related to these instruments, between enterprises covered by an FDI relationship other than between related financial intermediaries are included in FDI. The interest returns on the above instruments are included in FDI income on debt.

154. Positions and transactions in financial derivatives between entities in a direct investment relationship should be excluded from direct investment.

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155. Direct investment assets and liabilities for both equity and debt can be further classified by the nature of the relationship between the resident and non-resident FDI counterpart to the FDI position or transaction.

- *Direct investment assets* can be ascribed to the following three categories:
  - *i)* investment by a resident direct investor in its non-resident direct investment enterprises;
  - *ii)* reverse investment by a resident direct investment enterprise in its non-resident direct investor(s);
  - *iii)* investment by a resident fellow enterprise in non-resident fellow enterprises.
- *Direct investment liabilities* can be ascribed to the following three categories:
  - *i)* investment of non-resident direct investor in resident direct investment enterprises;
  - *ii)* reverse investment of non-resident direct investment enterprises in resident direct investors;
  - *iii)* investment of non-resident fellow enterprises in resident fellow enterprises.

156. These three categories of assets and liabilities lead to the classes and sub-classes itemised in the account presentations that follow. These categories are useful for analysis. In the first category, the financing flows in the same direction as the influence or control, from the direct investor to the direct investment enterprise. This is in line with the core principle for direct investment that a direct investor acquires influence or control through the provision of financing.

157. In the second category *reverse investment*, financing flows in the opposite direction as the influence or control. This category reflects the reverse of the standard FDI financing flows as the direct investor uses its influence to have its direct investment enterprises provide equity or debt financing for its own operations (see Section 4.3 for further details). Such investments, defined as *reverse investments,* are limited to cases where the acquisition of voting power by a direct investment enterprise in its direct investor does not meet the 10% criterion for establishing a separate direct investment relationship in its own right.

158. The last category shows financing involving fellow enterprises that have no direct investment influence upon one another (*i.e.* the 10% voting power criterion is not met as there is not sufficient equity ownership in each other) but have a common parent.

159. Reinvested earnings and reinvestment of earnings are separately identified components of equity in the *FDI income account* and in the *FDI transactions account* respectively. These flows are identified only between the direct investment enterprise and its immediate direct investors (although the value of these flows should reflect income earned from directly and indirectly owned direct investment enterprises through the current operating performance concept, see Annex 6). In cases where the equity asset holder has less than 10% voting power (*reverse investment* and investment in fellow enterprises), reinvested earnings and reinvestment of earnings are not recorded.

160. In summary direct investment equity and debt are *a)* financing provided by a direct investor to a directly or indirectly owned direct investment enterprise or *b)* financing received from a directly or indirectly owned direct investment enterprise by a direct investor or *c)* financing provided by or to fellow enterprises.

Box 4.1. **Financial instruments related to foreign direct investment**

Equity: Comprises: *i)* equity in branches; *ii)* all shares in subsidiaries and associates (except non-participating, preferred shares that are treated as debt securities and included under direct investment, debt instruments); and *iii)* other contributions of an equity nature. Ownership of equity is usually evidenced by shares, stocks, participations, depositary receipts or similar documents. Shares and stocks have the same meaning while depositary receipts are securities that represent ownership of securities by a depositary. This category includes proprietors' net equity in quasi-corporations, as well as shares and equity in corporations. It also includes preferred stocks or shares that provide for participation in the residual value on dissolution of an incorporated enterprise. Reinvestment of earnings comprises the claim of direct investors (in proportion to equity held) on the retained earnings of direct investment enterprises. Reinvestment of earnings represents financial account transactions that contribute to the equity position of a direct investor in a direct investment enterprise.

Deposits: Typical forms of deposits include savings deposits, term deposits, transferable and non-transferable deposits in local or foreign currencies (see the SNA guidelines for a more specific definition of deposits).

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

Loans: Loans are financial assets that are created when a creditor lends funds directly to a debtor through an instrument that is not intended to be traded. This category includes all loans and advances (except accounts receivable/payable which are treated as a separate category of financial assets). It also covers the treatment of financial leases and repurchase agreements.

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

Other accounts receivable/payable includes advances and deferred payments in respect of exchange of non-produced assets.

Note: Financial derivatives are not included in direct investment.

161. Within *reverse investment*, direct investment enterprises may raise loans which they on-lend to their direct investor, or may make loans to their direct investor from their own resources, so-called reverse investment. Such loans should be treated as direct investment debt and be included in the direct investment statistics. Similarly, loans involving fellow enterprises should be included under *debt* in direct investment statistics.

162. It is important to stress that all debt transactions and positions directly between two financial intermediaries within a direct investment relationship should be excluded from direct investment statistics (see Section 4.4.3 Banks and other financial intermediaries).

163. Direct investors may make loans to or borrow funds from their indirectly owned direct investment enterprises. An indirect ownership interest exists when a direct investment enterprise that is directly owned, in turn, has an equity holding in another non-resident direct investment enterprise, thereby making the first direct investment enterprise a direct investor in the second direct investment enterprise. In this example, the direct investor at the top of the ownership chain holds an indirect ownership interest in the

enterprise at the bottom of the ownership chain. Transactions and positions between all these directly and indirectly owned enterprises should be included in direct investment if they meet the requirements of the FDIR (see Section 3.4.3).

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

165. A direct investment enterprise or a fellow enterprise may also have loans or balances due to or from fellow enterprises abroad. None of these related enterprises needs to hold a 10% or more voting power in the other as long as they have directly or indirectly a common parent.

166. As a result, financial transactions and positions between an enterprise and its fellow enterprise, both included in the FDIR, are part of FDI, even though there may be no equity participation between them. For example, B, a direct investment enterprise of A, may raise funds which, under instructions from A, it lends to C, another direct investment enterprise of A. Such transactions/positions should be considered direct investment between the economy of B and the economy of C, even though there is no equity participation between B and C. Similarly, if a resident direct investor, A, has a direct investment enterprise abroad, B, as well as a resident subsidiary, C, then C is, by definition, not a direct investment enterprise of A, but B and C are fellow enterprises within the FDIR covering A, B, and C. Therefore, transactions between B and C should be recorded as direct investment.

4.3. FDI accounts

167. The main accounts for presenting FDI statistics are *FDI positions*, *FDI transactions* and *FDI income*. These accounts are described below along with a description of other changes that may impact on the value of FDI positions and transactions.

168. Building on the three categories of assets and liabilities and the descriptions of the previous section, six classes of direct investment *assets* and six classes of direct investment *liabilities* can be defined that will serve as the building blocks for the presentations of FDI statistics described in this section. These building blocks are consistent with the information requirements of earlier editions of the *Benchmark Definition*. The classes of assets and liabilities in or to fellow enterprises are further subdivided into two sub-classes according to the residence of the ultimate controlling parent (UCP), *i.e.* the direct investor at the top of the control chain.

- *Direct investment assets*: (FDI assets = A1 + A2 + A3 + A4 + A5 + A6).
  - ❖ A1: Equity assets of direct investors in direct investment enterprises.
  - ❖ A2: Debt instrument assets of direct investors in direct investment enterprises.
  - ❖ A3: Equity assets of direct investment enterprises in their direct investors (reverse investment).
  - ❖ A4: Debt instrument assets of direct investment enterprises in their direct investors (reverse investment).

- ❖ A5: Equity assets in fellow enterprises abroad.
  - – A5.1: If ultimate controlling parent is resident.
  - – A5.2: If ultimate controlling parent is non-resident.
- ❖ A6: Debt instrument assets in fellow enterprises abroad.
  - – A6.1: If ultimate controlling parent is resident.
  - – A6.2: If ultimate controlling parent is non-resident.

- *Direct investment liabilities*: (FDI liabilities = L1 + L2 + L3 + L4 + L5 + L6).
  - ❖ L1: Equity liabilities of direct investment enterprises to direct investors.
  - ❖ L2: Debt instrument liabilities of direct investment enterprises to direct investors.
  - ❖ L3: Equity liabilities of direct investor to their direct investment enterprises (reverse investment).
  - ❖ L4: Debt instrument liabilities of direct investor to their direct investment enterprises (reverse investment).
  - ❖ L5: Equity liabilities to fellow enterprises abroad.
    - – L5.1: If ultimate controlling parent is non-resident.
    - – L5.2: If ultimate controlling parent is resident.
  - ❖ L6: Debt instrument liabilities to fellow enterprises abroad.
    - – L6.1: If ultimate controlling parent is non-resident.
    - – L6.2: If ultimate controlling parent is resident.

169. These building blocks are based on balance sheet entries of direct investors, direct investment enterprises and fellow enterprises.

170. Each of these classes can be also classified by the industrial activity and residence of the counterparties. Discussion of these dimensions is covered in Chapter 7.

171. These building blocks can be arranged in different presentations suitable for a variety of analytical requirements. Macroeconomic accounts, balance of payments and the national accounts present financial data primarily on an asset and liability basis. Thus, FDI data on this basis are useful when analysing direct investment in relation to other macroeconomic variables of the external sector of the economy. In addition, most FDI data are compiled as part of the balance of payments programs in each country, bridging macroeconomic accounts and other presentations of FDI statistics.

172. The *Benchmark Definition* also calls, as prescribed in its earlier editions, for the presentation of FDI statistics according to the directional principle which requires the rearrangement of some of these building blocks. Data presented on the basis of the directional principle are better suited for some types of analysis. In particular it is the preferred presentation for industry and country data described later in this *Benchmark Definition*. Under the directional principle, when the direct investment enterprise holds less than 10% of the voting power in its direct investor, any reverse investment (either equity or debt) from the direct investment enterprise to its direct investor is to be accounted for under outward or inward FDI (as appropriate) as opposed to the asset/liability equivalent.

173. Similarly, recording of transactions and positions between fellow enterprises under the directional principle (categories A5, A6 and L5, L6) is to be made as appropriate by transposing where necessary their asset/liability equivalents to provide the directional information. This generally results in overall outward and inward FDI statistics being lower

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in magnitude than those presented on an asset/liability basis (but cases can arise where the opposite occurs). In order to apply the directional principle as presented in the exhibits below, the recording of direct investment between fellow enterprises (*i.e.* where they are covered by the FDIR) is to be presented according to the residence of the immediate counterpart but the direction of the investment is to be determined according whether the ultimate controlling parent is a "resident" or a "non-resident" of the compiling economy. In other words, if the ultimate controlling parent is not a resident of the compiling economy, all transactions and positions between the fellow enterprises are classified as inward FDI. If the ultimate controlling parent is resident in the compiling economy, all transactions and positions between that fellow enterprises are classified as outward FDI. Once the direction of the transaction/position is determined, in either case, the geographical allocation should be made on the basis of the location of the immediate counterparts.

4.3.1. FDI positions

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

175. Exhibits 4.1 and 4.2 below are included to illustrate how these building blocks are used to construct the various measures of FDI that are required. These illustrations may be different to the standard and supplemental presentations for reporting FDI statistics which are described in Annex 2.

176. To illustrate the asset/liability approach, the six classes presented above are to be grouped as follows:

Exhibit 4.1. **FDI positions according to the asset/liability principle**

Assets	Liabilities
Of *direct investors in direct investment enterprises*	*Of direct investment enterprises to direct investors*
A1. Equity	**L1.** Equity
A2. Debt instruments	**L2.** Debt instruments
Of direct investment enterprises in direct investors (reverse investment)	*Of direct investor to direct investment enterprises (reverse investment)*
A3. Equity	**L3.** Equity
A4. Debt instruments	**L4.** Debt instruments
In fellow enterprises	*To fellow enterprises*
A5. Equity	**L5.** Equity
A5.1. If ultimate controlling parent is resident	L5.1. If ultimate controlling parent is non-resident
A5.2. If ultimate controlling parent is non-resident	L5.2. If ultimate controlling parent is resident
A6. Debt instruments	**L6.** Debt instruments
A6.1. If ultimate controlling parent is resident	L6.1. If ultimate controlling parent is non-resident
A6.2. If ultimate controlling parent is non-resident	L6.2. If ultimate controlling parent is resident

177. As mentioned already in this *Benchmark Definition*, two terms are used in presenting FDI statistics according to the directional principle: *Outward FDI* and *Inward FDI*. Outward FDI includes the net assets of resident enterprises exerting control or influence on non-resident enterprises (net assets of resident direct investors and net assets in fellow enterprises abroad when the UCP is resident). Inward FDI includes the net liabilities of resident enterprises controlled or influenced by non-resident enterprises (net liabilities of resident direct investment enterprises to direct investors and net liabilities to fellow

enterprises abroad when the UCP is non-resident). The components of outward and inward FDI are schematically shown as follows:

Exhibit 4.2. **FDI positions according to the directional principle**

Outward foreign direct investment	Inward foreign direct investment
Outward equity position:	*Inward equity position:*
A1. Equity assets of DI in DIE	**L1.** Equity liabilities of DIE to DI
– L3. Equity liabilities of DI to DIE* (reverse investment)	**– A3.** Equity assets of DIE in DI* (reverse investment)
A5.1. Equity assets in fellow enterprises abroad *(if ultimate controlling parent is resident)*	**L5.1.** Equity liabilities to fellow enterprises abroad *(if ultimate controlling parent is non-resident)*
– L5.2. Equity liabilities to fellow enterprises abroad* *(if ultimate controlling parent is resident)*	**– A5.2.** Equity assets in fellow enterprises abroad* *(if ultimate controlling parent is non-resident)*
Outward debt instruments position:	*Inward debt instruments positions:*
A2. Debt instruments assets of DI in DIE	**L2.** Debt instruments liabilities of DIE to DI
– L4. Debt instruments liabilities of DI to DIE* (reverse investment)	**– A4.** Debt instruments assets of DIE in DI* (reverse investment)
A6.1. Debt instruments assets in fellow enterprises abroad *(if ultimate controlling parent is resident)*	**L6.1.** Debt instruments liabilities to fellow enterprises abroad *(if ultimate controlling parent is non-resident)*
– L6.2. Debt instruments liabilities to fellow enterprises abroad* *(if ultimate controlling parent is resident)*	**– A6.2.** Debt instruments assets in fellow enterprises abroad* *(if ultimate controlling parent is non-resident)*

* Entered as a deduction in outward or inward FDI.

178. FDI asset positions under the asset/ liability principle are (generally) greater than FDI outward positions calculated according to the directional principle. In the same manner, FDI liability positions under the asset/liability principle are (generally) greater than the FDI inward positions calculated according to the directional principle. The difference between the two presentations is equal to the sum of the assets of residents in non-residents when the residents are controlled or influenced by non-residents (either directly in the case of reverse investments or ultimately for positions with fellow enterprises) and of the liabilities of residents to non-residents when the residents are exerting control or influence on non-residents (either directly in the case of reverse investments or ultimately for positions with fellow enterprises). Comparing the two presentations as follows:

179. The difference between the asset position and the outward FDI position is equal to:

$$(A1 + A2 + A3 + A4 + A5 + A6) – (A1 – L3 + A5.1 – L5.2 + A2 – L4 + A6.1 – L6.2)$$

which simplifies to

$$\mathbf{A3 + A4 + A5.2 + A6.2 + L3 + L4 + L5.2 + L6.2.}$$

- The difference between the liability position and the inward FDI position is equal to:

$$(L1 + L2 + L3 + L4 + L5 + L6) – (L1 – A3 + L5.1 – A5.2 + L2 – A4 + L6.1 – A6.2)$$

which simplifies to

$$\mathbf{A3 + A4 + A5.2 + A6.2 + L3 + L4 + L5.2 + L6.2.}$$

180. The net position (outward FDI *less* inward FDI and assets *less* liabilities) is the same for both presentations; *i.e.*, the difference between FDI assets and FDI liabilities is equal to the difference between outward FDI and inward FDI.

4.3.1.1. Equity position

181. Equity positions cover all components of shareholders' funds (proportionate to the percentage of shares held). They, therefore, include equity, contributed surplus, reinvestment of earnings, revaluations, as well as any reserve accounts (Exhibit 4.1,

items A1 and L1). Reinvestment of earnings is not recorded for either reverse investment (items A3, L3) or for investment between fellow enterprises (items A5 and L5) where neither party holds 10% or more of the voting power in one another. The reason for not imputing reinvested earnings/reinvestment of earnings in these cases is that, as these parties do not have at least 10% of voting power in the other, none of them can exert influence over the earnings distribution policy of the enterprise. Reinvested earnings/ reinvestment of earnings apply only between a direct investment enterprise and its immediate direct investor.

182. As noted earlier, equity positions may arise from reverse investment, which occurs when a direct investment enterprise acquires an equity or debt claim on its direct investor without holding 10% or more of the voting power. In addition, as stated above, items A3, A5 and L3, L5 consist solely of equity capital, *i.e.*, reinvestment of earnings is excluded when the level of the equity investment is less than 10% of the voting securities of the direct investor. This exclusion would apply only if equity investment is recorded at book value. Since the *Benchmark Definition* recommends market value as the valuation of FDI positions, in principle this differentiation does not apply. In instances where a direct investment enterprise, holding less than 10% of the voting power in its direct investor, increases that voting power to 10% or more, the direct investment enterprise becomes, in its own right, a direct investor and a separate direct investment relationship is established with its direct investor. Similarly, when a fellow enterprise, holding less than 10% of the voting power in a non-resident fellow enterprise, increases that voting power to 10% or more, the acquiring enterprise becomes a direct investor in the foreign affiliate. How these transactions and the related changes in FDI positions are to be recorded is discussed further below (see Section 4.3.4.5).

183. It should therefore be emphasised that where a resident direct investment enterprise acquires a 10% or more voting power interest in its direct investor or in a fellow enterprise resident in a different economy, it is not treated as reverse (equity) investment in the first case but rather as a direct investment asset (item A1) in both cases, as the threshold of 10% of voting power has been reached to create a direct investor. Similarly, where a FDI enterprise holds 10% or more of the voting power of the resident direct investor or in fellow enterprises resident in different economies than itself, the investment should be recorded as direct investment liabilities (item L1) by the economies receiving the investment, as, by reaching 10% of the voting power in the resident enterprise, the non-resident enterprise itself becomes a direct investor.

4.3.1.2. Debt instruments positions

184. Inter-company accounts should be separately recorded for assets and liabilities. Debt positions include payables and receivables between enterprises in a direct investment relationship arising from loans, deposits, debt securities, suppliers' (trade) credit, financial leases, and non-participating preference (preferred) shares.[28] However, debt positions between FDI related financial intermediaries (such as commercial banks, savings institutions, credit unions, mutual funds or finance companies) are excluded from direct investment (though this exclusion does not apply if one of the parties is a holding company). The reason for this is that they are taken to represent "normal banking-type

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

business", so that their very nature is quite different from that of other direct investment enterprises. Consequently, it is felt that the inclusion of debt instruments between such related financial intermediaries would produce misleading results.

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

- the resident direct investor holds in its direct investment enterprises;
- the resident direct investment enterprise holds on its direct investor(s);
- the resident fellow enterprises hold in other fellow enterprises abroad.

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

- the resident direct investment enterprise issues to its direct investor(s);
- the resident direct investor issues to its direct investment enterprise(s);
- the resident fellow enterprises issue to other fellow enterprises abroad.

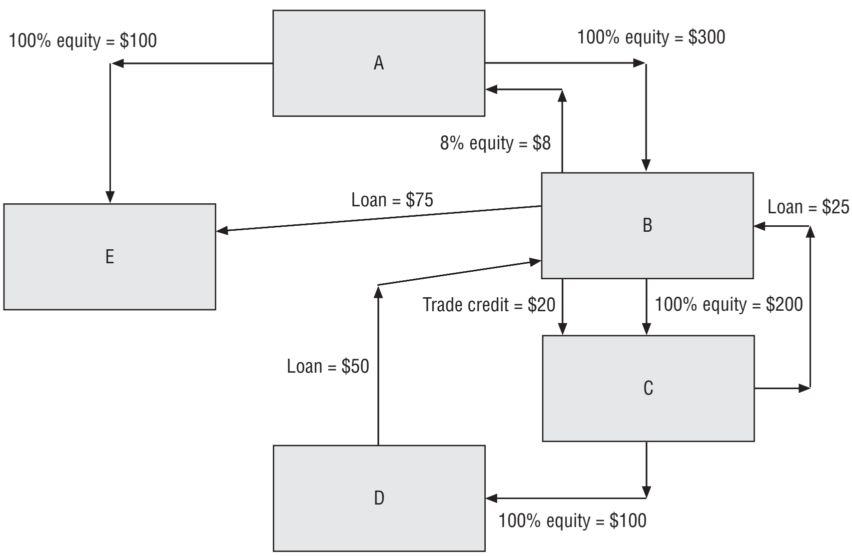
4.3.1.3. Changes in direct investment positions

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

4.3.1.4. Reconciliation of presentations according to the "asset/liability " and the "directional" principles: A numerical example

188. The numerical example in the figure below illustrates the differences in FDI presentations moving from the asset liability/principle to the directional principle:

In this example each of the enterprises A through E is in a different economy:



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Taking B as the reporting economy:

Asset liability principle: *Net FDI liability position: $72*

Assets	$303	Liabilities	$375
Of direct investors in direct investment enterprises		***Of direct investment enterprises to direct investor***	
A1. Equity		**L1.** Equity	
Equity in C	$200	Equity from A	$300
A2. Debt instruments		**L2.** Debt instruments	
Trade Credit in C	$20		
Of direct investment enterprises in direct investor – Reverse investment		***Of direct investor to direct investment enterprises – Reverse investment***	
A3. Equity		**L3.** Equity	
Equity in A	**$8**		
A4. Debt instruments		**L4.** Debt instruments	
		Loan from C	$25
		Loan from D	**$50**
In fellow enterprises		***To fellow enterprises***	
A5. Equity		**L5.** Equity	
A6. Debt instruments		**L6.** Debt instruments	
A6.2. Loan to E	**$75**		

Directional principle: *Net inward FDI position: $72*

Outward foreign direct investment	145	Inward foreign direct investment	217
Outward equity position:		***Inward equity position:***	
A1. Equity assets of DI in DIE	200	**L1.** Equity liabilities of DIE to DI	300
– L3. Equity liabilities of DI to DIE		**– A3.** Equity assets of DIE in DI	**–8**
A5.1. Equity assets in fellow enterprises *(if ultimate controlling parent is resident)*		**L5.1.** Equity liabilities to fellow enterprises *(if ultimate controlling parent is non-resident)*	
– L5.2. Equity liabilities to fellow enterprises *(if ultimate controlling parent is resident)*		**– A5.2.** Equity assets in fellow enterprises *(if ultimate controlling parent is non-resident)*	
Outward debt instruments position:		***Inward debt instruments positions:***	
A2. Debt instruments assets of DI in DIE	20	**L2.** Debt instruments liabilities of DIE to DI	
– L4. Debt instruments liabilities of DI to DIE	–25 –50	**– A4.** Debt instruments assets of DIE in DI	
A6.1. Debt instruments assets in fellow enterprises *(if ultimate controlling parent is resident)*		**L6.1.** Debt instruments liabilities to fellow enterprises *(if ultimate controlling parent is non-resident)*	
– L6.2. Debt instruments liabilities to fellow enterprises *(if ultimate controlling parent is resident)*		**– A6.2.** Debt instruments assets in fellow enterprise *(if ultimate controlling parent is non-resident)*	**–75**

- The same component entries appear in both accounts but the entries shown as negative amounts in the directional table correspond to the relevant positive entries on the opposite side of the asset/liability table.
- Gross values of assets and liabilities are presented.
- In both presentations net FDI is the same ($72).

Under the directional principle:

- The reverse investment asset position with A effectively reduces the the aggregate headline inward FDI position of B (it is netted out).
- There is a negative inward FDI debt liability position into E resulting from the recording of loans with fellow enterprises (as the ultimate controlling parent of "B" is non-resident). This also reduces the aggregate headline inward FDI position of B.

- The outward FDI position is effectively reduced as a result of the recording of the reverse investment loans from C and D (as in the preceding edition of the *Benchmark Definition*).

Under the asset/liability principle:

- There is an asset position with A that contributes to the gross total.
- There is a liability position with C that contributes to the gross total.
- The notion of inward and outward FDI is replaced by the notion of FDI asset and FDI liability.

4.3.2. FDI financial transactions

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

A1: Equity assets of direct investors in direct investment enterprises

A1.1. Equity transactions

A1.2. Reinvestment of earnings

L1: Equity liabilities of direct investment enterprises to direct investor

L1.1. Equity transactions

L1.2. Reinvestment of earnings

190. It is recommended that separate figures be collected and published for transactions in equity capital, reinvestment of earnings and debt for both direct investment assets and direct investment liabilities.

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

Exhibit 4.3. **Foreign direct investment transactions according to the asset/liability principle**

Transactions in assets	Transactions in liabilities
Of direct investors in direct investment enterprises	***Of direct investment enterprises to direct investors***
A1. Equity	**L1.** Equity
A1.1. Equity transactions	**L1.1.** Equity transactions
A1.2. Reinvestment of earnings	**L1.2.** Reinvestment of earnings
A2. Debt instruments	**L2.** Debt instruments
Of direct investment enterprises in direct investors- Reverse investment	***Of direct investors to direct investment enterprises – Reverse investment***
A3. Equity	**L3.** Equity
A4. Debt instruments	**L4.** Debt instruments
In fellow enterprises	***To fellow enterprises***
A5. Equity	**L5.** Equity
A5.1. If ultimate controlling parent is resident	**L5.1.** If ultimate controlling parent is non-resident
A5.2. If ultimate controlling parent is non-resident	**L5.2.** If ultimate controlling parent is resident
A6. Debt instruments	**L6.** Debt instruments
A6.1. If ultimate controlling parent is resident	**L6.1.** If ultimate controlling parent is non-resident
A6.2. If ultimate controlling parent is non-resident	**L6.2.** If ultimate controlling parent is resident

192. To illustrate the directional principle for transactions, the FDI elements are schematically shown as follows:

Exhibit 4.4. **Foreign direct investment transactions according to the directional principle**

Outward foreign direct investment	Inward foreign direct investment
Outward equity transactions	***Inward equity transactions***
A1. Equity assets of DI in DIE	**L1.** Equity liabilities of DIE to DI
A1.1. Equity transactions	**L1.2.** Equity transactions
A1.2. Reinvestment of earnings	**L1.2.** Reinvestment of earnings
– L3. Equity liabilities of DI to DIE(reverse investment)*	**– A3.** Equity assets of DIE in DI (reverse investment)*
A5.1. Equity assets in fellow enterprises abroad *(if ultimate controlling parent is resident)*	**L5.1.** Equity liabilities to fellow enterprises abroad *(if ultimate controlling parent is non-resident)*
– L5.2. Equity liabilities to fellow enterprises abroad* *(if ultimate controlling parent is resident)*	**– A5.2.** Equity assets in fellow enterprises abroad* *(if ultimate controlling parent is non-resident)*
Outward debt instruments transactions	***Inward debt instruments transactions***
A2. Debt instruments assets of DI in DIE	**L2.** Debt instruments liabilities of DIE to DI
– L4. Debt instruments liabilities of DI to DIE (reverse investment)*	**– A4.** Debt instruments assets of DIE in DI (reverse investment)*
A6.1. Debt instruments assets in fellow enterprises abroad *(if ultimate controlling parent is resident)*	**L6.1.** Debt instruments liabilities to fellow enterprises abroad* *(if ultimate controlling parent is non-resident)*
– L6.2. Debt instruments liabilities to fellow enterprises abroad* *(if ultimate controlling parent is resident)*	**– A6.2.** Debt instruments assets in fellow enterprises abroad* *(if ultimate controlling parent is non-resident)*

* Entered as a deduction in outward or inward FDI.

193. As explained in the section on foreign direct investment positions, the presentation of outward foreign direct investment transactions is different to that for foreign direct investment assets. Similarly, the presentation for inward foreign direct investment transactions is different to that for foreign direct investment liabilities. These differences essentially involve transposing reverse transactions and transactions between fellow enterprises in the two presentations (see Section 4.3.1).

4.3.2.1. Equity and reinvestment of earnings

194. Transactions by a direct investor in the equity of its direct investment enterprises include both reinvestment of earnings and other equity transactions [Exhibits 4.3 and 4.4, items A1 (A1.1, A1.2) and L1 (L1.1, L1.2)]. Transactions by a direct investment enterprise in the equity of its direct investor (reverse investment; items A3 and L3) or in the equity of a fellow company (items A5 and L5) do not include reinvestment of earnings.

4.3.2.2. Equity transactions

195. Equity increases result from a direct investor's establishment of a new direct investment enterprise, through:

a) its initial acquisition of equity that represents a 10%-or-more voting power interest in an existing enterprise;

b) its acquisition of an additional voting share ownership interest in an existing enterprise which takes the accumulated holding to at least the 10% voting power threshold; and

c) from its equity contributions to an existing direct investment enterprise.

196. Equity decreases result from:

a) the liquidation of a direct investment enterprise;

b) the partial or total sale of an ownership interest in a direct investment enterprise; and

c) the return of capital contributions;

d) liquidating dividends, which are considered to be a withdrawal of equity rather than a distribution of income.

197. For a given category of equity transactions (items A1, A3, A5 and L1, L3, L5), decreases in assets are deducted from increases in assets to derive the net transactions in assets within a given period, and similarly for liabilities. Equity transactions exclude changes in equity that result from the reinvestment of earnings, which constitute a separate sub-component of the accounts.

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

4.3.2.3. Reinvestment of earnings

199. Reinvestment of earnings of direct investment enterprises (items A1.2 and L1.2) reflects earnings accruing to direct investors (that is, proportionate to the ownership of equity) during the reference period less earnings declared for distribution in that period. Earnings are included in direct investment income because they are deemed to accrue to the direct investor, whether they are reinvested in the direct investment enterprise or remitted to the direct investor. However, reinvested earnings are not actually transferred to the direct investor but rather increase the direct investor's investment in its direct investment enterprise. Therefore, an entry that is equal to that made in the direct investment income account but that flows in the opposite direction is made in the direct investment financial transactions account. In the direct investment income account, this form of income is referred to as "reinvested earnings". However, in the direct investment transactions account, "reinvestment of earnings " is the term that is used, to more clearly differentiate between the income and financial transactions (see the discussion of reinvested earnings in the direct investment income account for more details, Section 4.3.3: Direct investment income).

4.3.2.4. Debt instrument transactions

200. For each category of debt instrument, decreases in assets are deducted from increases in assets to derive the net transactions in assets within a given period, and similarly for liabilities. Transactions in debt instruments between enterprises in a direct investment relationship should be recorded separately as shown in Exhibits 4.3 and 4.4 (items A2, A4, A6, L2, L4, L6). However, just as debt positions between FDI related financial intermediaries (such as commercial banks, savings institutions, credit unions, mutual funds or finance companies) are excluded from direct investment, so are the related transactions.

- *For debt instrument assets*, included are transactions that increase or decrease:
  - *i)* the resident direct investor's debt instrument claims on direct investment enterprise (A2);

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ii) the resident direct investment enterprise 's debt instrument claims on direct investors (A4);

iii) other resident fellow enterprises ' debt instrument claims on fellow enterprises abroad (A6), distinguishing whether the ultimate controlling parent is resident (A6.1) or non-resident (A6.2).

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

i) the financial obligations of a resident direct investment enterprise to direct investors (L2);

ii) the financial obligations of a resident direct investor to direct investment enterprises (L4);

iii) the financial obligations of other resident fellow enterprises to fellow enterprises abroad (L6) distinguishing whether the ultimate controlling parent is non-resident (L6.1) or resident (L6.2).

201. When a direct investor lends funds to its direct investment enterprise, the level of the direct investor's assets claim (receivables) on the enterprise increases. Subsequently, when the direct investment enterprise repays the principal owed to its direct investor, the level of the direct investor's receivables from the enterprise is reduced. Similarly, when a direct investor borrows funds from its FDI enterprise, the level of the direct investor's liabilities (payables) to the enterprise increases and when the direct investor repays the principal, the level of the direct investor's payables is reduced. The same would be applicable to fellow enterprises.

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

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

204. Direct investors may make loans to or borrow funds from their indirectly owned direct investment enterprises. An indirect ownership interest exists when a direct investment enterprise that is directly owned, in turn, owns an enterprise that also qualifies as a direct investment enterprise of its own direct investor. In this example, the direct investor at the top of the ownership chain holds an indirect ownership interest in the enterprise at the bottom of the ownership chain. The *Benchmark Definition* recommends that such

transactions be included in direct investment and allocated to the country of the indirectly owned direct investment enterprises (see Chapter 3 for a description of the FDIR).

205. Enterprises which are fellow enterprises may make loans to or borrow funds from other fellow enterprises. The *Benchmark Definition* recommends that such transactions be included in direct investment and allocated to the economies of the counterpart fellow enterprises. Loans made by enterprises included in the FDIR in economy A to fellow enterprises in economy B should be included in direct investment assets for compiling economy A and as direct investment liabilities for compiling economy B.

4.3.3. Direct investment income

206. Direct investment income is part of the return on the direct investment position; that is, it is the return on equity and debt investment. Direct investment income consists of earnings on equity investment (for example, a resident direct investor's share in the net income or earnings of its direct investment enterprises) plus income on debt between direct investors and direct investment enterprises and between fellow enterprises. Direct investment income payables are calculated in a similar way. Direct investment income is recorded as it accrues. However, as debt instruments involving FDI-related financial intermediaries are excluded from direct investment, so is the debt income between them (see also Section 4.4.3).

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

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

- *i)* any gains or losses arising from valuation changes, such as inventory write-offs, write-downs, or write-ups;
- *ii)* gains or losses on plant and equipment from the closure of part or all of a business;
- *iii)* writing-off of intangible assets, including goodwill, due to unusual events;[29]
- *iv)* writing-off of research and development expenditures capitalised in a prior period;
- *v)* provisions for losses on long-term contracts;
- *vi)* exchange rate gains and losses incurred by the direct investment enterprise both from its trading activities and from its holdings of foreign currency assets and liabilities;
- *vii)* unrealised gains or losses from the revaluation of fixed assets, investments and liabilities;

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

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

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

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

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

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

Exhibit 4.5. **Foreign direct investment income according to the asset/liability principle**

Receivables	Payables
Of direct investors from direct investment enterprises	***Of direct investment enterprises to direct investors***
A1. Earnings on equity	**L1.** Earnings on equity
A1.1. Distributed earnings	**L1.1.** Distributed earnings
A1.2. Reinvested earnings	**L1.2.** Reinvested earnings
A2. Interest (on debt instruments)	***L2.*** Interest (on debt instruments)
Of direct investment enterprises from direct investors – Reverse investment	***Of direct investors to direct investment enterprises – Reverse investment***
A3 Distributed earnings	**L3** Distributed earnings
A4. Interest (on debt instruments)	**L4.** Interest (on debt instruments)
From fellow enterprises abroad	***To fellow enterprises abroad***
A5. Distributed earnings	**L5.** Distributed earnings
A5.1. If the ultimate controlling parent is resident	**L5.1.** If the ultimate controlling parent is non-resident
A5.2. If the ultimate controlling parent is non-resident	**L5.2.** If the ultimate controlling parent is resident
A6. Interest (on debt instruments)	**L6.** Interest (on debt instruments)
A6.1. If the ultimate controlling parent is resident	**L6.1.** If the ultimate controlling parent is non-resident
A6.2. If the ultimate controlling parent is non-resident	**L6.2.** If the ultimate controlling parent is resident

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

Exhibit 4.6. **Foreign direct investment income according to the directional principle**

Income on outward foreign direct investment	Income on inward foreign direct investment
Income on outward equity	***Income on inward equity***
A1. Earnings on equity	**L1.** Earnings on equity
A1.1. Distributed earnings	**L1.1.** Distributed earnings
A1.2. Reinvested earnings	**L1.2.** Reinvested earnings
– L3. Distributed earnings of DI to DIE (reverse investment)*	**– A3.** Distributed earnings of DIE from DI (reverse investment)*
A5.1. Distributed earnings from fellow enterprises abroad (*if ultimate controlling parent is resident*)	L5.1. Distributed earnings to fellow enterprises abroad (*if ultimate controlling parent is non-resident*)
– L5.2. Distributed earnings to fellow enterprises abroad* (*if ultimate controlling parent is resident*)	– A5.2. Distributed earnings from fellow enterprises abroad* (*if ultimate controlling parent is non- resident*)
Interest on outward debt instruments	***Interest on inward debt instruments***
A2. Interest receivable from DIE	***L2.*** Interest payable to DIs
– L4. Interest payable by DI to DIE (reverse investment)*	**– A4.** Interest receivable by DIE from DI (reverse investment)*
A6.1. Interest receivable from fellow enterprises (on debt instruments) *(if ultimate controlling parent is resident)*	**L6.1.** Interest payable to fellow enterprises (on debt instruments) *(if ultimate controlling parent is non-resident)*
– L6.2. Interest payable to fellow enterprises (on debt instruments)* *(if ultimate controlling parent is resident)*	**– A6.2.** Interest receivable from fellow enterprises (on debt instruments)* *(if ultimate controlling parent is non-resident)*

* Entered as a deduction in outward or inward FDI.

4.3.3.1. Direct Investment Income on equity

214. Once a direct investment relationship exists, direct investment earnings are based on the direct investor 's percentage share (based on their equity share) in the current earnings of the given direct investment enterprise.

215. Direct investment income on equity (Exhibits 4.5 and 4.6, items A1 and L1) – or direct investment earnings – is the return of the direct investor on the equity component of the direct investment position. For investment by a direct investor in its direct investment enterprise [Exhibits 4.5 and 4.6, items (A1.1, A1.2) and (L1.1, L1.2)] it consists of "distributed earnings " and "reinvested earnings ". For investment by a direct investment enterprise in its direct investor (A3 and L3) or investment between fellow enterprises (items A5 and L5), income on equity consists only of distributed earnings as reinvested earnings are not included. The reason for this is that the direct investment enterprise does not hold 10% or more of the voting power in its direct investor. Consequently, the enterprise is not considered able to influence the savings and distribution policies of the direct investor or fellow enterprise. If, however, the direct investment enterprise does hold 10% or more of the voting power in its direct investor, it then becomes a direct investor in its direct investor, and reinvested earnings are attributed to it.

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

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

218. When a direct investment ownership chain exists, direct investment earnings should reflect income from direct and indirect enterprises. All earnings from an ownership chain are geographically allocated to the enterprises directly owned. However, these earnings should include the claims of directly owned enterprises' on the earnings of enterprises below them in the ownership chain, proportionate to the immediate direct investor 's ownership of shares. For example, if A (resident in Country A) owns 100% of B (resident in B), which, in turn, owns 100% of C (resident in C), B's FDI earnings will include all of the earnings from its current operations, including its investment income, which, by definition, includes all of C's reinvested earnings (as C is 100% owned by B, B will be deemed to receive all of C's reinvested earnings as reinvested earnings). As a consequence, the reinvested earnings receivable by A from its ownership of all the shares in B will include C's reinvested earnings. Therefore, A does not need to seek the information on C's reinvested earnings directly from C, in order for that income to be measured correctly, but it is recommended that the compiler of direct investment data in Country A makes sure that B understands that it should report C's reinvested earnings, even though it is an imputed transaction. (In instances, where the direct investors do not hold 100% of the equity in an immediate direct investment enterprise, their reinvested earnings receivable should be in accordance with the proportion of the shares they own (see Annex 6 on reinvested earnings for another example of calculation of reinvested earnings along a chain of related enterprises). The compiler will often find that the information required in order to determine a direct investor's share of the reinvested earnings of indirectly owned direct investment enterprises becomes more difficult to determine once its share of indirect ownership falls below 50%. In that instance, it is recommended that it be impressed upon respondents to direct investment surveys of the importance that this information be collected.

4.3.3.2. Distributed earnings

219. Distributed earnings (items A1.1, A3, A5 and L1.1, L3, L5) consist of dividends and distributed branch profits. Dividends include those to shareholders, both common and participating preferred stock, whether voting or non-voting, according to the contractual relationship between the enterprise and these various types of shareholders, before deduction for withholding taxes. Dividends exclude liquidating dividends and bonus shares (which are dividends in the form of additional shares of stock). Liquidating dividends are excluded because they are a return of equity rather than a remittance of earnings (liquidating dividends are included instead as transactions in the direct investment equity). Distributed earnings can be paid out of current or past earnings and

may result in negative reinvested earnings if the distribution of dividends exceeds total earnings in a particular reference period. Bonus shares are excluded because they are a capitalisation of retained earnings – a substitution of one type of equity (capital stock) for another (retained earnings). In an accounting sense, they reduce the amount of retained earnings available for distribution but leave total owners' equity unchanged.

4.3.3.3. Reinvested earnings

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

4.3.3.4. Direct Investment income on debt

221. Direct investment interest payables (on liabilities) and interest receivables (on assets) are separately recorded. Thus, interest receivables comprise interest accruing to residents (direct investors, direct investment enterprises and fellow enterprises) on their debt receivables, and interest payables comprise interest accruing to non-residents (direct investment enterprises, direct investors and fellow enterprises) on debt payables.

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

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

224. The interest component of direct investment income reflects accruals of interest on debt in the current period (*i.e.* interest accrued), whether or not paid.[30] Interest receivable and payable should be compiled separately. Interest receivable by direct investors from their direct investment enterprises, receipts from direct investment enterprises from their direct investors and receipts from fellow enterprises are included. Payables are calculated in an analogous manner.

225. Interest accruals on marketable securities should be calculated under the debtor basis, not the creditor basis. Under the debtor basis, interest accruals on fixed interest rate

30. Accrual accounting records flows at the time economic value is created, transformed, exchanged, transferred or extinguished. This means that flows which imply a change of economic ownership are entered when ownership passes and services are recorded when provided. In other words, the effects of economic events are recorded in the period in which they occur, irrespective of whether cash was received or paid or was due to be received or paid (*SNA 2008*, paragraph 3.94 and *GFSM 2001*, paragraph 3.25).

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

226. Interest on debt accrues continually over the life of the debt and adds to the principal. Thus, actual payments of the debt (as opposed to accruals) are investment transactions and not income. Therefore, they should be recorded in the *FDI transactions account*.

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

4.3.4. Other changes

228. As described in Section 4.3.1.3 a direct investment position can change due to transactions and to other changes, where other changes consist of valuation changes and volume changes. Valuation changes can further be considered to consist of exchange rate changes and other price changes. Exchange rate changes generally reflect the impact on the position of exposure of the instrument to a currency other than that in which the accounts are compiled. Other price changes reflect all other changes in the market value of the instrument as expressed in the compilation currency.

229. The other changes account is an important component of direct investment statistics as it allows transactions to be reconciled with positions. As such, it provides a method of validating and testing the consistency of transactions and positions. While other changes can be measured residually, it is through direct measurement of this account (and its components) that the improvements to quality of transactions and positions are made possible. The standard and supplemental reporting to the OECD (see Annex 2) does not involve the reporting of the other changes account.

4.3.4.1. Valuation changes

230. Chapter 5 describes methods for identifying the market value of a position or a transaction. Valuation changes reflect changes in the market value of a position.

4.3.4.2. Exchange rate changes

231. "Exchange rate changes" reflect the impact that changes in exchange rates have on instruments that are denominated in a currency other than that in which the accounts are compiled. Equity is considered to be denominated in the currency of the economy in which the enterprise is resident. As a result, all equity liabilities of an economy are considered to be denominated in the local currency and if the accounts are compiled in the local currency, the exchange rate changes for equity liabilities will be zero. Debt securities are denominated in the currency in which they are to be redeemed except in the case where the principal is indexed to another currency. When the principal of a debt security is linked to another currency, the debt security is treated as though it were denominated in that currency. In all other cases, reference should be made to the contractual arrangements of the debt position to determine in which currency it is denominated.

232. Exchange rate changes may be referred to by enterprises as realised or unrealised exchange rate or foreign exchange gains or losses. These impacts should not be included in the earnings of an enterprise when calculating income flows.

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

234. Transactions are converted to the compilation currency at the rate prevailing when they took place, and positions are converted at the rate prevailing on the reference date. The mid-point between the buying and selling rates should be used at the time of transaction (for transactions) and at the close of business on the reference date for positions. The impacts of changes in the exchange rate on this conversion are recorded as exchange rate changes.

235. If the accounts are compiled in the local currency, and the local currency appreciates against the currency of denomination of a financial instrument, exchange rate changes will reflect a decrease in the value of the instrument in the local currency. This is the case whether the instrument is an asset or a liability.

4.3.4.3. Other price changes

236. "Other price changes" reflect all changes to the market value of an instrument as expressed in the compilation currency that are not exchange rate changes or attributable to transactions. For the asset holder, these changes may be referred to as holding gains or losses. Other price changes reflect the change in the market value of an instrument in the currency in which it is denominated. This market price change is then converted to the currency of compilation and may also give rise to exchange rate changes if the exchange rate changes over the period during which the market price change occurred (see Section 4.3.4.4).

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

238. Another example of a change that will be recorded as an other price change' is when a direct investor sells its direct investment enterprise for more (or less) than the value recorded in the direct investment position. The amount received from the sale of the enterprise is recorded as a financial inflow in the direct investment accounts compiled by the country of the direct investor; the difference between the financial inflow/outflow and the value of the direct investment enterprise in the position must be attributed as an other price change so as to remove from the position the full value of the affiliate that has been sold.

239. A direct investment enterprise may have assets or liabilities expressed in a currency other than its local currency. Changes in exchange rates will have an impact on the value of the direct investment enterprise's assets and/or liabilities. These changes are likely to impact on the market valuation of the direct investment enterprise itself. The change in

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the asset value of the direct investment enterprise to its direct investor is recorded as an "other price change".

240. Similarly, external factors can influence the market value of a debt position. If the credit rating of the issuer of a debt instrument is changed, then this may have an impact of the value of the debt instrument.

241. If equity listed on resident markets is generally increasing in value, this will be reflected in an increase in the value of equity liabilities; while if equity listed on non-resident markets is generally increasing in value, this will be reflected in an increase in the value of equity assets.

242. Where debt positions between related enterprises are in the form of debt securities, the market value of these positions will be affected by changes in interest rates. If resident interest rates are generally increasing, this will be reflected in a decrease in the value of debt securities issued in the local economy; while if non-resident interest rates are generally increasing, this will be reflected in a decrease in the value of debt securities issued abroad. To determine the impact of these changes on the values of positions, it is necessary to understand whether debt security assets/liabilities between related enterprises are issued locally or abroad.

4.3.4.4. Recording valuation changes

243. It is not unusual for positions to change due to both exchange rate changes and other price changes. It is analytically useful to separate the causes of the changes in valuation.

244. For instruments denominated in a currency other than that in which the accounts are compiled, the opening position (or position at creation) is converted to the compilation currency at the exchange rate prevailing at the time, and similarly for the closing position (or position when extinguished). The difference between these two values consists of both exchange rate changes and other price changes.

245. The other price changes should be calculated in the currency of denomination. This is converted to the compilation currency using a mid-point exchange rate. The mid-point exchange rate is calculated as the mid-point between the exchange rate at the start of the period (or at the time when the position was created if this was during the period) and the exchange rate at the end of the period (or at the time when the position was extinguished if that occurred during the period).

246. The exchange rate changes can then be calculated as the difference between the total valuation change and the other price change.

247. Under the International Financial Reporting Standards (IFRS), enterprises may keep their books in a currency other than the local currency or the currency in which the accounts are compiled. The IFRS refer to this currency as the currency of account. When these enterprises report information to the compiling authority, it will need to be converted to the domestic currency (or the compilation currency). Exchange rate changes are calculated as the impact of changes in the exchange rate between the currency in which an instrument is denominated and the currency in which the accounts are compiled; other valuation changes identified during the conversion process should be recorded as price changes, regardless of movements in the exchange rates used in the conversion.

4.3.4.5. *Volume changes*

248. The volume of financial assets and liabilities for an economy can change due to either transactions or other changes in volume. The causes of other changes in volume include debt cancellation and write-offs, liquidations, uncompensated seizure, and reclassifications.

Debt cancellation and write-offs

249. Changes in claims resulting from debt cancellation or write-offs are treated as volume changes and are not treated as financial transactions. Specifically, a creditor may recognise that a financial claim can no longer be collected from the debtor and may remove the claim from its balance sheet. Debt cancellations and write-offs are unilaterally determined by the creditor as well as by courts, arbitrators and related out-of-court settlements; unilateral cancellation of a financial claim by a debtor (debt repudiation) is not recognised. Debt forgiveness and debt assumption are both treated as financial transactions.

250. Debt forgiveness usually involves the intention by the creditor to convey a benefit to the debtor. Debt assumption (including one-off guarantees) usually involves a third party with which there may be transactions.

251. Partial write-offs (write-downs) of debt assets by creditors are not considered to change the volume of financial claims of the creditor on the debtor. Partial write-offs are treated as a revaluation of the claim and are classified as other price changes. If a bankruptcy process results in all debt being written off, then the loss is recorded as a volume change; if the bankruptcy process results in even a token return to the creditor, then the debt is reduced as a valuation change with a transaction to extinguish the debt. The nature of the underlying loss is similar and the distinction may not be practical or analytically useful. As a result, a simplifying convention may be to treat these cases in the same way as full write-offs.

Liquidations and failed exploration activities

252. When a direct investment enterprise is liquidated, the equity investment in the enterprise is often written off by the direct investor and removed from its balance sheet. This situation is treated as a volume change as the equity claim is considered to have disappeared. The treatment is analogous to the write-off of debt. If there is a partial return to the direct investor, then this should be treated as a valuation change with a transaction to extinguish the claim. As with debt write-offs, it may not be practical or analytically useful to make this distinction, and these cases may be treated in the same way as where there is no return.

253. Mineral exploration activities present a special case of equity write-offs. The purchase of a mineral exploration licence is a sufficient criterion to recognise a notional unit within the economy where the mineral exploration is to take place. As activity takes place and equipment is purchased or provided to the exploration operations, a branch is considered to be established. The provision of equipment is recorded as a transaction reflecting the injection of equity in the branch. Valuation changes may also occur dependent on the expectations of a find. If the exploration fails to identify a viable resource discovery and the operator walks away' from the activities, the investment in the branch is extinguished through a volume change. This is a borderline case – where there are assets that are sold, the appropriate treatment is to revalue the investment to the value received

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for the assets and then extinguish the investment through a transaction reflecting the sale of the assets and withdrawal of equity.

Uncompensated seizure

254. Direct investment enterprises may also be subject to seizure by national governments on occasion (for example where a government decides to nationalise certain industries within its jurisdiction without compensation). This extinguishes the equity that the direct investor has in the enterprise in the economy, with the equity position being reduced to zero through a volume change.

Reclassification

255. A reclassification entry is necessary when a financial instrument changes its characteristics without there having been a cross-border transaction.

256. For direct investment, a common issue is how to treat an existing equity position when a further purchase is made to take the total position to one that represents at least 10% of the voting power in an organisation. The original equity position is reclassified to direct investment through a volume change to include it in the direct investment equity position. Similarly, any pre-existing debt positions are reclassified to direct investment debt positions through a volume change. When voting power is reduced, equity and debt positions are removed from direct investment through volume changes. It should be recognised that there does not need to be any transactions for voting power to cross the 10% threshold – for example, a position can increase in proportion due to share buybacks; while positions can decrease due to the issue of additional shares.

257. The migration of persons can also result in reclassifications of direct investment. When a person changes residence, this is considered to be a reclassification of his/her residence – any direct investment assets which they hold which are resident in the economy to which the person has moved are reclassified out of the direct investment position as a volume change (as the position has become one between two residents of the same economy). Assets with which the person is in a direct investment relationship in their former place of residence are reclassified into the direct investment position as a volume change.

258. On occasion, land can change from being part of one economy to being considered part of another economy, whether through mutual agreement or annexation, or be considered to be a new economy. This may create or extinguish direct investment positions that residents of either economy had with residents of the area of land that changed jurisdiction. The creation and extinction of the direct investment positions is treated as a volume change.

259. A similar situation arises with the change of membership in country groups. For example, the European Union has increased its membership on a number of occasions. This can result in the positions between the country group and the new member being extinguished (for statistics for the country group as a whole), positions between the country group and other countries being created. Conceptually, these should be treated as volume changes. An alternative approach is to treat the country group as if it had always consisted of its current membership and to revise historical series associated with the country group.

4.4. Scope of FDI

4.4.1. Standard content of FDI statistics

260. The scope of direct investment covered in this *Benchmark Definition* was reviewed to take into account the economic and financial developments over the past decade or so[31] which may directly or indirectly impact the measurement of the FDI activity. As described in Section 2.4.2, there are two standard (core) presentations of direct investment statistics, both of which represent breaks from historical series:

- Aggregate FDI statistics for assets and liabilities by instrument (equity, debt).
- Detailed FDI statistics under the directional principle by *i)* geographical allocation; and *ii)* industry classification (each category broken down by instrument (equity, debt).

261. Investors apply a large variety of financing structures as markets evolve and as they put in place new instruments. The growing complexity of the measurement of the direct investment activity was accelerated with the expansion of globalisation and its effects. As a consequence, users indicated that international standards should be revisited to respond to the need for more and more sophisticated statistics for analytical research and for policy making. Against this background, the traditional FDI statistics had to be expanded and tailored for new data requirements.

4.4.1.1. Aggregate FDI statistics (asset/liability principle)

262. The analytical presentation of FDI statistics showing non-resident assets and liabilities of direct investors and direct investment enterprises is a new feature of the *Benchmark Definition*. It complies fully with the overall presentation of macro-economic statistics. Conceptually, these data are in line with the balance of payments and the international investment position statistics[32] as well as the national accounts presentation of the institutional sectors of the economy. Direct investment measured in terms of assets and liabilities constitute the basis for compiling FDI statistics from which other presentations can be derived provided that additional relevant pieces of information are included in national data collection systems.

263. Aggregate FDI statistics include all types of enterprises (operational direct investment entities as well as Special Purpose Entities (SPEs) following the relationship identified by the FDIR (see also Chapter 3) and all types of transactions/positions (including pass through funds and capital in transit). These statistics are compiled according to first counterparty (*i.e.* immediate investor or immediate direct investment enterprise). The identification of counterpart residency information is not required for aggregate data dissemination but constitutes to a large extent the fundamental basis for data compilation. Industry classification is not required for these data either. Aggregate FDI statistics on this same asset and liability basis should also be provided separately for resident SPEs.

31. The *Benchmark Definition, 3rd edition* was published in 1996.
32. The asset/liability approach constitutes a break in series from previous aggregate data compilation of balance of payments and international investment position. Linkages between the two data sets are provided in Chapter 4.

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4.4.1.2. Detailed FDI statistics (directional principle)

264. As from its first edition, the *Benchmark Definition* recommends that countries compile and disseminate detailed FDI statistics broken down by *i)* geographical allocation; and *ii)* industry classification. Such statistics provide a further refinement to an aggregate statistical framework which is traditionally used for balance of payments and international investment position presentations. It allows FDI analyses by source and destination country/industry which cannot be achieved by aggregate data. Current standards for detailed FDI statistics have refined further the directional principle as compared to the previous version of the *Benchmark Definition*. The revised directional principle reflects the guiding principle of FDI which is influence (or control) of the direct investor over the direct investment enterprise (see Section 4.3 FDI accounts).

265. Recourse to complex financing structures by multinational enterprises (MNE) in their cross-border investments is more and more frequent. Funds transmitting through intermediate entities of different types are common practice. Such investment patterns distort the analysis of the source and destination of FDI and may lead to undesirable statistical and analytical results when they are recorded strictly according to the immediate counterparty.[33] Moreover, they result in the overstatement or multiplication of direct investment transactions (also referred as the "inflation" of FDI data) both at the country and at regional or global levels. Countries hosting the intermediate entities (SPEs or other entities acting on behalf of the parent), observe artificially high investment statistics. These pass-through investments have no real immediate economic impact such as job creation, productivity gains etc. on the host economy. To circumvent such problems,[34] the present edition of the *Benchmark Definition* recommends, while preserving consistency of geographical (industrial) breakdowns provided by different countries, that compilers exclude SPEs resident in their economies when presenting FDI statistics on a directional basis. However, compilers are at the same time asked to provide in a separate column and on the same basis the transactions and positions of resident SPEs according to the geographical and industrial classifications. Chapter 7 provides more information on the geographical and industry classification of FDI data presented according to the directional principle.

266. For the standard presentation of FDI under the directional principle, the exclusion of SPEs was limited only to resident entities even if it is recognised that it would be more meaningful to exclude non-resident SPEs as well. Due to difficulties compilers currently may encounter in achieving this, the alternative option of "looking through" non-resident SPEs is recommended only on a supplemental basis and is subject to further priority research (see Section 4.4.2.1).

267. This standard presentation of FDI statistics excluding resident SPEs, considered by users as more suitable for FDI analysis, constitutes one of the main focuses of this *Benchmark Definition*. Relative to the previous edition of the *Benchmark Definition* it represents a substantial improvement of the analysis of FDI figures broken down by country and industry. Obviously, in view of the complexity of the global network of FDI relationships and the many aspects to it, some issues still need to be further investigated and will remain on the agenda for future research.

33. This approach was recommended in earlier versions of the *Benchmark Definition*.
34. It should be noted that MNEs also pass funds through their operating affiliates. However, these structures can be very complicated and require further research (see Annex 13).

268. Extensive research has shown that a variety of (overlapping) definitions of SPEs exist. As there is no single universal definition of SPEs, it is left to individual countries to identify such entities according to their own definitions or descriptions. Countries that have not yet adopted a definition of SPE (which is the case in a large majority of countries) may be assisted by the criteria listed in Chapter 6.

269. The directional principle, in addition, involves the deducting of some building blocks of the FDI accounts as presented in Section 4.3. Under this presentation any reverse investment (equity or debt) from the direct investment enterprise in its direct investor is to be deducted from the inward FDI when the direct investment enterprise holds less than 10% of the voting power in its direct investor. Data on the directional principle is also to be applied between fellow enterprises (see section 4.3). The recording of direct investment between fellow enterprises is to be presented according to the residence of the immediate counterpart but the direction of the investment is to be determined according to whether the ultimate controlling parent is a resident or a non-resident of the compiling economy. In other words, if the ultimate controlling parent is not a resident of the compiling economy, all transactions and positions between the fellows are classified as inward FDI. If the ultimate controlling parent is resident in the compiling economy, the transactions and positions are classified as outward FDI.

4.4.2. Supplemental FDI series

4.4.2.1. FDI looking through non-resident SPEs (directional principle)

270. Compilers are strongly encouraged to provide on a supplemental basis a breakdown of FDI by country and industry that is obtained by looking through immediate non-resident counterparts that are SPEs. Due to the fungibility of funds and the use of SPEs as financial turn-tables for different destinations/countries – an outward flow may split beyond the SPE – it may not (always) be possible to look through non-resident SPEs in an unambiguous way. Compilers are therefore encouraged to intensify bilateral exchanges of information with compilers of countries hosting SPEs.[35] Some bilateral asymmetries may remain, but these would seem less serious than distortions of geographical breakdowns, in which countries with many SPEs would, for instance, give the wrong impression of being overly attractive as a location for direct investment or overly active in investing in developing countries, for instance.

271. Where considered necessary compilers are also encouraged, at least once a year, to provide FDI statistics according to the criteria of the *Benchmark Definition*, 3rd edition[36] *i.e.* to include all resident enterprises in compiling these FDI statistics irrespective of whether they are SPEs or not.

4.4.2.2. FDI by type: Mergers and acquisitions (directional principle)

272. International standards for compiling FDI statistics described in earlier editions of the *Benchmark Definition* have focused mostly on types of financing, types of enterprises, types of transactions, etc. For the first time, a methodology was put together to construct

35. The allocation of inward amounts to outward destinations may still require some rules of thumb, which countries are asked to clarify in meta-data.

36. According to the former 3rd edition of the *Benchmark Definition*, the basis for data reporting was the directional principle which was then primarily concerned with reverse investments by direct investment enterprises in direct investors.

statistical series by types of FDI which is largely determined by the purpose of direct investment. FDI statistics encompass mainly four types of operations that qualify as FDI:

i) purchase/sale of existing equity in the form of mergers and acquisitions (M&A);

ii) greenfield investments;

iii) extension of capital (additional new investments); and

iv) financial restructuring.

273. While M&A transactions imply the purchase or sale of existing equity, greenfield investments refer to altogether new investments (*ex nihilo* investments). Extension of capital relates to additional new investments as an expansion of an established business; conceptually and in terms of economic impact, it is similar to greenfield investments. Financial restructuring refers to investment for debt repayment or loss reduction.

274. Direct investment will have, all other aspects being equal, a different impact, in particular, on the "host" economy depending on the type of FDI. It is generally considered that cross-border investments in the form of M&As will not involve significant changes in the performance of economic variables such as production, employment, turnover, etc., unless the acquired enterprise is subject to significant restructuring. On the other hand, new investments, greenfield investments and extension of capital, are likely to add new dimensions to the economic performance of the host economy and to the earnings of the direct investor.

275. Moreover, to measure the impact of FDI in host and home economies, users need detailed analytical information: FDI by type broken down by partner country and by industry (see also Chapter 2). This novel feature of FDI statistics is at the centre of arguments which have led to the revision of the *Benchmark Definition*, *i.e.* to align international standards to economic and financial developments since the last edition. To avoid any confusion, it should be clear to the reader that the statistics of M&As shown as an "of which" category of FDI are not identical to what is generally referred to as "M&A statistics" by private commercial sources compiled and disseminated outside the context of FDI statistics. It is more appropriate to call the former "M&A transactions" and the latter M&A statistics as the scope and the coverage of the two data sets differ but they remain complementary.

276. In the current edition of the *Benchmark Definition* a primary focus is to compile and disseminate on a supplemental basis FDI showing M&A type transactions, *i.e.* purchase/sale of existing FDI equity by non-residents. The examination of greenfield investments, extension of capital, and financial restructuring is deferred to the research agenda as they require further research which could not be completed in time for the publication of the present edition. However, after deducting M&A equity transactions from total FDI equity, users would be able to obtain, as a residual, "other types" of investments (for equity transactions). Compilers are also asked in their presentation of FDI for M&As to identify all relevant transactions (for both influence and control relationships – equity share 10%-100%) and to distinguish separately those involving control relationships (*i.e.* equity share more than 50%).

277. M&A as a sub-category of FDI refers to cross-border financial transactions which qualify as FDI according to the criteria described earlier. These data do not relate to FDI positions as it would be superfluous to distinguish the stock of FDI by type. Breakdowns by type of FDI have analytical significance mostly at the time of the initial decision of the

investor and for the related transaction but not in subsequent periods. Compilers are strongly encouraged to provide "M&A type transactions" as an "of which" item of total inward and outward FDI equity transactions. More specifically, data relate only to FDI financial flows in the form of equity but *exclude* reinvested earnings and debt instruments (inter-company loans). Box 4.2 describes the recommended components of the data to be compiled.

278. Furthermore, Annex 9 provides the details on how to record M&A transactions as a part of FDI equity transactions. This annex also provides a comparison of "M&A transactions" as a part of FDI and "M&A statistics".

Box 4.2. **Components of M&A transactions**

Foreign direct investment	
Inflows: *Gross* investments and divestments by non-residents	
Investment in equity	Divestment in equity
Of which:	*Of which:*
Acquisition of existing stake in resident companies by non-residents	Sale of existing stake in resident companies by non-residents
i) partner country and	*i)* partner country and
ii) industry	*ii)* industry
Outflows: *Gross* investments and divestments by residents	
Investment in equity	Divestment in equity
Of which:	*Of which:*
Acquisition of existing stake in non-resident companies by residents	Sale of existing stake in non-resident companies by residents
i) partner country and	*i)* partner country and
ii) industry	*ii)* industry
Memo items: Total of which M&A under control	
i) partner country and	
ii) industry	

Note: The above presentation relates to the conceptual framework by country allocation and by industry classification. For data dissemination, data may be disseminated at higher level of aggregation if limited by confidentiality.

4.4.2.3. FDI according to Ultimate host/investing country

279. This *Benchmark Definition* recognizes additional user needs for information, to the extent meaningful definitions allow, on the economic distribution of direct investment capital, as well as on the countries that ultimately control direct investment enterprises. These needs have grown in recent years, as ownership structures have become more complex and as it has become more common for direct investment enterprises to be owned through intermediate entities such as holding companies and regional management centres.

280. While these needs are clear-cut, the means of addressing them sometimes are far more complex. *Conceptual* difficulties may arise, for example, when funding provided to an enterprise by a direct investor is co-mingled with other funding obtained by the enterprise before being further invested in other enterprises. In addition, practical difficulties may arise in collecting detailed information on ownership chains leading to a foreign-owned enterprise in the compiling economy. In the light of these difficulties, this *Benchmark Definition* provides recommendations only for the allocation of inward investment positions for the compiling economy to the countries where the investors controlling these

positions are established. Allocation of outward positions, across ultimate host countries (including intermediate countries in longer investment chains), remains on the research agenda. At this stage, research work has not progressed enough to reallocate outward investment in an unambiguous way across different entities down the FDI ownership chain.[37]

281. Details of the recommendations for allocating inward direct investment positions to ultimate investing countries are given in Chapter 7 as well as compilation guidance in Annex 10.

4.4.3. Banks and other financial intermediaries

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

4.4.4. Financial leases

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

37. Attempts to allocate investments to ultimate host countries are hampered by difficulties related to the inter-changeability of money – linking specific sources of funding with specific uses – and by the fact that direct investments made by intermediate enterprises in ownership chains may reflect not only funding provided by direct investors, but also funding that these enterprises may, in turn, have obtained from other sources, such as local owners or lenders. Consequently, more work needs to be done to determine whether it is possible to develop reallocation schemes of outward investments.

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Chapter 5

FDI Accounting Principles and Valuation

5.1. Summary

284. This edition of the *Benchmark Definition* maintains the recommendation of the previous edition that market value is the conceptually ideal basis for valuing direct investment transactions and positions. The use of market prices is the only basis under which all parties can calculate their assets and liabilities consistently. In addition to outlining some of the main accounting principles, this chapter also provides guidance on the calculation of FDI at market value. While this might be relatively straightforward for equity transactions and positions involving companies where the equity securities are listed on an organised stock exchange, it is much less so for unlisted (or unquoted) shares. In this latter case market value may have to be estimated from the data provided by these unlisted companies. This chapter lists a number of recommended methods by which this can be achieved, as well as listing those methods that are not recommended. This chapter also discusses the valuation of debt where it recommends the use of the nominal value of the debt as the proxy to market value. Finally the valuation of transactions where transfer pricing is operating is discussed.

5.2. Accounting principles

285. In principle, FDI transactions are to be recorded when a change of equity ownership occurs between a resident and a non-resident when, and while an FDI relationship exists between the two. The creation, change or extinguishing of foreign direct investment positions results from these transactions. As stated in the System of National Accounts (SNA, 2008 Rev. 1, §3.7), "a transaction is an interaction between two institutional units by mutual agreement…". It follows that transactions and positions should be recorded on an accrual basis (see SNA, 2008 Rev. 1, §3.163), that is when the event giving rise to them occurs rather than when they are settled. While every effort is to be made to obtain data on an accrual basis, it may prove difficult to achieve this in practice. Often the sources of information determine the time at which the transactions and positions may be recorded.

286. Market prices are the appropriate principle for valuation of transactions and positions data. Market prices reflect the command that entities have currently over resources (for assets) and the current charge on their resources required for the liquidation of their liabilities. The use of market prices also serves as the only basis under which all parties can calculate their assets and liabilities consistently, and thereby helping to reduce asymmetries between the creditor and debtor. Market prices are used for transactions as they best reflect the mutual exchange of value between two unrelated entities. However, in some cases for related entities, transaction prices may not reflect market prices. These cases are referred to as transfer pricing and are discussed in Section 5.3.2.

287. Holdings included in the direct investment position may be denominated in a foreign currency. When these positions are translated into the compilation currency of the reporting economy, the closing mid-point between the buy and sell spot exchange rate relevant at the date to which balances relate should be used. Similarly, transactions should

be converted at the mid-point of the buy and sell spot exchange rates at the time of the transaction.

5.3. Valuation

288. The fourth edition of the *Benchmark Definition* maintains the earlier recommendation that market value is the conceptually ideal basis for valuing direct investment transactions and positions. The methodological guidance contained in the *Benchmark Definition* reflects the synthesis of three fundamental goals:

- first, to use *market value* as the preferred conceptual basis for measuring all positions and transactions;
- second, to provide practical guidance to enable compilers to implement the recommendations in ways that are not unduly burdensome or costly;
- third, to facilitate the compilation of statistics that are comparable across countries.

Market valuation places all assets at current prices rather than when last purchased or re-valued, and promotes consistency in the value of assets of different vintages. It also promotes consistency when comparing stocks, transactions and other flows of different enterprises, industries, and countries. It is accepted that sometimes compromises may have to be made between pure concepts and other goals such as those of practicality and comparability.

289. Although market value is the recommended basis for valuation it is recognized that, in practice, values based on the books of direct investment enterprises (or investors) are often used to determine the values of direct investment positions (stocks) or transactions. This is because enterprise balance sheet values – whether they are regularly re-valued on a current value basis, reported on a historical cost basis, or reported on some other basis – may represent the only source of information on valuation available in many countries, particularly in regard to unlisted shares. However, the collection of data from enterprises on a current market value basis is strongly encouraged whenever feasible.

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

5.3.1. Valuation of foreign direct investment positions

5.3.1.1. Equity positions

291. As noted earlier, market valuation is the recommended principle to be used when measuring equity positions. In reality, the actual market value of the equity may not be available in all cases and for these an approximation may be required. The discussion on the valuation of direct investment equity positions focuses on methods that may be used to value *quoted shares*, *unquoted shares*, and *equity in unincorporated enterprises* (including joint ventures and branches) at market values.

292. When valuing equity positions, a distinction is made between the valuation of listed equity and unlisted equity. This is because listing on an organised market provides a good basis for calculating the market value of equity, while in many cases an approximation will be necessary for unlisted equity. In either case, if there has been a material change in the financial position of an enterprise since the date to which the valuation applies (up to and

including the reference date), an adjustment may have to be made. Examples of such material events may include an unexpected decision in a lawsuit, credit downgrade or upgrade, major new invention or mineral discovery, or bankruptcy.

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

294. For countries that begin their valuation process via the collection of book value[38] information, the books of the direct investment enterprise should serve as the starting point.

295. The books of the direct investment enterprise are usually more comprehensive than those of the direct investor. This is because, under tax and financial accounting rules followed by most countries, the books of the direct investment enterprise will typically reflect current period earnings, from which retained earnings can be readily derived. Availability of direct investment enterprise accounting data therefore facilitates the compilation of inward direct investment. In contrast, the books of direct investors may not reflect the current period earnings of their direct investment enterprises; particularly in the case where these direct investment enterprises are not majority owned (these investments are sometimes carried at cost on the investor's books). Such shortcomings can have an adverse impact on the compilation of outward direct investment.

Listed (or quoted) shares

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

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

Unlisted (or unquoted) shares

298. Unlisted (or unquoted) shares represent equity not listed on an organised or public stock exchange. By their nature, a market valuation estimate is not regularly available for unlisted equity and an approximation to the market value is required to measure direct

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

investment. Several methods for approximating market value are acceptable and are discussed in detail in Annex 5.

299. In practice, the choice of the method to be used by a compiler will depend on three factors:

i) the type of information available on which to base an approximation;

ii) how well the method approximates market value; and

iii) the need to allow for comparability across countries and for symmetrical recording by creditors and debtors.

300. In most cases, these arguments are also applicable to the valuation of equity in unincorporated direct investment enterprises. To assist users, compilers should state clearly the method(s) they employ in developing their direct investment aggregates.

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

302. Flexibility in the approaches to valuing unquoted equity is recommended. Methods accepted by the *Benchmark Definition* to approximate the market value of unlisted equity positions are the following:

- Recent transaction price
- Own funds at book value
- Net asset value
  - ❖ Including goodwill and intangibles
  - ❖ Excluding goodwill and intangibles
- Market capitalization method
- Present value of expected earnings
- Apportioning market value of global enterprise group to local operation.

Each of the above methods is described in Annex 5.

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

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

These methods are also briefly described in Annex 5.

Equity in unincorporated enterprises (including branches)

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

5.3.1.2. Debt positions

305. The basic principle is that the market value of debt should be used. However, apart from debt securities, international standards (including this *Benchmark Definition*) recommend the use of nominal values as a proxy for market value for all other debt positions. The use of nominal values in valuing direct investment loans is consistent with international standards for valuation of loans with parties related under the Framework for Direct Investment Relationships (FDIR). The *Benchmark Definition* recommends that the values of all debt outstanding be inclusive of accrued interest, with foreign currency debt converted to the national currency using the rate of exchange (mid-point of the buy and sell rates) at the close of business on the reference date. The use of nominal values is partly influenced by pragmatic concerns about data availability and the need to maintain symmetry between debtors and creditors. In addition, because loans are not intended to be negotiable and do not have an active market, a market price can be somewhat subjective. Nominal value is also useful because it shows actual legal liability and the starting point of creditor recovery behaviour. In some instances, loans may also be traded, often at discount, or a fair value may exist or would be possible to estimate. It is recognized that nominal value provides an incomplete view of the financial position, particularly when the loans are impaired. Therefore, supplementary information on the fair value of the claims in loans is useful if it is available.

5.3.2. Valuation of FDI financial flows and transfer pricing

306. When a transaction in goods or services occurs between two enterprises, this transaction is to be recorded at market prices. The Balance of Payments Manual defines market prices as amounts of money that willing buyers pay to acquire something from willing sellers … on commercial considerations only – sometimes called at "arm's length".

307. Due to the nature of the relationship between enterprises related under the FDIR, the transaction value for a good or service between related enterprises may not always reflect market values. "Transfer pricing" refers to this distortion between transaction values and market values. It can be motivated by income distribution or equity injections or withdrawals. Where the distortion is significant and data is available to do so, the *Benchmark Definition* recommends that adjustments be made to remove the impact of transfer pricing.

308. Identification of instances of transfer pricing and selection of the best market value equivalents to replace reported transaction values is an exercise calling for cautious and informed judgement. In most cases, sample surveys, contacts with enterprises and government agencies engaging in international transactions on a large scale, exchanges of information between compilers in partner countries, or similar statistical research will be necessary to provide the basis for such judgement. Adjustments for transfer pricing have

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implications for the data of the counterpart economy therefore it is useful to exchange information with compilers in counterpart economies (to the extent possible) to avoid asymmetries.

5.3.2.1. Hidden dividends

309. Where a direct investment enterprise is over-invoiced on a good or service provided by the direct investor, the difference in payment between the market value and the invoice price is effectively a distribution by the direct investment enterprise to the direct investor (a "hidden dividend"). Distributed earnings and total earnings of the direct investment enterprise should be adjusted upwards by the difference (in the balance of payments, this would be balanced by an adjustment to the value of trade in goods or services).

5.3.2.2. Hidden withdrawals of equity

310. Where a direct investor is under-invoiced on a good or service provided by the direct investment enterprise, the difference in payment between the market value and the invoice price is effectively a return of assets by the direct investment enterprise to the direct investor (goods) or a rundown of the assets of the direct investment enterprise by the direct investor (services). This is a withdrawal of equity and equity transactions should be adjusted by the difference. In addition, the earnings of the direct investment enterprise should be adjusted upwards by the same amount.

5.3.2.3. Hidden injections of equity

311. Where a direct investment enterprise is under-invoiced on a good or service provided by the direct investor, or a direct investor is over-invoiced on a good or service provided by the direct investment enterprise, the difference between the market value and the invoice price is effectively an injection of equity into the direct investment enterprise by the direct investor. This injection takes the form of provision of additional assets (under-invoiced goods), improvement in the operational capacity (under-invoiced services) or cash (over-invoices). Equity transactions should be adjusted to remove the impact of the transfer pricing. Also, the earnings of the direct investment enterprise should be adjusted downwards by the same amount.

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Chapter 6

Special Entities

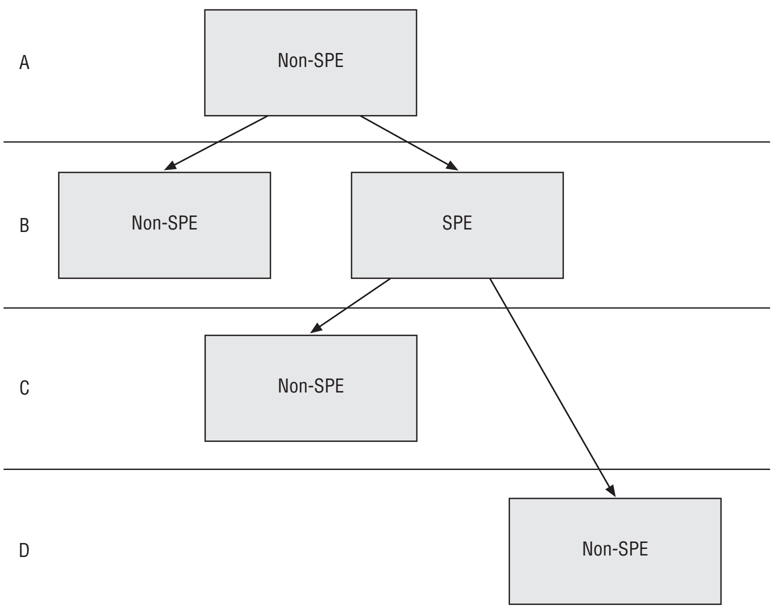
6.1. Summary

312. There are a number of special cases where it may be unclear whether or why a particular type of enterprise or activity qualifies for treatment as a direct investment enterprise or direct investment. Several of these cases are discussed below. These are Special Purpose Entities (SPEs); collective investment institutions (CIIs); land, structures and other immovable objects; construction enterprises; mobile equipment; and insurance companies.

6.2. Special purpose entities

313. Multinational enterprises (MNEs) often diversify their investments geographically, through organisational structures. These may include certain types of SPEs. Examples are *financing subsidiaries* , *conduits*, *holding companies*, *shell companies, shelf companies and brass-plate companies* (Box 6.1). Although there is no universal definition of SPEs, they do share a number of features. They are all legal entities that have little or no employment, or operations, or physical presence in the jurisdiction in which they are created by their parent enterprises which are typically located in other jurisdictions (economies). They are often used as devices to raise capital or to hold assets and liabilities and usually do not undertake significant production. In Figure 6.1, for instance, the SPE in country B is used by its parent in country A to indirectly hold enterprises in country C and country D. As explained in Chapter 4, country B should distinguish FDI positions and transactions of SPEs and non-SPEs.

Figure 6.1. **Positions held *via* an SPE**



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314. As legal devices SPEs may be relatively cheap to create and to maintain. They may offer taxation, regulatory, and confidentiality benefits. Incorporation of SPEs is often associated with off-shore financial centres[39] but they may also be found in other jurisdictions.

Box 6.1. **Some examples of SPEs: Shell companies, conduits and holding companies**

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

A *conduit* is a company that obtains or borrows funds, often from unaffiliated enterprises, and remits those funds to its direct investor or another affiliated enterprise. A *holding company* is established to hold participation interests in other enterprises on behalf of its owner. Some conduits and holding companies may have a substantial physical presence as evidenced by, for example office buildings, equipment, and employees. Others may have little or no physical presence and may exist only as shell companies. If a direct investor incorporates a shell company or conduit in a non-resident economy and manages or operates it entirely from its own home economy, it is treated as an incorporated direct investment enterprise in its country of incorporation. If a shell company is incorporated abroad but all of its physical assets, operations, or management activities are in a second foreign country, then it is classified as a direct investment holding company in its country of incorporation, and its activities in the second foreign country would be evaluated to determine whether a separate institutional unit exists and thus be treated as a direct investment enterprise. Similarly, if a shell company is incorporated abroad and has some physical assets or operations in two or more other foreign countries, the resident unit in the country of incorporation is classified as a holding company, and the activities in the other foreign country are evaluated individually to determine whether they meet the criteria for treatment as a direct investment enterprise.

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

315. SPEs are residents of the economies in which they are incorporated and, therefore, they may be direct investors or direct investment enterprises, even if they are shell companies or pass-through entities without any other productive economic activity of their own. They qualify as part of a direct investment relationship (and are included with the Framework for Direct Investment Relationships – FDIR) by virtue of being resident in one economy and being owned by, or owning, an enterprise in a different economy in compliance with the 10% voting power criterion. Consequently, in Figure 6.1, country B

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

should include in its FDI assets and liabilities presentation all the FDI investments held by or in resident SPEs as well as the FDI investments held by or in resident non-SPEs.

316. In recent years, direct investors have made an extensive use of SPEs for the purpose of channelling funds to, and for borrowing funds from, third countries, and for the purpose of holding ownership interests in direct investment enterprises. As a result, when a country hosts SPEs and includes them in its FDI statistics, an increasing part of transactions and positions merely reflects the channelling of funds *via* this country. This can lead to a more and more significant overstatement of FDI activity. FDI transactions passing through a SPE generally do not have the expected immediate impact of direct investment concerning matters such as technology transfers, access to competitive markets, and poverty reduction in the SPE host countries. As a consequence, users are more and more interested in series segregating transactions and positions of SPEs, which are purely pass-through capital, and which render the data difficult to interpret for policy or other decision making processes. Therefore, in standard presentations of FDI according to this *Benchmark Definition*, countries should explicitly separate FDI statistics on SPEs and non-SPEs for reporting according to the directional principle.

317. Since there is no internationally agreed definition of SPEs, this *Benchmark Definition* provides some criteria to assist compilers to identify resident SPEs, in case they do not yet distinguish them on the basis of a national legal or statistical definition of SPEs. Many varieties of SPEs exist, but the general criteria listed below (Box 6.2) could nonetheless be used to identify them and be further refined by individual countries, depending on specific, national features of resident SPEs.

Box 6.2. **General criteria to assist compilers to identify SPEs**

An enterprise is usually considered as an SPE if it meets the following criteria:

i) The enterprise is a legal entity,

  a) formally registered with a national authority; and

  b) subject to fiscal and other legal obligations of the economy in which it is resident.

ii) The enterprise is ultimately controlled by a non-resident parent, directly or indirectly.

iii) The enterprise has no or few employees, little or no production in the host economy and little or no physical presence.

iv) Almost all the assets and liabilities of the enterprise represent investments in or from other countries.

v) The core business of the enterprise consist of group financing or holding activities, that is – viewed from the perspective of the compiler in a given country – the channelling of funds from non-residents to other non-residents. However, in its daily activities, managing and directing plays only a minor role.

318. If a special entity has only assets and liabilities *vis-à-vis* affiliated non-residents, its classification as an SPE is straightforward. In some instances, however, MNEs may use existing operational companies to perform functions usually associated with SPEs. SPEs may also be members of more complicated resident groups consisting of both SPEs and non-SPEs. Countries are recommended to deal with these cases in line with the above

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recommendations, the aim of which is to separately identify all FDI transactions and positions not having the economic impact usually to be expected of them in the reporting economy where these companies are established. A way to treat local mixed groups of SPEs and non-SPEs is suggested in Annex 7.

319. Not only may the amounts of FDI shown in statistical presentations be inflated (by the inclusion of *resident* SPEs), the geographical and industry *breakdowns* of FDI statistics may also be distorted (by the inclusion of *non-resident* SPEs). In the latter context, if the non-resident counterpart is an SPE, the economic impact of investments is generally expected to occur in a country other than the country of that SPE (the immediate counterpart country). In Figure 6.1, for instance, the ultimate direct investment enterprises of A are actually located in countries C and D.[40] This *Benchmark Definition* therefore recommends this distortion be addressed as well, and to differentiate between non-resident SPEs and non-resident non-SPEs. If the non-resident counterpart is an SPE, countries are encouraged to *look through* the country where it is located, and to reallocate on a supplemental basis the reported amounts to the country of the direct investor or direct investment enterprise corresponding to the first non-resident non-SPE encountered. When the reporting SPE is part of a chain of entities, the reallocation should aim at the first non-SPE encountered. Countries are encouraged to provide supplemental breakdowns of positions and transactions on the basis of "*first non-SPE*" counterparts.

320. The reallocation of transactions/positions to the first non-SPE countries contributes to economically more meaningful FDI data. Due to practical difficulties it may not always be easy or possible for data reporters or compilers to look through non-resident SPEs. It would therefore be desirable if one could then also rely on information provided by the "SPE countries" themselves. This *Benchmark Definition* therefore also suggests each country hosting a significant number of SPEs to provide on voluntary basis information on the specific routes followed by capital flowing into and out of its SPEs.[41]

6.3. Collective investment institutions

321. The *Benchmark Definition* recommends that, when an investor in one economy acquires at least 10% of the voting power in a collective investment institution (CII) in another economy, this investment should be regarded as direct investment. Similarly, when a CII owns at least 10% of the voting power in a non-resident entity, whether it is a CII or not, this should also be considered as direct investment. More precisely, investment in and investment by CIIs, such as mutual funds, feeder/master funds, hedge funds and distressed funds, should be included in FDI data if the standard 10% voting power threshold is met (see Annex 8 for examples of CIIs).

6.4. Land, structures and other immovable objects

322. Ownership of land and structures, including natural resources, in the compiling economy by an entity resident in another economy establishes a direct investment

40. It should be noted that the amount of FDI leaving country A need not be equal to the amount arriving in country C. This simply reflects the intermediary role of the SPE between entities in a multinational enterprise (the SPE may raise additional funds outside the group, transform equity received from its parent into loans provided to a subsidiary, etc.; see Annex 7).

41. Annex 7 explains the concept of so-called origin and destination matrix for SPEs, which gives an indication of the way funds coming from one country have been passed through to other countries.

relationship. The one-year rule that is usually used to define centre of economic interest (see Chapter 3, Section 3.2) does not apply to land and buildings. Land is always considered to be the property of the residents of the economy in which it is located. The only exception to this general concept is the ownership of land and buildings by foreign governments in the form of embassies, consulates, military bases, scientific stations, information or immigration offices, aid agencies, etc.[42]

323. An entity resident in one economy may acquire direct ownership (that is, without the creation of a separate legal entity) of land or buildings in another economy. The relevant transactions, positions and associated income flows should be recorded in the direct investment statistics of both economies. However, given the specific nature of the assets acquired, a notional direct investment enterprise is created by the relevant compilers as the immediate owner of the assets in question. This notional enterprise is deemed to be resident in the economy where these assets are located. The actual owner of the assets, *i.e.* the direct investor resident in another economy is deemed to own the notional enterprise. In other words, land, structures, and other immovable equipment in the host economy that are indirectly owned by a non-resident entity should be regarded as direct investment enterprises, even if the period of ownership is less than one year. Acquisitions of land, mineral rights, and associated assets, and preparatory expenses for future direct investment units should be regarded as direct investment transactions.

324. Within the context of the previous paragraph, land and buildings owned for personal use but not for production or other business purposes are also considered as direct investment enterprises. Holiday and second homes owned by non-residents should therefore be treated in the same way as described above. Similarly where an investor resident in one economy acquires at least 10% of the ownership of property in another economy for commercial purposes (*e.g.* rental residential or office accommodation) this investment constitutes FDI.

325. In accordance with the System of National Accounts (SNA), in contrast to an operational lease, the existence of a financial lease on land and buildings gives rise to the creation of a notional direct investment enterprise with the understanding that it should be for a very long period rather than for a few years.

Box 6.3. **Definition of land**

Land is the ground, including the soil covering and any associated surface waters, over which ownership rights are enforced; included are major improvements that cannot be physically separated from the land itself but it excludes any buildings or other structures situated on it or running through it; cultivated crops, trees and animals; subsoil assets; non-cultivated biological resources and water resources below the ground (SNA, 2008, § 10.175).

326. Where a direct investment enterprise is established for the purposes of *natural resource exploration*, its exploration expenditures should be capitalised (even if the exploration does not prove sufficient economic resources to be viable) as part of the equity investment in the direct investment enterprise and written off (or written-down) as

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

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appropriate. This promotes consistency with the *SNA* , which treats these expenditures as fixed capital formation.

327. For example, assume an oil company incorporates a direct investment enterprise that drills an oil well. Assume also that the direct investor makes an equity investment in its direct investment enterprise of 100 in period 1 (including expenditure on bonus preliminary fee payments made by the direct investor to a resident of the host country, usually the government for the right to undertake exploration for natural resources), 30 in period 2, and then closes down the operation at the end of period 2 when the well proves to be dry. There is a financial flow from the direct investor to the direct investment enterprise of 100 in period 1 and 30 in period 2 in direct investment accounts of both economies. No further entries for cross-border transactions are recorded after the shutdown of the operation in period 2. Instead, a negative stock adjustment of 130 is made in the direct investment asset position of the economy where the oil company parent is located, and an equal reduction is made in the direct investment liability position of the economy where the affiliate was located.[43]

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

6.5. Construction enterprises

329. A *construction enterprise* in one economy may undertake the construction of plant, buildings, etc., in another economy through subsidiary or associate companies in that economy, through a foreign branch in that economy, or by directly undertaking the work itself. The construction work abroad is to be regarded as a direct investment activity in the economy in which it is being carried out in the first two circumstances. If the construction enterprise undertakes the work itself (such as through an unincorporated site office), its activities may be regarded either as a direct investment activity or as an export of services by that enterprise, depending on circumstances. If certain criteria are met, such as the project extending over a period of at least one year, the maintenance of a complete and separate set of accounts for the activity (*i.e.* income statement, balance sheet, transactions with the parent company, etc.), the activity being subject to tax and other legislation in the host country, the existence of a substantial physical presence, the receipt of funds for its work for its own account, etc. the work undertaken is to be treated as having involved the creation of a separate institutional unit – a branch – resident in the economy where the activity is being carried out and therefore a direct investment enterprise. If the criteria are not met, the activity is to be treated as an export of services by the construction enterprise. Constructions involved with major projects (bridges, dams, power stations, etc.) that are carried out through unincorporated site offices, in most cases, meet the criteria that requires treatment as the production of a resident unit, *i.e.* a direct investment enterprise

43. Both adjustments should be recorded under "volume changes" in the international investment position.

and thus as part of the production of the host economy, not as an export of services to that economy.

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

6.6. Mobile equipment

331. The operator of mobile equipment (such as ships, aircraft, gas and oil drilling rigs) that operate within a single economy for at least one year and that fulfil the criteria for treatment as an unincorporated direct investment enterprise should be treated as direct investment branches (see also Chapter 3).

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

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

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

334. If the owner and the operator are the same entity (such as when the owner operates the ship in its own economy of residence), then there is no direct investment. If the owner and the operator are not the same entity (or are not related), then they are separate institutional units. The owner will typically receive a fee from the operator, reflecting the payment (rental services) for the use of the vessel. In this case, the owner is a lessor, and is not a provider of transportation services. The operator of the vessel provides transportation services; it receives revenues for transporting passengers and/or freight, pays wages to crew members (who may be residents of a different economy than the operator), and incurs other transportation-related expenses including port expenditures. The relationship between the owner and the operator of the ship is essentially that of a lessor and its lessee, not that of direct investor and a direct investment enterprise, though it is possible that they could be in a direct investment relationship if the lessor owns at least 10% of the voting power in the lessee.

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

336. The classification of management offices and business promotion and ticket sales offices also depends upon the criteria listed for the determination of, firstly, the existence of an institutional unit and then for a direct investment enterprise. In some circumstances, they will qualify for classification as direct investment and, in other circumstances, they will not. Under the criteria used to determine the existence of direct investment (see Chapter 3), a distinction should be made between those enterprises that engage in real economic activities and have income statements, etc., and units that are set up to increase sales of the institutional units that established them but that have no sales of their own, such as ticket sales offices and business promotion offices.

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

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

6.7. Insurance

339. The treatment of insurance raises many complex methodological questions. Most of these questions have applicability beyond direct investment, such as to portfolio investment, other investment, other investment income, and services (see BPM6). The *Benchmark Definition* is intended to be fully consistent with the other major international standards where cross-cutting questions concerning the handling of insurance and insurance enterprises are more thoroughly discussed.

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

341. One complex area involves the treatment of non-life insurance company technical reserves (actuarial reserves against outstanding risks, prepayments of premiums, reserves for with-profits insurance, and reserves against unsettled claims). Normally, these reserves should not be included in the direct investment equity position, because these are amounts that are considered to be set aside for eventual payment of claims to policyholders. In the special case of a captive insurance affiliate, however, the policyholder

may be affiliated with the insurance enterprise. Businesses may establish or acquire a "captive" insurance company, in order to obtain insurance coverage for unusual types of risk, or for lower premiums than may be available commercially. In this case, a 10% or more ownership level often is reached, and the captive insurance company then meets the criteria for treatment as a direct investment enterprise.

342. In this circumstance, the technical reserves should be included in the direct investment debt component of the position.

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

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

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Chapter 7

Classification of FDI by Economy and Industry

7.1. Summary

345. The classification of investment by partner country and by industry sector are the two major dimensions required in presenting more detailed analyses of foreign direct investment (FDI) statistics under the directional principle. These detailed directional data are complementary with the FDI assets and liabilities aggregates also recommended by this *Benchmark Definition* and published as a part of the balance of payments and international investment position statistics. This chapter describes the recommended methodology for presenting these detailed breakdowns of direct investment statistics by partner country and industry sector under the directional principle.

346. In summary, for a reporting economy under the directional principle:

i) FDI statistics should be compiled by immediate partner country using the debtor/creditor principle. Ideally, the geographical allocation should exclude resident Special Purpose Entities (SPEs) and "look through" non-resident SPEs involved in investment chains and should reflect the first non-SPE host/investing country. However, given the practical difficulties involved for compilers, this *Benchmark Definition* recommends the use of both standard and supplemental presentations for dealing with the statistics concerning SPEs. In addition, it is strongly encouraged that supplemental inward FDI position statistics be compiled on an ultimate investing country (UIC) basis.

ii) FDI statistics by sector of industrial activity should be compiled on a similar basis to that outlined for partner country above. Each direct investor/direct investment enterprise should be classified to a single industry, according to the main activity of the enterprise. As a core requirement, industry classification of positions and transactions should be compiled according to the activity of the direct investment enterprise (and on a supplemental basis according to the activity of the direct investor) for both inward and outward investments. In addition, the compilation on a supplemental basis of inward FDI position statistics according to the industrial sector of the ultimate investing country is encouraged.

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

iv) FDI equity by type for merger and acquisition (M&A) transactions compiled by partner country and by industrial sector is strongly encouraged on a supplemental basis. When dissemination of such data is limited due to confidentiality, data can be presented for higher partner country or industry aggregates. This present edition of the *Benchmark Definition* limits the FDI data by type to M&A and the residual element.

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7.2. Attribution to an economy[44]

7.2.1. General principles to identify home and host economies

347. Direct investment statistics, *i.e.* financial transactions and positions and associated income flows, should be compiled under the *directional principle* described in Chapter 3 and Chapter 4. The statistics should be published for all partner countries individually as well as for major geographical regions or economic zones and currency or monetary unions. Country and regional statements are of prime importance to direct investment statistics. In addition to analytical uses of such detailed information (see Chapter 2), bilateral data provide valuable information to compilers to identify and to examine at a more detailed level potential quality concerns in the data when large differences arise in bilateral comparisons.

348. Notwithstanding the general guidance above for compiling direct investment statistics, compilers have obligations to protect confidentiality of sensitive data. Their obligations to protect data may at times limit their ability to disseminate transactions/ positions at the level of an individual economy. When necessary, compilers are encouraged to combine individual country data in higher aggregates that allow the release of as much geographical detail as their confidentiality constraints allow.

349. In general, the organisational structures of multinational enterprises (MNEs) are changing more frequently than before. These changes may impact on the allocation of FDI to an economy, especially as a particular counterpart within an MNE may cease to exist, or where FDI interactions occurring with one partner country up to a point in time may change to another partner country. The methodology to record standard and supplemental FDI series is described in Chapter 4. The detailed requirements of the standard and supplemental FDI series are given in Annex 2 including the country codes to be used.

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

351. There are two possible approaches to identify the home country (of the direct investor) for inward FDI and the host country (of the direct investment enterprise) for outward FDI:

- *i)* by immediate host country/investing country (IHC/IIC),
- *ii)* by ultimate host country/ultimate investing country (UHC/UIC).

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

352. While the identification of IHC and IIC is generally straightforward that of UIC is more complex and that of UHC even more so. Compilers in countries with well developed business registers that include the ownership links of their MNEs (often limited to control links only) may find these of assistance in identifying the UIC. It may also help with the UHC but as the outward FDI may pass through an influence link (and the fact that outward chains of FDI can split) mean that further investigation beyond the business registers is needed to identify the UHC. This *Benchmark Definition* recommends a supplemental presentation by the UIC. Identification of the UHC remains the subject of further research (Annex 13).

7.2.2. Standard and supplemental geographical presentations

353. The standard geographical presentational requirement recommended is that all inward and outward FDI transactions, positions and associated income flows be compiled for the reporting economy on a directional basis, excluding resident SPEs, according to the host (outward FDI) or investing (inward FDI) economy of residence of the immediate partner. This parallels the debtor/creditor principle as it is the country to which the funds are payable, or from which the funds are receivable that determines the actual host/investing country.

354. Moreover, the standard geographical presentation also requires, on the same basis, that the reporting economy presents separately FDI transactions, positions and associated income flows of all its resident SPEs. This presentation of the core data facilitates users assessing the impact of SPE activity in individual economies and also helps in reconciling the directional data with the overall FDI asset/liability based aggregates.

355. On a supplemental basis, compilers are strongly encouraged to compile four sets of additional FDI data (see also Chapter 4):

i) The first supplemental data request concerns inward and outward FDI data (transactions, positions and income) according to the directional principle excluding resident SPEs and looking through non-resident SPEs, involved in inward or outward FDI investment chains. The data should show the partner country analysis as determined by the first non-SPE encountered for inward and outward investment chains. For outward FDI, the data reflect the economy of the first non-resident non-SPE subsidiary, associate or unincorporated enterprise (including branch) which is a direct investment enterprise. For inward FDI, the data reflect the economy of the first non-resident non-SPE investor which is a direct investor. This analysis facilitates users assessing the impact of FDI on economies in terms of the most immediate source and destination of investment when the impact of SPEs is removed from the data.

ii) The second supplemental data request concerns inward and outward FDI data (transactions, positions and income) according to the directional principle (as defined in Chapter 4) including all entities whether SPEs or not. The data should show the economy of residency of the immediate partner for both inward and outward investment. These data provide historical consistency and may facilitate cross country analysis as they are on the same basis as the 3rd edition of the *Benchmark Definition*.

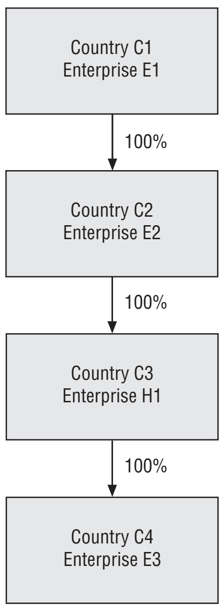
iii) The third supplemental data request concerns inward and outward FDI equity flows showing information on M&A according to the directional principle. The data should show inward and outward transactions (not positions) concerning the purchase/sale of existing equity classified according to the economy of residency of the first non-SPE. This analysis facilitates users in determining the extent to which investment activity relies on M&A as opposed to other modes of FDI activity.

iv) The fourth supplemental data request concerns inward FDI positions for equity and debt according to the ultimate investing country (UIC). This analysis facilitates users in determining the location of the ultimate source of control of the stocks of inward FDI for a reporting economy. As mentioned requirements for outward FDI data according to the ultimate host country are the subject of further research.

356. While compilers will necessarily take account of possible confidentiality constraints in disseminating results, such presentations should be developed with the maximum possible level of detail for individual economies to be of most help to data users.

357. The simple example illustrated in Figure 7.1 below is included to demonstrate the basic approach towards preparing standard and supplemental geographical data under the directional principle (although in reality business combinations may be much more complex). An ultimate parent company in economy C1 (E1) acquires existing shares (10% or more) of a subsidiary company in economy C2 (E2). The latter company makes an equity investment in its direct investment enterprise in economy C4 (E3) through its SPE holding company in economy C3 (H1). E2 in C2 also provides a loan directly to enterprise E3 in C4.

Figure 7.1. **Example of Immediate Investor Country (IIC) and Ultimate Investing Country (UIC)**



358. In Figure 7.1, H1 in country C3 is the immediate direct investor in E3 in country C4 and hence C3 is the immediate investor country for E3. Similarly C2 and C1 are the immediate investor countries for H1 and E2 respectively. As E1 is the ultimate controlling investor in all of the enterprises below it, C1 is the ultimate controlling investor country for each of these enterprises.

359. More complex examples can be constructed in which multiple chains of ownership emanate from a given direct investment enterprise. However, the allocation principles that should be followed are the same as those described above, with the investment in each chain individually allocated to immediate and, alternately ultimate investing countries.

360. For the first standard geographical presentation (excluding resident SPEs), reporting (for example) by economy C3 and C4 should be as follows:

- *Inward/outward direct investment country allocation (excluding resident SPEs):*
  - ❖ Because a resident SPE is involved in the investment chain, C3 (H1) will show no inward investment from C2 (E2). For the same reason, C3 will show no outward investment to C4 (E3).
  - ❖ C4 (E3) will show inward investment from the holding company H1 in C3.
  - ❖ C4 (E3) will record under inward investment the loan transaction and position from the parent (E2) for country C2.

361. For the second standard geographical presentation showing the activity of resident SPEs, reporting (for example) by economy C3 should be as follows:

- *Inward/outward direct investment country allocation for resident SPEs:*
  - ❖ Because a resident SPE is involved in the investment chain, C3 (H1) will show inward investment from C2 (E2) and C3 will show outward investment to C4 (E3).

362. For the first supplemental geographical presentation of FDI excluding or looking through all SPEs whether resident in the reporting economy or not, reporting (for example) by economy C3 and C4 should be as follows:

- *Inward/outward direct investment country allocation excluding all SPEs:*
  - ❖ Because a resident SPE is involved in the investment chain, C3 (H1) will show no inward investment from C2 (E2). For the same reason, C3 will show no outward investment to C4 (E3).
  - ❖ C4 (E3) will look through SPE holding company H1 in C3 and record under inward investment the equity transaction and position from its parent enterprise E2 for country C2 as this is the first non-SPE in the inward investment chain.
  - ❖ C4 (E3) will record under inward investment the loan transaction and position from the parent (E2) for country C2.

363. For the second supplemental geographical presentation of FDI including all entities with allocation according to immediate partner country, reporting (for example) by economy C3 and C4 should be as follows:

- *Inward/outward direct investment country allocation including all entities:*
  - ❖ C3 (H1) will show inward investment from C2 (E2) and C3 will show outward investment to C4 (E3) even though H1 is an SPE.
  - ❖ C4 (E3) will show inward investment from the SPE holding company H1 in C3.
  - ❖ C4 (E3) will record under inward investment the loan transaction and position from the parent (E2) for country C2.

364. For the third supplemental geographical presentation of FDI showing mergers and acquisitions transactions data for equity only according to the first non-SPE partner economy, reporting (for example) by economy C1, C2 and C4 should be as follows:

- *Mergers and acquisitions transactions country allocation:*
  - ❖ C1 (E1) will record the outward direct investment equity transaction (only) to show the acquisition of E2 in C2.
  - ❖ C2 (E2) will record the inward direct investment equity transaction (only) to show the acquisition by E1 in C1 of E2. If, prior to its acquisition by E1, E2 had an existing direct investor then it will be necessary for C2 to record the relevant disinvestment as well under inward direct investment (mergers and acquisitions).
  - ❖ C2 (E2) will record the outward direct investment equity transaction (only) to show the acquisition of E3 in C4.
  - ❖ C4 (E3) will record the inward direct investment equity transaction (only) to show the acquisition by E2 in C2 of E3. If, prior to its acquisition by E2, E3 had an existing direct investor then it will be necessary for C4 to record the relevant disinvestment as well under inward direct investment (mergers and acquisitions).

365. For the fourth supplemental geographical presentation of FDI showing inward FDI positions according to the economy of location of the investor of the ultimate investing country (for example) reporting by economy C4 should be as follows:

- *Inward direct investment positions ultimate investing country allocation:*
  - ❖ C4 (E3) will allocate all inward equity positions, emanating from C2 (E2) via C3 (H1), to the ultimate controlling parent E1 resident in country C1 (*i.e.* not to country C2 (E2) or to C3 the location of the holding company H1) as E1 is the ultimate controlling parent of the investor H1;
  - ❖ C4 will record inward loan (debt) positions from the parent (E2) in country C2 to country C1 (E1), the ultimate investing country of the controlling parent as E1 is the ultimate controlling parent of the investor E2.

7.3. Industry classification

7.3.1. General principles to identify industry allocation

366. There is significant interest in the industry classification of both direct investment enterprises and their direct investors. Direct investment enterprises and direct investors engage in a variety of economic activities. For a comprehensive economic analysis, enterprises should be grouped by type of economic or industrial activity. Under ideal circumstances, data should be available to compilers to classify both inward and outward direct investment on a dual basis to the industry of the direct investment enterprise and the industry of its direct investor. Compilers are requested to present direct investment statistics on a directional basis and classified according to the economic activity of the counterparts involved.

367. If data for both inward and outward direct investment cannot be compiled on both of these bases, the *Benchmark Definition* recommends that data be compiled *at least* according to the activity of the direct investment enterprise, for both inward and outward direct investment. In other words, inward direct investment should reflect the industry of the resident direct investment enterprise and outward investment should reflect the industry of the non-resident direct investment enterprise. Compilers are encouraged to provide on

a supplemental basis the inward and outward investment data according to the economic activity of the direct investor.

368. Each direct investor and each direct investment enterprise must be classified to a single industry, even though many direct investors and direct investment enterprises are involved in a wide range of activities. The industry classification of the enterprise should be based on its principal economic activity. Ideally, the principal activity can be determined on the basis of which activity contributes most to the value added of the enterprise. In some cases, it is recognised that data on value added may not be available and that data on sales, revenues, or payroll or other basis may need to serve as a proxy. The detailed requirements of the standard and supplemental FDI series are given in Annex 2 including the industry codes to be used.

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

370. Data that are presented based on the industry of the direct investment enterprise should be based on the reporting enterprise. (If the reporting unit is a direct investment enterprise and, at the same time, a direct investor, its industry classification should be based on the activities that it conducts and should exclude those conducted by its own FDI enterprises.) It is recommended that the industry of the enterprise represents the principal activity of that enterprise, including all of its subsidiaries, associates and branches in its country of residence.

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

7.3.2. Standard and supplemental industrial activity presentations

372. The two standard presentations required for the geographical analysis (see Section 7.1.2) are also required for the industrial or economic activity analysis:

i) The standard industrial activity presentational requirement recommended is that all FDI transactions, positions and associated income flows be compiled for the reporting economy on a directional basis, excluding resident SPEs, according to the industrial activity of the resident direct investment enterprise involved for inward investment and of the direct investment enterprise abroad for outward investment.

ii) As for the partner country allocation, the standard presentation requires the reporting economy presents on the same basis all FDI transactions, positions and associated income flows of all its resident SPEs.

373. All of the supplemental presentations required for the geographical analysis are also required for the industrial or economic activity analysis based on the activity of the direct investment enterprise involved.

i) The first supplemental data presentation concerns inward and outward FDI data (transactions, positions and income) according to the directional principle

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excluding resident SPEs and looking through non-resident SPEs involved in inward or outward FDI investment chains. The presentation should show an analysis according to the industrial activity of the direct investment enterprise involved *i.e.* that of the resident direct investment enterprise for inward investment, and that of the first non-SPE encountered for outward investment chains.

ii) The second supplemental data presentation concerns inward and outward FDI data (transactions, positions and income) according to the directional principle including all entities whether SPEs or not. This presentation should facilitate cross-country analysis by industry.

iii) The third supplemental data presentation concerns inward and outward FDI data showing information on mergers and acquisitions according to the directional principle. The data should show inward and outward equity transactions (only) concerning the purchase/sale of existing equity classified according to the industrial activity of the direct investment enterprise involved *i.e.* that of the resident direct investment enterprise for inward investment and that of the first non-SPE enterprise abroad for outward investment.

iv) The fourth supplemental data presentation concerns inward FDI positions for equity and debt according to the industry of the ultimate investing country. This analysis complements the supplemental country analysis according to ultimate investing country.

374. Additional supplemental industrial activity presentations are encouraged whereby the above requirements (*i.e.* two standard and four supplemental, giving data classified according to the industrial activity of the inward/outward direct investment enterprise) would be repeated but with the analysis based on the industrial activity of the inward/outward direct investor.

7.3.3. International Standard Industry Classification (ISIC)

375. Countries should compile data by industries that correspond to the major tabulation categories in the United Nations' ISIC (or NACE equivalent). The major categories in ISIC Revision 4 (and which are common to NACE Rev. 2) are:[45]

A) Agriculture, forestry and fishing

B) Mining and quarrying

C) Manufacturing

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

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

F) Construction

G) Wholesale and retail trade

H) Transportation and storage

I) Accommodation and food service activities

J) Information and communication

K) Financial and insurance activities

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

L) Real estate activities

M) Professional, scientific and technical

N) Administrative and support services

O) Public administration

P) Education

Q) Human health and social work

R) Arts, entertainment and recreation

S) Other services activities

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

U) Activities of extra-territorial organizations and bodies

7.3.4. Holding companies

376. The classification of holding companies merits additional clarification. ISIC4 provides the ability to distinguish between two types of holding activities: financial and management activities:[46]

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

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

- ❖ head offices,
- ❖ centralised administrative offices,
- ❖ corporate offices,
- ❖ district and regional offices,
- ❖ subsidiary management offices.

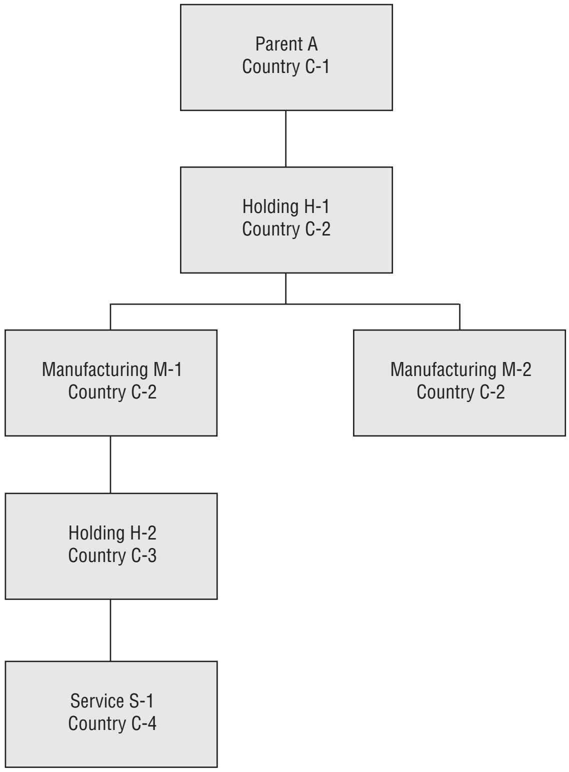
377. If a holding company has subsidiary operations in the local economy as well as abroad, the approach to classifying the holding company should be based on the predominant activity of the local enterprise group.

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

Case 1: Holding Company H-1 has two manufacturing subsidiaries, company M-1 and company M-2, both in country C-2. In turn, company M-1 has a holding-subsidiary H-2 in country C-3. *The industry classification of H-1 should be manufacturing* (Figure 7.2).

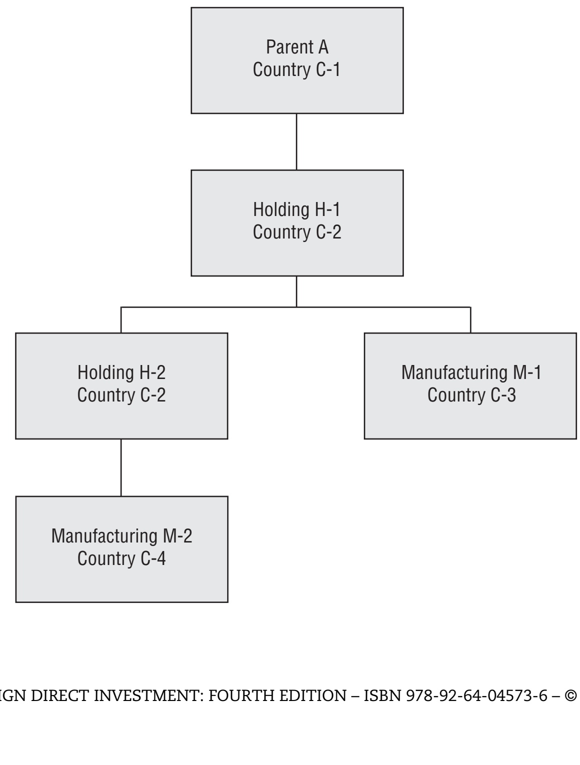
46. The ISIC definition of holding companies, applied within the industry classification of FDI statistics is different from the definition in the SNA, used for institutional sector classification.

Figure 7.2. **Industry classification of holding companies (1)**



Case 2: Holding Company H1 has two subsidiaries of which one is a resident holding company H-2 in country C-2 and a non-resident manufacturing subsidiary M-1 in country C-3. Holding subsidiary H-2 in turn has a non-resident manufacturing subsidiary in country C-4. *The industry classification of H-1 should be holding activities* (Figure 7.3).

Figure 7.3. **Industry classification of holding companies (2)**



7.4. Country attribution linked with industry classification

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

Top-top aggregation of ISIC:

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

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Chapter 8

FDI and Globalisation

8.1. Summary

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

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

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

- What is the value of inward and outward FDI relative to the size of home and host economies?
- How does the return on FDI compare to the investment positions from which the return is generated?
- What is the value of goods and services delivered – or sold – by foreign affiliates, both in their countries of location and elsewhere?
- How much of this value represents value added within the affiliates, as compared to value added by the producers that supply affiliates with intermediate inputs or goods for resale?
- What is employment by foreign affiliates, and how does it compare with employment in home and host economies, or with total employment within the multinational firms to which they belong?
- How much international trade is accounted for by foreign affiliates or by direct investors? What is the value of the goods and services that they export and import?

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383. The indicators that are suggested to address such questions fall into two major categories – FDI-based indicators and indicators drawn from statistics on the activities of foreign affiliates. International recommendations for the compilation of both types of indicators are found in the *OECD Handbook on Economic Globalisation Indicators (OECD Handbook)*. Guidelines for activity-based indicators may also be found in the international *Manual on Statistics of International Trade in Services (MSITS)*, and in the Eurostat Recommendations Manual on the production of Foreign Affiliate Statistics (FATS). With regard to activity-based indicators, all of these guidebooks, in turn, draw upon the *System of National Accounts (SNA)* in identifying the firms that should be covered and defining the indicators that are to be compiled.

384. The main recommendations of this chapter are summarised below, both for FDI-based indicators of globalisation and for statistics on the Activities of Multinational Enterprises (AMNE).

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

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

- *i)* AMNE statistics should cover *controlled* affiliates, as defined in the FDIR. However, countries that are able to do so may wish to provide supplemental statistics covering cases in which foreign control may be deemed to be present, even though no single foreign direct investor holds a majority stake.
- *ii)* For statistics on foreign-owned affiliates in the compiling economy (inward AMNE statistics), the first priority for geographical attribution should be the country of ultimate investor. However, to facilitate linkages with FDI data, countries are encouraged also to provide some data in which attribution is based on the country of the immediate investor (first foreign parent). Statistics for foreign affiliates of the compiling economy (outward AMNE statistics) should be attributed based on the country of location of the affiliate whose operations are being described.
- *iii)* Because it is the basis required for some variables as well as the basis on which data probably are, at present, most widely available, an activity basis is recommended as the initial priority for AMNE statistics. However, the provision of data on a product basis is recognised as a longer-term goal, and countries are encouraged to work toward providing product detail for those variables that lend themselves to this basis of attribution (namely, sales [turnover] and/or output, exports, and imports).
- *iv)* For reporting to international organisations, AMNE variables should be disaggregated according to the ISIC.
- *v)* It is recommended that the AMNE variables to be collected include at least the following basic measures of foreign affiliate activity: *i)* sales (turnover) and/or output, *ii)* employment, *iii)* value added, *iv)* exports and imports of goods and services, and *v)* number of enterprises. Additional measures are suggested for countries wishing to expand AMNE data collection beyond this basic set.

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

388. The *Benchmark Definition* draws from these existing guidelines, in suggesting basic data and methodology that may be used in creating both FDI-based indicators and indicators relating to the activities of foreign affiliates. Following the *OECD Handbook*, the latter indicators, which may be supplemented by comparable data on the direct investors that own them, will be referred to as statistics on the *activities of multinational enterprises (AMNE* statistics).[47]

389. The discussion that follows is in six sections. The first identifies a number of FDI-based indicators of globalisation. The second explores the intersection between FDI statistics and AMNE statistics. The third discusses the coverage of AMNE statistics in terms of ownership criteria and the selection of statistical units. The fourth considers the attribution, or classification, of AMNE variables, both geographically and by activity or by product. The fifth identifies and defines economic variables for AMNE statistics. The sixth section provides a brief discussion of compilation issues for AMNE statistics.[48]

8.2. FDI statistics as indicators of globalisation

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

391. The *OECD Handbook* proposes the construction of a number of "reference" indicators of globalisation related to FDI. Reference indicators are the indicators expected to be most commonly used, and are necessary for the analysis of economic globalisation in all or parts of the world economy. The data needed to construct them are generally available in OECD member countries, which are encouraged to produce these indicators as a first priority. The *OECD Handbook* also suggests a number of lower-priority, or "supplemental", FDI-based indicators. The reference indicators are reproduced below in Box 8.1, grouped according to whether they relate to *i)* the extent of globalisation through FDI, *ii)* the contribution of host and investing (home) economies or of economic sectors to globalisation through FDI, or *iii)* the return on FDI.

392. The supplemental indicators (also shown in Box 8.1) suggested in the *OECD Handbook* relate to *i)* concentration of FDI (for total FDI or by industry or by geographical distribution), *ii)* dynamics of FDI in the reporting economy (as indicated by FDI positions relative to domestic balance sheet totals), and *iii)* shares of FDI by category (components of FDI financial flows and positions relative to their respective totals).

47. A variety of other terms also have been used to describe these data, including "foreign affiliates' trade statistics", "foreign affiliates' statistics", "establishment trade" and "financial and operating data" of multinational enterprises.

48. Compilation issues for FDI statistics are discussed elsewhere in previous chapters.

Box 8.1. **Indicators of globalisation related to FDI**

Reference indicators:

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

1. Inward FDI financial flows as a percentage of GDP.
2. Outward FDI financial flows as a percentage of GDP.
3. Inward FDI income flows as a percentage of GDP.
4. Outward FDI income flows as a percentage of GDP.
5. Inward FDI positions as a percentage of GDP.
6. Outward FDI positions as a percentage of GDP.

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

1. Relative share of inward FDI financial flows by partner country as a percentage of total inward FDI flows.
2. Relative share of outward FDI financial flows by partner country as a percentage of total outward FDI flows.
3. Relative share of inward FDI positions by partner country as a percentage of total inward FDI positions.
4. Relative share of outward FDI positions by partner country as a percentage of total outward FDI positions.
5. Relative share of inward FDI financial flows by industry as a percentage of total inward FDI flows.
6. Relative share of outward FDI financial flows by industry as a percentage of total outward FDI flows.
7. Relative share of inward FDI positions by industry as a percentage of total inward FDI position.
8. Relative share of outward FDI positions by industry as a percentage of total outward FDI position.

iii) Return on FDI

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

Supplemental indicators

iv) Degree of concentration of FDI (for total FDI or by economic sector or by geographical distribution)

1. Herfindhal index of inward FDI financial flows.
2. Herfindhal index of outward FDI financial flows.
3. Herfindhal index of inward FDI positions.
4. Herfindhal index of outward FDI positions.

v) Dynamics of FDI in reporting economy

1. Inward FDI positions as a % of total liabilities of the domestic economy (balance sheet totals).
2. Outward FDI positions as a % of total assets of the domestic economy (balance sheet totals).
3. Share of FDI by category [by *i)* partner country and *ii)* economic sector].
4. Inward equity capital flows as a % of inward FDI flows.
5. Inward reinvested earnings as a % of inward FDI flows.

Box 8.1. **Indicators of globalisation related to FDI** *(cont.)*

6. Inward other capital flows as a % of inward FDI flows.
7. Outward equity capital flows as a % of outward FDI flows.
8. Outward reinvested earnings as a % of outward FDI flows.
9. Outward other capital flows as a % of outward FDI flows.
10. Inward position of equity capital and reinvested earnings as a % of FDI positions.
11. Inward other capital positions as a % of inward FDI positions.
12. Outward positions of equity capital and reinvested earnings as a % of FDI positions.
13. Outward other capital positions as a % of outward FDI positions.

vi) Share of FDI by type

1. Inward M&A equity flows as a % of total inward FDI equity flows.
2. Outward M&A equity flows as a % of total outward FDI equity flows.

393. The above indicators are suggestive of the ways in which FDI data can cast light upon globalisation phenomena, but they do not constitute an exhaustive list. For particular purposes it might be useful, for example, to identify separately those flows that occur as a result of cross-border mergers and acquisitions (M&As). This would serve to distinguish between FDI in which ownership of existing enterprises is transferred and FDI in which new enterprises are established by direct investors – often termed "greenfield" investments – or in which existing direct investment enterprises are expanded. This distinction would allow insights to be gained into, not only the *amount* of FDI, but also into its likely economic effects.[49] Other breakdowns might be created to segregate FDI flows involving Special Purpose Entities (SPEs) from other FDI flows. These breakdowns could, for example, provide additional insights into which flows have the greatest potential to result in changes in production in the host economies to which the flows are attributed, and which flows would be likely to have a greater impact on production in other countries.

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

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

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

Table 8.1. **Foreign affiliate balance sheet**

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

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

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

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

(2) L1 + O1 – A1 – A2 = A3 – L2 – O2

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

8.4. Coverage of AMNE statistics

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

8.4.1. Ownership criteria

399. Although 10% ownership of the voting power is recommended as the lower threshold for FDI, the *Benchmark Definition* follows the *OECD Handbook* in recommending that AMNE statistics should be compiled, as a first priority, for the controlled subset of foreign affiliates, as control is defined by the FDIR. Majority ownership is already used as the basis for AMNE statistics in key countries that maintain this type of data, and is an operationally practical criterion for the selection of firms that are to be regarded – following a concept found in the *SNA* – as "foreign-controlled enterprises". The Eurostat Recommendations Manual on the production of FATS foresees the compilation of FATS/AMNE statistics on controlled foreign affiliates. However, majority ownership has been used as a proxy in the joint OECD-Eurostat questionnaire on foreign-affiliate operations used for data collection. Also, statistics based on control appear relevant to the needs of the General Agreement on Trade in Services (though it should be noted that the agreement does not contain statistical definitions).

400. Although it may in some respects have been conceptually more appealing to categorise firms on the basis of the actual presence or absence of foreign control in an operational sense, control as defined by the Framework for Direct Investment Relationships (FDIR)[50] has been selected as the recommended ownership criterion for AMNE statistics. Unlike *de facto* control, its implementation does not require the use of subjective criteria, nor does it require that compilers examine the nature of investments on a case-by-case basis. The absence of a subjective factor has the added benefit of eliminating a potential source of bilateral asymmetry – namely, the possibility that the issue of control will be assessed differently by home and host country compilers.

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

402. Examples of investments that might be covered on a supplemental basis are majority ownership by multiple unaffiliated foreign direct investors, ownership of exactly 50% by a foreign direct investor, and cases in which a qualitative assessment has been made that effective control has been achieved through a minority stake in an enterprise.[51] Such supplemental statistics may be particularly relevant where majority ownership by non-resident investors is restricted.

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

8.4.2. Statistical units

404. In principle, AMNE statistics could be collected at either the enterprise (company) level or the level of individual business locations or establishments. Neither basis of collection is unequivocally superior to the other; rather, each has its own strengths and weaknesses. For example, some financial indicators, such as total assets, are more naturally collected from enterprises than from establishments. In addition, because FDI statistics usually are

50. *OECD Handbook* refers to the Fully Consolidated System which was the recommended by the *Benchmark Definition, 3rd edition.*

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

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collected at the enterprise level, collection of AMNE statistics at this same level facilitates linkages between the two types of data. However, because enterprises are more likely than establishments to have activities in multiple industries, data that are classified on the basis of primary activity can be more difficult to interpret for enterprises than for establishments. Although there may thus be advantages and disadvantages associated with each basis of collection, there is no recommendation concerning the statistical unit to be used. AMNE statistics often will be developed in the context of existing statistical systems, in which the statistical units are already defined, and in these cases there may be little choice in the units that are to be used.

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

8.5. Attribution of AMNE variables

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

8.5.1. Attribution by country

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

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

8.5.1.1. Inward AMNE statistics

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

410. Abstracting from practical considerations, the country of the ultimate investor is conceptually preferable for attribution of variables concerning industrial activity because that is the country that ultimately owns or controls, and therefore derives the benefits from owning or controlling the direct investment enterprise. In light of the relevance of the ultimate-investor basis and the demonstration by a number of countries that compilation on this basis is feasible, the ultimate-investor basis is recommended as the first priority for compilation of AMNE statistics and the basis on which estimates should be prepared in the greatest detail. However, considering that information on immediate investors may be

available as a by-product of linkages to FDI data, and to facilitate comparisons with these data, countries are encouraged to make available some data classified according to the country of the first foreign parent.

8.5.1.2. Outward AMNE statistics

411. For affiliates owned by residents of the compiling economy, two options for the geographic attribution of AMNE variables are possible. The variables could be attributed to the country of location of the affiliate or, if the ownership is through a directly held affiliate located in another country, to the country of that affiliate. International guidelines recommend that attribution of AMNE statistics be to the country of the affiliate whose operations are described by the variables, for that is the country in which the foreign direct investor 's commercial presence exists, and it is the country where the various activities – sales, employment, and so forth – tracked by the statistics are carried out. This basis of attribution is recommended in the *OECD Handbook*. In addition, it is consistent with the treatment of foreign-controlled enterprises in the *SNA*, in that the value added in production by the enterprise is attributed in both cases to (*i.e.* is included in the gross domestic product of) the economy of location of the enterprise. To the extent that the statistics may be used in conjunction with FDI statistics, it should be reiterated that the latter are to be attributed to the immediate host country, as is appropriate for tracking financial flows and positions.

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

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

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

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8.5.2. Attribution by activity and by product

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

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

8.5.2.1. Activity

416. For reporting to international organisations, it is recommended that AMNE variables be classified by activity according to the United Nations *International Standard Industrial Classification of All Economic Activities* (ISIC) – or the NACE equivalent

417. Primarily because the activities carried out by a given firm are often not limited to its activity of classification, the data recorded against any given activity must be interpreted as an indication of total activity of firms for which the given activity is the most important, or primary, activity, rather than as a precise measure of the activity itself.[52]

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

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

AMNE statistics may give a truer picture of the economic nature of the productive activities of foreign affiliates than does that of FDI statistics.

8.5.2.2. Product

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

8.6. Economic variables for AMNE statistics

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

8.6.1. Sales (turnover) and/or output

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

422. For certain services activities, special conventions are used for measuring output. Services activities do not involve stocks of finished goods, and changes in work-in-progress will usually be impossible to measure. In practice, therefore, measured output will be identical to sales for most service activities. For wholesale and retail distribution, although the sales are of goods, the output is defined as a service, equal not to the total value of sales but to the trade margins realised on goods purchased for resale. For financial intermediaries, output includes not only services that are charged for by explicit fees, but also margins on buying and selling transactions, asset management costs deducted from property income receivable in the case of asset-holding entities, and margins between interest payable and the reference rate on loans (called financial intermediation service charges indirectly measured, often abbreviated as FISIM). For insurance, output is measured not by total premiums earned, but by a service charge that takes into account the income earned on technical reserves and also the fact that a portion of premiums must

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be devoted, not to the provision of services, but to the payment of claims and to the accumulation of capital sums guaranteed under life insurance policies, annuity plans, and pension entitlement schemes. In all these cases, output will generally be considerably lower than sales because it, unlike sales, excludes the amounts – which may constitute a large portion of total operating revenues – that pass through the enterprise without being considered a part of its intermediate consumption.

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

424. In addition to disaggregation by industry and by country (following the principles of attribution discussed earlier), other breakdowns of sales may be useful for particular purposes. One such breakdown is to distinguish among sales within the host country (local sales), sales to the country of the parent enterprise (*i.e.*, the immediate investor), and sales to third countries.[53] All three types of sales result from a commercial presence by the home country in the host country. However, only the local sales represent the delivery of output within host economies. In any analysis of AMNE variables in conjunction with data on the parent country's trade with non-residents, it should be noted that the foreign affiliates' sales to the parent country would appear in both data sets, which may suggest the usefulness of an adjustment to eliminate the duplication, or a memorandum item to identify it.

425. Among other sales breakdowns that may prove useful would be a breakdown of sales within each industry as between sales of goods and sales of services, which would represent a first step toward a product breakdown of sales. As a longer-term goal, countries are encouraged to work toward developing product detail on sales.

8.6.2. Employment

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

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

of strong seasonal or other fluctuations in employment, it may be measured as of a point in time, such as the end of the year, following national practices.

427. Data on employment by affiliates can be used in several ways. They can be used in determining the share of foreign affiliates in host country employment, or in attempts to determine the extent to which employment by foreign affiliates complements or substitutes for domestic (home country) employment by parent companies[54] or other domestic firms. An industry breakdown of affiliates' employment can yield further insights into the impact of foreign-owned enterprises on specific parts of the economy. Used in conjunction with data on compensation of employees – one of the "additional" variables suggested below – the employment variable may be used in examining compensation practices of affiliates relative to those of domestically owned firms.

8.6.3. Value added

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

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

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

8.6.4. Exports and imports of goods and services

431. International goods and services transactions of foreign affiliates are another basic indicator of activity. Both balance of payments data and data provided by parent

54. OECD *Handbook* includes the following definitions for "parent" or "parent companies": The general definition of a parent is a firm directly controlling another firm. For inward investment: "the parent company of a foreign company in a compiling country is the first foreign investor outside the borders of the country exercising direct or indirect control over the foreign affiliate." For outward investment: "from the point of view of a compiling country, the parent company of an affiliate controlled by residents of this country and located abroad is the consolidated enterprise (enterprise group) comprising the domestic ultimate beneficiary owner controlling the firm investing abroad and the domestic firms which the preceding firm controls directly or indirectly".

enterprises and affiliates in separate questionnaires may be appropriate sources for such information. To a large extent, the possibilities for disaggregating total exports and total imports may depend on the sources used to obtain the data.

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

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

8.6.5. Number of enterprises

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

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

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

8.6.6. Other variables

437. Although not included as priority items, there are other AMNE variables of significance, perhaps for certain countries of equal or greater importance than some of those previously discussed. As is the case for the priority items, comparisons with the total economy and with specific sectors can be made and used for assessing the impact of foreign-controlled enterprises on home and host economies.

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

- *Assets* – Entities over which ownership rights are enforced and from which economic benefits may be derived by their owners by holding or using them. These include both financial assets and non-financial assets, whether produced or non-produced.
- *Compensation of employees* – The total remuneration, in cash or in kind, payable by an enterprise to an employee in return for work done by the employee during the accounting period.
- *Net worth* – The difference between the value of all assets – produced, non-produced, and financial – and all liabilities.
- *Net operating surplus* – Measured as value added (gross), less compensation of employees, consumption of fixed capital, and taxes on production, plus subsidies receivable.
- *Gross fixed capital formation* – Measured by the total value of a producer's acquisitions, less disposals, of fixed assets during the accounting period plus certain additions to the value of non-produced assets realised by productive activity. (Fixed assets are defined as produced assets that are themselves used repeatedly, or continuously, in processes of production for more than one year).
- *Taxes on income* – These consist of corporate income taxes, corporate profit taxes, corporate surtaxes, and so forth, and taxes that accrue to owners of unincorporated enterprises as a result of the income of those enterprises. Taxes on income include only taxes in the host country of the affiliate and not any taxes paid by the parent in the home country as a result of income earned or distributed by the affiliate. Taxes on income are usually assessed on the total income of corporations from all sources and not simply profits generated by production.
- *Research and development expenditures* – Expenditures for activities undertaken for the purpose of discovering or developing new products (goods and services), including improved versions or qualities of existing products, or discovering or developing new or more efficient processes of production.

8.7. Compilation issues for AMNE statistics

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

440. Whichever of these approaches is taken, there are likely to be links to existing data on FDI. Where there are surveys for AMNE statistics, registers used in collecting FDI data typically would be used to identify majority-owned affiliates for which variables should be collected. Alternatively, key AMNE variables might be added to existing FDI surveys. However, because FDI surveys may be conducted more frequently than AMNE statistics are compiled (*e.g.* quarterly rather than annually) and require a quick turnaround, as well as because AMNE statistics are needed for only the majority-owned portion of the FDI universe, separate surveys probably would offer a better solution in most cases. Where existing domestic statistics are used as the source of information, links to FDI data will often provide the means of determining which resident enterprises are majority-owned and should be included, as well as the means of identifying the country of owner. Under this approach, AMNE statistics would be obtained as an aggregation of statistical variables across the foreign-owned statistical population.

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

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

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

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

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Fourth Edition

ANNEX 1

Changes from Benchmark Definition of Foreign Direct Investment 3rd Edition

445. This revision of the third edition of the Benchmark Definition started in 2004.[55] However, it was not possible to finalise all the research in time for publication of the fourth edition in 2008. One of the main novel features of the *Benchmark Definition* is the introduction of a research agenda which includes work to be conducted after the publication of the present edition. Results of that work will be published as an addendum to the fourth edition as soon as it is completed.

This revision of the *Benchmark Definition* involves several types of changes relating to

i) Changes in concepts, definitions and methods

ii) Greater clarity of recommendations and underlying rationale

iii) Changes in the structure of the manual

1. Changes in concepts, definitions and methods

446. *Permanent Debt:* The previous (third) edition of the *Benchmark Definition* referred to the concept of "permanent debt " and recommended that in the case of banks, financial intermediaries (*e.g.* dealers in securities and certain other financial instruments), and Special Purpose Entities whose sole purpose is to serve as financial intermediaries, all inter-company debt flows (with the exception of those considered to represent permanent debt or equities) with related affiliates should not be counted as part of direct investment. The concept of *permanent debt* was abandoned in the latest version of the *Benchmark Definition* so that all inter-company debt flows between related financial intermediaries are excluded from direct investment (see Section 4.4.3).

447. *Fully Consolidated System* versus *Framework for Direct Investment Relationships:* Since its first edition, the Benchmark Definition recommended the use of the Fully Consolidated

55. IMF/OECD Direct Investment Technical Expert Group (DITEG) was created in 2004 as a joint IMF/OECD expert group to make recommendations on the methodology of FDI statistics within the framework of the revision of the IMF *Balance of Payment and International Investment Position Manual* and the OECD *Benchmark Definition of Foreign Direct Investment*. DITEG held three meetings (in 2004 and 2005). The joint group was co-chaired by IMF and OECD and was serviced by a joint IMF/OECD Secretariat. Based on DITEG recommendations, the OECD Working Group on International Investment Statistics (WGIIS) agreed on a final set of standards which served as the basis for the revision of the *Benchmark Definition*. The Benchmark Advisory Group assisted the Secretariat in drafting the revised manual under the guidance of WGIIS which had the technical responsibility of the revision of international standards for FDI statistics.

System (FCS) which is the scheme used hitherto to identify foreign direct investment (FDI) relationships. FCS was not fully comprehensive particularly for horizontal enterprise relationships but focused on vertical relationships. The FCS, was replaced by a more comprehensive scheme in this latest edition of the Benchmark Definition, the Framework of Direct Investment Relationships (FDIR) (see Section 3.4 and Annex 4).

448. *Debtor/creditor principle*: In contrast to the third edition, this version of the *Benchmark Definition* makes a clear recommendation that FDI transactions and positions be compiled according to the debtor/creditor principle for partner country allocation (but not according to the transactor principle – see Section 3.4.4).

449. *Collective Investment Institutions (CII)*: Hereafter, Collective Investment Institutions are included in FDI statistics as long as investments in, or investment by, them meet the FDI criteria. Previously, international standards were not clear on the treatment of CIIs, leading many compilers to treat all investment in, or by, CIIs as excluded from FDI, as they were (primarily) included under portfolio investment (see Section 6.3) for both assets and liabilities.

450. *Non-profit institutions serving households (NPISH)*: Transactions/positions by non-profit institutions serving households are included in FDI if they meet the FDI criteria. A NPISH can be a direct investor but not a direct investment enterprise.

451. *Fellow enterprises*: As an improvement from the previous edition of the *Benchmark Definition*, the definition of fellow enterprises was clarified. Enterprises that have little (or no) equity in each other but are influenced by the same enterprise are referred to as fellow enterprises; they were previously referred to as "fellow subsidiaries " (see Chapter 3, sub-section 3.4.3.4 and Box 3.4).

452. *Directional principle* : The *directional principle* in this edition of the Benchmark Definition was extended to cover transactions/positions between fellow enterprises, in addition to *reverse investments* included in the directional principle applied in the *Benchmark Definition*, 3rd edition. The direction of a transaction/position between fellow enterprises is determined according to the residence of the ultimate controlling parent of the fellow enterprise (see Chapter 4).

453. *Special Purpose Entities (SPE)*: According to the 3rd edition of the *Benchmark Definition*, all FDI transactions/positions should be recorded for the country or industry of the first counterpart enterprise (including SPEs). This treatment has led to distortion of FDI statistics at the country and regional levels as well as worldwide. This 4th edition of the Benchmark Definition introduces the notion of *pass-through capital* in standard and supplemental FDI series to partially resolve the problem caused by such transactions.

454. FDI transactions and positions by partner and by industry should be recorded on a directional principle. In the standard directional presentation, compilers should provide the key FDI statistics excluding resident SPEs but also giving separate details for these resident SPEs. In addition, compilers are strongly encouraged to provide supplemental series looking through all (including non-resident) SPEs. These novel features are improvements for obtaining analytically more meaningful data as compared to recording transactions/positions for the first counterpart. This edition also devotes an annex to SPEs (see Annex 7).

455. *Standard FDI statistics – Aggregate data (asset/liability)*: Historically, the *Benchmark Definition* related to detailed FDI statistics presented by partner country and by industry classification. Presentation of aggregate FDI series as additional standard FDI data was

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introduced in the present edition. These data are based on the asset/liability principle and are fully consistent with the balance of payments statistics under the functional category *Direct Investment*. The *Benchmark Definition* provides clear guidance on the building blocks required for deriving data according to the directional principle from those based on the asset/liability principle (see Section 3.4.5 and Chapter 4).

456. *Supplemental FDI statistics:* Compilers are strongly encouraged to provide on a supplemental basis FDI series by partner country and by industry classification looking through all SPEs (see reference above).

457. For the first time the Benchmark Definition introduces the concept of analysing *FDI by type* and the creation of supplemental series on Mergers and Acquisitions (M&A) transactions by country allocation and industry classification for equity transactions. A new methodology for data collection for M&As is also proposed in Annex 9.

458. Previously the *Benchmark Definition* recommended the compilation of FDI statistics according to ultimate host/investing country without providing any specific methodology for such compilation. The present edition includes guidance for compiling inward *FDI positions* according to ultimate controlling investor country/industry with presentation of these supplemental data by country and by industry (see Section 7.2).

2. Greater clarity of recommendations and underlying rationale

459. This edition of the *Benchmark Definition* includes additional description and explanation with a view to clarifying the recommendations. In the past, misinterpretation of certain recommendations has led to differences in country practices and to deviations from standard methodologies. The following improvements are worth noting:

i) Explanations of the *components*, a*ccounts* and *scope* of foreign direct investment are given much more detailed attention in Chapter 4.

ii) *Market valuation*, which is central to FDI statistics, is one of the more difficult recommendations that compilers encounter. Several methods to estimate market values for unlisted companies are provided in the present edition allowing alternative approaches for compilers to choose from depending on the information available to them and the intended purpose of the information compiled (see Annex 5).

iii) An annex was dedicated to reinvested earnings to clarify the methodology required to measure and to record this item (see Annex 6).

iv) Concepts such as FDI influence and control, enterprise group, etc are clarified by the introduction of the Framework for Direct Investment Relationships replacing the earlier Fully Consolidated System (see above).

v) In the absence of a universal definition of Special Purpose Entities, some practical criteria were provided to guide national compilers when identifying such entities;

vi) Rules for the allocation of industry sector were clarified to indicate that as first priority countries should report FDI statistics according to the industry of the direct investment enterprise, for both inward and outward investment (see Section 7.3).

vii) Further consistency with other international manuals was achieved in various concepts such as the treatment of land and buildings, natural resource exploration, construction, shipping, and banking activities.

viii) Further clarification is given on borderline cases as guidance to compilers (see Annex 3).

3. Structure of the *Benchmark Definition*

460. Not only was the structure of the current edition of the *Benchmark Definition* substantially modified but also new chapters/sections were included:

- Chapter 2: Uses of FDI statistics.
- Chapter 8: FDI and Globalisation.

In addition, a section was devoted to statistical units (in Chapter 3).

461. More extended use was made of annexes for compilation and clarification of various recommendations. Several annexes were added on the following topics:

- Presentation of FDI statistics: standard and supplemental presentations including information on country and industry classifications (Annex 2).
- Borderline cases: provides guidance to compilers for excluding activities which may represent similarities to FDI but which do not fully qualify as FDI (Annex 3).
- Framework for Direct Investment Relationships: provides examples of the FDI relationships for the recommended and for the alternate methods (Annex 4).
- Explanation of various methods to estimate market value including pros and cons for each method (Annex 5).
- Reinvested earnings: provides technical guidance on recording reinvested earnings (Annex 6).
- Special Purpose Entities: the content of this annex has been substantially modified (Annex 7).
- Collective Investment Institutions are a new feature in FDI statistics: this annex provides further information on CIIs (Annex 8).
- Guidance is provided on how to compile FDI by type, distinguishing mergers and acquisitions (Annex 9).
- Further clarifications are provided on recording FDI according to the ultimate investing country (Annex 10).
- Guidance on the specific data compilation needs of Economic or Currency Unions (Annex 11).
- General guidance on FDI data collection is provided in Annex 12.
- Future research work to complement current standards is listed in Annex 13.

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ANNEX 2

Presentations of FDI Statistics

462. The *Benchmark Definition* recommends two types of standard presentations for the dissemination of foreign direct investment (FDI) statistics, one according to the *assets/liabilities principle*, and the other according to the *directional principle* . In addition, further analyses of direct investment are to be reported on a supplemental (voluntary) basis but their reporting is strongly encouraged. Overall, the presentations for direct investment statistics recommended by this *Benchmark Definition* can be summarised as follows:

1. Standard FDI statistics

i) ***FDI aggregates for macro-economic statistics*** (according to the assets/liability principle)

a) Positions in Asset/liabilities of FDI.

b) Transactions in Asset/liabilities of FDI.

c) FDI income debits/credits.

Memorandum item: FDI aggregates for resident SPEs

ii) ***FDI Statistics*** (according to the *directional principle*)

a) Inward/Outward FDI positions

1. Excluding resident SPEs
   - by partner country,
   - by industry.
2. Resident SPEs
   - by partner country,
   - by industry.

b) Inward/Outward FDI financial flows (inflows/outflows)

1. Excluding resident SPEs
   - by partner country,
   - by industry.
2. Resident SPEs
   - by partner country,
   - by industry.

c) FDI income: receivables/payables

1. Excluding resident SPEs
   - by partner country,
   - by industry.
2. Resident SPEs
   - by partner country,
   - by industry.

2. Supplemental FDI statistics (according to the directional principle)

i) FDI Statistics (excluding resident SPEs and looking through non-resident SPEs)

a) Inward/Outward FDI positions
- by partner country,
- by industry.

b) Inward/Outward FDI financial flows (inflows/outflows)
- by partner country,
- by industry.

c) FDI income: receivables/payables
- by partner country,
- by industry.

ii) Mergers and Acquisition for FDI equity flows

a) Inward/Outward FDI financial flows
- by partner country (or regions),
- by industry.

iii) Inward FDI positions according to Ultimate Investor Country

a) by partner country,

b) by industry.

3. Supplemental FDI statistics (according to the directional principle recommended in the 3rd Edition of the Benchmark Definition –)[56]

a) Inward/Outward FDI positions
- by partner country,
- by industry.

b) Inward/Outward FDI financial flows (inflows/outflows)
- by partner country,
- by industry.

c) FDI income: receivables/payables
- by partner country,
- by industry.

56. These series are required according to the standards defined in the *3rd edition of the Benchmark Definition of Foreign Direct Investment* in which the compilation of investment on a directional basis was limited to offsetting any reverse investment (by a direct investment enterprise in its direct investor).

Box A.2.1 Sign convention

In presenting the various tables of FDI data, compilers should note that the ***sign convention*** required is as follows:

FDI positions

FDI positions presented on an assets/liabilities basis should be shown so that increases in either are shown with a positive (+ve) sign and decreases with a negative (-ve) sign. The net position should be derived arithmetically as

Net FDI position = FDI assets – (minus) FDI liabilities

FDI positions presented on a directional basis should follow the same sign convention, *i.e.* increases in Outward FDI or in Inward FDI are shown with a positive (+ve) sign and decreases with a negative (-ve) sign. The net position should be derived arithmetically as

Net FDI position = outward FDI – (minus) inward FDI

Note: The net FDI position for both presentations should be the same (where the coverage is identical).

FDI financial flows

The sign convention described for FDI positions applies also to FDI financial flows.

FDI income flows

For the compiling economy, FDI income inflows are shown as positive (+ve) credits and income outflows are shown as positive (+ve) debits. The net income flow should be derived arithmetically as:

Net FDI income = FDI income credit – (minus) FDI income debit.

Notes: Readers, especially compilers and users are urged to take note that the sign convention recommended in this Benchmark Definition differs from that recommended in the BPM6 and caution is necessary in interpreting the results from both standards.

463. The structure and content of the specific FDI series required are described below. In generating the tables, compilers are requested to report the data using the sign convention described in Box A.2.1.

1.1. Foreign direct investment aggregates for macro-economic statistics

1. FOREIGN DIRECT INVESTMENT POSITIONS: MACRO-ECONOMIC AGGREGATES – Standard presentation

	Assets	Liabilities
1.1.1. Equity (including Reinvestment of earnings)		
1.1.1.1. Direct investor in direct investment enterprises		
1.1.1.2. Direct investment enterprises in direct investor		
1.1.1.3. Fellow enterprises in other fellow enterprises		
1.1.1.3.1. Ultimate controlling parent is resident		
1.1.1.3.2. Ultimate controlling parent is non-resident		
1.1.2. Debt instruments		
1.1.2.1. Direct investor in direct investment enterprises		
1.1.2.2. Direct investment enterprises in direct investor		
1.1.2.3. Fellow enterprises in other fellow enterprises		
1.1.2.3.1. Ultimate controlling parent is resident		
1.1.2.3.2. Ultimate controlling parent is non-resident		
Of which: Resident SPEs		
1.2.1. Equity (including reinvestment of earnings)		
1.2.1.1. Direct investor in direct investment enterprises		
1.2.1.2. Direct investment enterprises in direct investor		
1.2.1.3. Fellow enterprises in other fellow enterprises		
1.2.1.3.1. Ultimate controlling parent is resident		
1.2.1.3.2. Ultimate controlling parent is non-resident		
1.2.2. Debt instruments		
1.2.2.1. Direct investor in direct investment enterprises		
1.2.2.2Direct investment enterprises in direct investor		
1.2.2.3Fellow enterprises in other fellow enterprises		
1.2.2.3.1Ultimate controlling parent is resident		
1.2.2.3.2Ultimate controlling parent is non-resident		

2. FOREIGN DIRECT INVESTMENT TRANSACTIONS: MACRO-ECONOMIC AGGREGATES – Standard presentation

	Net acquisition of financial assets	Net incurrence of liabilities
2.1.1. Equity (excluding reinvestment of earnings)		
2.1.1.1. Direct investor in direct investment enterprises		
2.1.1.2. Direct investment enterprises in direct investor		
2.1.1.3. Fellow enterprises in other fellow enterprises		
2.1.1.3.1. Ultimate controlling parent is resident		
2.1.1.3.2. Ultimate controlling parent is non-resident		
2.1.2. Reinvestment of earnings		
2.1.3. Debt instruments		
2.1.3.1. Direct investor in direct investment enterprises		
2.1.3.2. Direct investment enterprises in direct investor		
2.1.3.3. Fellow enterprises in other fellow enterprises		
2.1.3.3.1Ultimate controlling parent is resident		
2.1.3.3.2. Ultimate controlling parent is non-resident		
Of which: Resident SPEs		
2.2.1. Equity (excluding reinvestment of earnings)		
2.2.1.1. Direct investor in direct investment enterprises		
2.2.1.2. Direct investment enterprises in direct investor		
2.2.1.3. Fellow enterprises in other fellow enterprises		
2.2.1.3.1. Ultimate controlling parent is resident		
2.2.1.3.2. Ultimate controlling parent is non-resident		
2.2.2. Reinvestment of earnings		
2.2.3. Debt instruments		
2.2.3.1. Direct investor in direct investment enterprises		
2.2.3.2. Direct investment enterprises in direct investor		
2.2.3.3. Fellow enterprises in other fellow enterprises		
2.2.3.3.1. Ultimate controlling parent is resident		
2.2.3.3.2. Ultimate controlling parent is non-resident		

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3. FOREIGN DIRECT INVESTMENT INCOME: MACRO-ECONOMIC AGGREGATES – Standard presentation		
	Credits	Debits
3.1. Direct investment income		
3.1.1. Income on Equity		
3.1.1.1. Distributed profits		
3.1.1.1.1. Direct investor in direct investment enterprises		
3.1.1.1.2. Direct investment enterprises in direct investor		
3.1.1.1.3. Fellow enterprises in other fellow enterprises		
3.1.1.1.3.1. Ultimate controlling parent is resident		
3.1.1.1.3.2. Ultimate controlling parent is non-resident		
3.1.1.2. Reinvested earnings		
3.1.2. Income on debt (interest)		
3.1.2.1. Direct investor in direct investment enterprises		
3.1.2.2. Direct investment enterprises in direct investor		
3.1.2.3. Fellow enterprises in other fellow enterprises		
3.1.2.3.1. Ultimate controlling parent is resident		
3.1.2.3.2. Ultimate controlling parent is non-resident		
3.2. Of which: Resident SPEs		
3.2.1. Income on Equity		
3.2.1.1. Distributed profits		
3.2.1.1.1. Direct investor in direct investment enterprises		
3.2.1.1.2. Direct investment enterprises in direct investor		
3.2.1.1.3. Fellow enterprises in other fellow enterprises		
3.2.1.1.3.1. Ultimate controlling parent is resident		
3.2.1.1.3.2. Ultimate controlling parent is non-resident		
3.2.1.2. Reinvested earnings		
3.2.2. Income on debt (interest)		
3.2.2.1. Direct investor in direct investment enterprises		
3.2.2.2. Direct investment enterprises in direct investor		
3.2.2.3. Fellow enterprises in other fellow enterprises		
3.2.2.3.1. Ultimate controlling parent is resident		
3.2.2.3.2. Ultimate controlling parent is non-resident		

1.2. Foreign direct investment statistics: (according to the directional principle) – Standard presentation

A. By geographical allocation

B. By industry classification

1.2.1. FDI positions

Declaring country:	FDI positions (excluding resident SPEs)									FDI positions of resident SPEs								
	[INWARD] OR [OUTWARD]									[INWARD] OR [OUTWARD]								
	Equity[57]			Debt instruments			Total			Equity[57]			Debt instruments			Total		
Year:	Claims	Liabilities	Net	Claims	Liabilities	Net	Claims	Liabilities	Net	Claims	Liabilities	Net	Claims	Liabilities	Net	Claims	Liabilities	Net
TOTAL																		

1.2.2. FDI financial flows

Declaring country:	FDI financial flows (excluding resident SPEs)										FDI financial flows of resident SPEs									
	[INFLOW] OR [OUTFLOW]										[INFLOW] OR [OUTFLOW]									
	Equity[58]			Reinvest-ment of earnings	Debt instruments			Total			Equity[58]			Reinvest-ment of earnings	Debt instruments			Total		
Year:	Claims	Liabili-ties	Net	Net	Claims	Liabili-ties	Net	Claims	Liabili-ties	Net	Claims	Liabili-ties	Net	net	Claims	Liabili-ties	Net	Claims	Liabili-ties	Net
TOTAL																				

1.2.3. FDI income flows

Declaring country:	FDI income flows (excluding resident SPEs)												FDI income flows of resident SPEs											
	Income on equity						Income on debt (interest)			Total income			Income on equity						Income on debt (interest)			Total income		
	Dividends			Reinvested earnings									Dividends			Reinvested earnings								
Year:	Credit	Debit	Net	Credit	Debit	Net	Credit	Debit	Net	Credit	Debit	Net	Credit	Debit	Net	Credit	Debit	Net	Credit	Debit	Net	Credit	Debit	Net
TOTAL																								

57. Including reinvestment of earnings.
58. Excluding reinvestment of earnings.

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2. Foreign direct investment statistics: supplemental series (Directional principle)

2.1. Foreign direct investment statistics excluding resident spes and looking through non-resident spes – supplemental series (Directional principle)

A. By geographical allocation

B. By industry classification

2.1.1 FDI positions

Declaring country:	FDI positions (excluding resident SPEs and looking through non-resident SPEs)								
	[INWARD] OR [OUTWARD]								
	Equity[59]			Debt instruments			Total		
Year:	Claims	Liabilities	Net	Claims	Liabilities	Net	Claims	Liabilities	Net
TOTAL									

2.1.2. FDI financial flows

Declaring country:	FDI financial flows (excluding resident SPEs and looking through non-resident SPEs)									
	[INFLOW] OR [OUTFLOW]									
	Equity[60]			Reinvestment of earnings	Debt instruments			Total		
Year:	Claims	Liabilities	Net	Net	Claims	Liabilities	Net	Claims	Liabilities	Net
TOTAL										

2.1.3. FDI income flows

Declaring country:	FDI Income flows (excluding resident SPEs and looking through non-resident SPEs)											
	Income on equity						Income on debt (interest)			Total income		
	Dividends			Reinvested earnings								
Year:	Credit	Debit	Net	Credit	Debit	Net	Credit	Debit	Net	Credit	Debit	Net
TOTAL												

59. Including reinvestment of earnings.
60. Including reinvestment of earnings.

2.2. Mergers and acquisitions – fdi equity financial flows – supplemental series (Directional principle)

A. By geographical allocation

B. By industry classification

Declaring country:		**Equity inflows**						**Equity outflows**					
		Equity ownership 10%-100%			Of which acquisition over 50% or more equity ownership			Equity ownership 10%-100%			Of which acquisition over 50% or more equity ownership		
Partner country:	**Year:**	Investment	Disinvest-ment	Net	Investment	Disinvest-ment	Net	Investment	Disinvest-ment	Net	Investment	Disinvest-ment	Net
	TOTAL												

2.3 FDI positions according to ultimate investing country – supplemental series (Directional principle)

A. By geographical allocation

B. By industry classification

Declaring country:	**FDI positions**								
	INWARD								
	Equity[61]			Debt instruments			Total		
Year:	Claims	Liabilities	Net	Claims	Liabilities	Net	Claims	Liabilities	Net
TOTAL									

3. Foreign direct investment statistics: supplemental series (According to the Benchmark Definition, 3rd edition)

A. By geographical allocation

B. By industry classification

3.1. Foreign direct investment positions

Declaring country:	**FDI positions (all enterprises)**		
	[INWARD] OR [OUTWARD]		
Year:	Equity[62]	Debt instruments	Total
TOTAL			

61. Including reinvestment of earnings.
62. Including reinvestment of earnings.

3.2. Foreign direct investment financial flows

Declaring country:	**FDI financial flows (all enterprises)**			
	[INWARD] OR [OUTWARD]			
	Equity[63]	Reinvested earnings	Debt instruments	Total
Year:				
TOTAL				

3.3. Foreign direct investment income flows

Declaring country:	**FDI financial flows (all enterprises)**			
	Income on equity		Income on Debt (interest)	Total income
	Dividends	Reinvested earnings		
Year:				
TOTAL				

63. Including reinvestment of earnings.

GEOGRAPHICAL AND ECONOMIC ZONES[64]

1 – Geographical zones

E1	**EUROPE**	E4	**AFRICA**
A3	BLEU	E5	***NORTH AFRICA***
BE	Belgium	DZ	Algeria
BG	Bulgaria	EG	Egypt
LU	Luxembourg	LY	Libyan Arab Jamahiriya
DK	Denmark	MA	Morocco
DE	Germany	TN	Tunisia
GR	Greece	E6	***OTHER AFRICAN COUNTRIES***
ES	Spain	AO	Angola
FR	France	BJ	Benin
IE	Ireland	BW	Botswana
IT	Italy	IO	British Indian Ocean Territory
NL	Netherlands	BF	Burkina Faso
PT	Portugal	BI	Burundi
GB	United Kingdom	CM	Cameroon
AT	Austria	CV	Cape Verde
FI	Finland	CF	Central African Republic
SE	Sweden	TD	Chad
CY	Cyprus	KM	Comoros
CZ	Czech Republic	CG	Congo
HU	Hungary	CI	Côte d’Ivoire
MT	Malta	CD	Congo, the Democratic Republic of the
PL	Poland	DJ	Djibouti
RO	Romania	GQ	Equatorial Guinea
SK	Slovakia	ER	Eritrea
SI	Slovenia	ET	Ethiopia
E3	***BALTIC COUNTRIES***	GA	Gabon
EE	Estonia	GM	Gambia
LT	Lithuania	GH	Ghana
LV	Latvia	GN	Guinea
CH	Switzerland	GW	Guinea-Bissau
IS	Iceland	KE	Kenya
LI	Liechtenstein	LS	Lesotho
NO	Norway	LR	Liberia
E2	***OTHER EUROPEAN COUNTRIES***	MG	Madagascar
AL	Albania	MW	Malawi
AD	Andorra	ML	Mali
BY	Belarus	MR	Mauritania
BA	Bosnia and Herzegovina	MU	Mauritius
HR	Croatia	MZ	Mozambique
FO	Faeroe Islands	NA	Namibia
GI	Gibraltar	NE	Niger
GG	Guernsey	NG	Nigeria
VA	Holy See (Vatican City State)	ZA	South Africa
IM	Isle of Man	RW	Rwanda
JE	Jersey	SH	St. Helena
MK	Macedonia, the Former Yugoslav Republic of	ST	Sao Tome and Principe
MD	Moldova, Republic of	SN	Senegal
ME	Montenegro	SC	Seychelles
RU	Russian Federation	SL	Sierra Leone
SM	San Marino	SO	Somalia
RS	Serbia	SD	Sudan
TR	Turkey	SZ	Swaziland

64. Country codes are based on ISO – International Organization for Standardization.

GEOGRAPHICAL AND ECONOMIC ZONES[64] *(cont.)*

1 – Geographical zones

UA	Ukraine	TZ	Tanzania
[CS]	[Serbia and Montenegro]	TG	Togo
UG	Uganda	F2	**ASIA**
ZM	Zambia	F3	***NEAR AND MIDDLE EAST***
ZW	Zimbabwe	IR	Iran, Islamic Republic of
E7	**AMERICA**	IL	Israel
E8	***NORTH AMERICA***	F4	***GULF ARABIAN COUNTRIES***
US	United States	BH	Bahrain
GL	Greenland	IQ	Iraq
CA	Canada	KW	Kuwait
E9	***CENTRAL AMERICA***	OM	Oman
AI	Anguilla	QA	Qatar
AG	Antigua and Barbuda	SA	Saudi Arabia
AW	Aruba	AE	United Arab Emirates
BS	Bahamas	YE	Yemen
BB	Barbados	F5	***OTHER NEAR AND MIDDLE EAST COUNTRIES***
BZ	Belize	AM	Armenia
BM	Bermuda	AZ	Azerbaijan
VG	Virgin Islands, British	GE	Georgia
KY	Cayman Islands	JO	Jordan
CR	Costa Rica	LB	Lebanon
CU	Cuba	PS	Palestinian Territory, Occupied
DM	Dominica	SY	Syrian Arab Republic
DO	Dominican Republic	F6	***OTHER ASIAN COUNTRIES***
SV	El Salvador	AF	Afghanistan
GD	Grenada	BD	Bangladesh
GT	Guatemala	BT	Bhutan
HT	Haiti	BN	Brunei Darussalam
HN	Honduras	KH	Cambodia (Kampuchea)
JM	Jamaica	CN	China
MX	Mexico	HK	Hong Kong, China
MS	Montserrat	IN	India
AN	Netherlands Antilles	ID	Indonesia
NI	Nicaragua	JP	Japan
PA	Panama	KZ	Kazakhstan
KN	St. Kitts and Nevis	KP	Korea, Dem. People's Republic of (North Korea)
LC	Saint Lucia	KR	Korea, Republic of (South Korea)
VC	St Vincent and the Grenadines	KG	Kyrgyzstan
TT	Trinidad and Tobago	LA	Lao People's Democratic Republic
TC	Turks and Caicos Islands	MO	Macao
VI	Virgin Islands, US	MY	Malaysia
F1	***SOUTH AMERICA***	MV	Maldives
AR	Argentina	MN	Mongolia
BO	Bolivia	MM	Myanmar
BR	Brazil	NP	Nepal
CL	Chile	PK	Pakistan
CO	Colombia	PH	Philippines
EC	Ecuador	SG	Singapore
FK	Falkland Islands (Malvinas)	LK	Sri Lanka
GY	Guyana	TW	Taiwan, Province of China
PY	Paraguay	TJ	Tajikistan
PE	Peru	TH	Thailand
SR	Suriname	TL	Timor-Leste
UY	Uruguay	TM	Turkmenistan
VE	Venezuela	UZ	Uzbekistan
		VN	Vietnam

GEOGRAPHICAL AND ECONOMIC ZONES[64] *(cont.)*

1 – Geographical zones

F7	**OCEANIA and POLAR REGIONS**		
AQ	Antarctica	NR	Nauru
AS	American Samoa	NU	Niue
AU	Australia	NZ	New Zealand
BV	Bouvet Island	PF	French Polynesia
CC	Cocos (Keeling) Islands	PG	Papua New Guinea
CK	Cook Islands	PN	Pitcairn
CX	Christmas Island	PW	Palau
FJ	Fiji	SB	Solomon Islands
FM	Micronesia, Federal States of	TF	French Southern Territories
HM	Heard Island and McDonald Islands	TO	Tonga
GS	South Georgia and the South Sandwich Islands	TK	Tokelau
GU	Guam	TV	Tuvalu
KI	Kiribati	UM	US Minor Outlying Islands
MH	Marshall Islands	VU	Vanuatu
MP	Northern Mariana Islands	WF	Wallis and Futuna
NC	New Caledonia	WS	Samoa
NF	Norfolk Island		
		Z1	**World not allocated**
		A1	**TOTAL WORLD**

2 – Economic zones		3 – Additional economic zones	
Z8	**Extra-EU not allocated**	B2	**Latin America countries**
D3	**EU25**	B5	**ACP countries**
D5	**Extra EU25**	B6	African ACP countries
W5	**Extra EU25 not allocated**	B7	Caribbean ACP countries
V1	**EU27**	B8	Pacific ACP countries
V2	**Extra-EU27**	C3	**Mediterranean Basin countries**
I2	**Euro area 12**	C7	**Maghreb countries**
J2	**Extra euro area 12**	C8	**Mashrek countries**
I3	**Euro area 13**	A9	**Central and Eastern Europe**
J3	**Extra euro area 13**	C5	**French Franc zone**
I5	**Euro area 15**	C9	**MERCOSUR**
J5	**Extra euro area 15**	D7	**Mediterranean countries in the Euro-Mediterranean Partnership**
U4	**Extra euro zone**	4F	**European Central Bank**
W4	**Extra euro zone not allocated**	7Z	**International Organisations (excluding EU institutions)**
A5	**EFTA**		
A8	**OECD**		
B1	**NAFTA**		
B9	**NICs1**		
C1	**NICs2A**		
C2	**NICs2LA**		
C6	**CIS countries**		
B3	**ASEAN countries**		
B4	**OPEC countries**		
C4	**Offshore Financial Centres**		

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International Standard Industry Classification (ISIC4)

ECONOMIC ACTIVITY	ISIC Rev. 4
AGRICULTURE, FORESTRY AND FISHING	Section A
MINING AND QUARRYING	Section B
Extraction of crude petroleum and natural gas; mining support services	Division 06, 09
MANUFACTURING	Section C
Food products, beverage, and tobacco products	Divisions 10, 11, 12
Textiles and wearing apparel	Divisions 13, 14
Wood, paper, printing and reproduction	Divisions 16, 17, 18
[TOTAL textiles + wood activities]	[Divisions 13, 14, 16, 17, 18]
Coke and refined petroleum products	Division 19
Manufacture of chemicals and chemical products	Division 20
Pharmaceuticals products and preparations	Division 21
Rubber and plastic products	Division 22
[TOTAL petroleum, chemical, pharmaceuticals, rubber and plastic products]	[Divisions 19, 20, 21, 22]
Basic metal and fabricated metal products	Divisions 24, 25
Computer, electronic and optical products	Division 26
Machinery and equipment n.e.c.	Division 28
[TOTAL metal, computer and machinery]	[Divisions 24, 25, 26, 28]
Motor vehicles, trailers and semi-trailers	Division 29
Other transport equipment	Division 30
Manufacture of air and spacecraft and related machinery	group 303
[TOTAL vehicles and other transport equipment]	[Divisions 29, 30]
Other manufacturing	Divisions 15, 23, 27, 31, 32, 33
ELECTRICITY, GAS, STEAM AND AIR CONDITIONING SUPPLY	Section D
WATER SUPPLY; SEWERAGE, WASTE MANAGEMENT AND REMEDIATION ACTIVITIES	Section E
Water collection, treatment and supply	Division 36
Sewerage, waste management and remediation activities	Divisions 37, 38, 39
CONSTRUCTION	Section F
WHOLESALE AND RETAIL TRADE; REPAIR OF MOTOR VEHICLES AND MOTORCYCLES	Section G (divisions 45, 46, 47)
Wholesale and retail trade and repair of motor vehicles and motorcycles	Division 45
Wholesale trade, except of motor vehicles and motorcycles	Division 46
Retail trade, except of motor vehicles and motor cycles	Division 47
TRANSPORTATION AND STORAGE	Section H
Land transport and transport via pipelines	Division 49
Water transport	Division 50
Air transport	Division 51
Warehousing and support activities for transportation	Division 52
[TOTAL transport and storage]	[Divisions 49, 50, 51, 52]
Post and courier activities	Division 53
ACCOMODATION AND FOOD SERVICE ACTIVITIES	Section I
INFORMATION AND COMMUNICATION	Section J
Motion picture, video and television programme production, sound recording and music publishing activities; programming and broadcasting activities	Divisions 59, 60
Telecommunications	Division 61
Other information and communication activities	Divisions 58, 62, 63
FINANCIAL AND INSURANCE ACTIVITIES	Section K
Financial services activities, except insurance and pension funding	Division 64
of which:	
Monetary intermediation	Group 641
Activities of holding companies	Group 642
Trusts, funds and similar financial entities	Group 643
Insurance, reinsurance and pension funding, except compulsory social security	Division 65
Activities auxiliary to financial services and insurance activities	Division 66

International Standard Industry Classification (ISIC4) *(cont.)*

ECONOMIC ACTIVITY	ISIC Rev. 4
REAL ESTATE ACTIVITIES	Section L
PROFESSIONAL, SCIENTIFIC AND TECHNICAL ACTIVITIES	Section M
Legal and accounting activities	Division 69
Activities of head offices; management and consultancy activities	Division 70
Scientific research and development	Division 72
Advertising and market research	Division 73
Other professional, scientific and technical activities	Division 74
ADMINISTRATIVE AND SUPPORT SERVICE ACTIVITIES	Section N
Rental and leasing activities	Division 77
Other administrative and support services activities	Divisions 78, 79, 80, 81, 82
EDUCATION	Section P
HUMAN HEALTH AND SOCIAL WORK ACTIVITIES	Section Q
ARTS, ENTERTAINMENT AND RECREATION	Section R
***Of which:* Sports activities and amusement and recreation activities**	Division 93
OTHER SERVICE ACTIVITIES	Section S
SUB-TOTAL	
***Of which:* Private purchases and sales of real estate**	
Unallocated	
TOTAL	

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ANNEX 3

List of Borderline Cases and Exclusions from FDI

1. List of borderline cases

1.1. SPEs and "capital in transit "

464. Financial corporations such as Special Purpose Entities (SPEs) or conduits that raise funds in open markets on behalf of their parent corporation or fellow enterprises are usually encompassed in the SNA definition of "Other financial corporations". Therefore, non-equity transactions/positions between these financial corporations should be included in FDI. A more detailed discussion of the SPEs and related issues may be found in Annex 7.

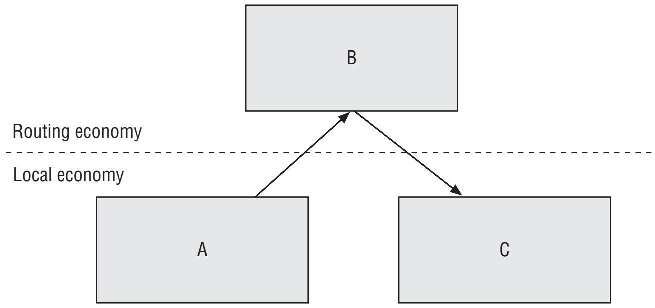
465. Fiscal SPEs are entities owned or controlled by general government that are resident in another territory and used for fiscal purposes. Such entities are resident in their economy of incorporation or registration, not in the economy of their owner. For example, a government may use a special purpose or other entity to issue securities to fund its expenditure. The *Benchmark Definition* recommends that fiscal SPEs should be treated as direct investment enterprises. All financial transactions and positions between them and their parent government should be recorded as direct investment.

466. More generally, cross-border transactions/positions which are pass-through capital (also referred to as "capital in transit ") via structures put in place to facilitate the financing and transfer of investment for multinational enterprises are included in direct investment as they are integral parts of a direct investment relationship identified according to the Framework of Direct Investment Relationships (FDIR). Nevertheless, these transactions often transit through a country without producing the expected impact of FDI in its economy when the final destination of investments is in a different economy. Since these transactions may distort the analysis of direct investment positions/transactions, this edition of the *Benchmark Definition* recommends that countries *i)* in their standard FDI presentation exclude funds going through resident SPEs from the key FDI statistics but to present them as a separate series; and *ii)* on a supplemental basis FDI looking through all (resident and non-resident) SPEs to the first non-SPE in the inward or outward chain. These statistics should be geographically broken down by country of counterpart and by industry classification to facilitate the economic analysis of direct investment. The presentation of direct investment statistics excluding "capital in transit" through operating subsidiaries is subject to further research (see Annex 13).

1.2. Round-tripping

467. Round-tripping refers to the channelling abroad by direct investors of local funds and the subsequent return of these funds to the local economy in the form of direct investment. From the perspective of the local economy, the simplest example of round-tripping occurs when a domestic investment is disguised as FDI through a subsidiary or associate located abroad, in the "routing economy" (*i.e.* the economy through which the funds are routed). For example in Figure A.3.1 a company A in the local economy provides FDI funds to a non-resident related company (company B) for investing back in another company (company C) in the local economy.

Figure A.3.1. **A simple case of round-tripping**



468. The simple group structure in Figure A.3.1 can be easily extended to cover other more complex group structures that are conducive to round-tripping. Two examples of such structures are included in Figures A.3.2 and A.3.3 below:

Figure A.3.2. **A case of round-tripping with many entities in routing economies**

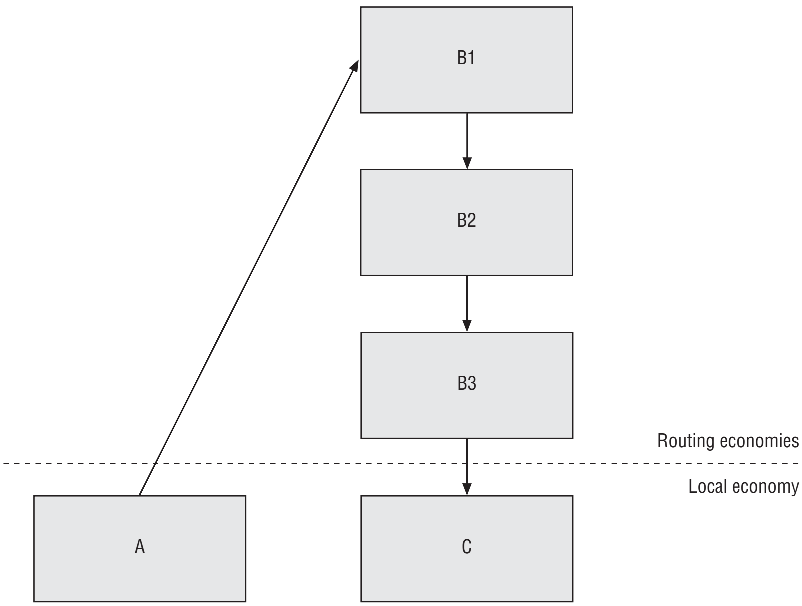
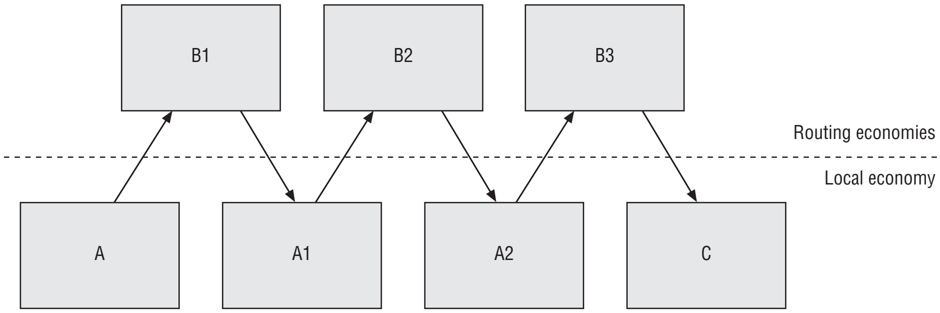


Figure A.3.3. **A case of round-tripping with many entities in routing and local economies**



469. There are many incentives for round-tripping, such as:

- *Tax and fiscal advantages*: Some economies provide preferential policies to attract FDI, including low taxation, favourable land use rights, convenient administrative support, etc. Since it is not always easy for local enterprises to attract foreign investors, they may channel domestic capital abroad which is then repatriated as foreign capital for local investment to take advantage of the preferential treatments only available to foreign investors;
- *Property right protection:* Infrastructure for property right protection in some economies is not well established. Therefore, the enterprises in these economies may have the motivation to locate their wealth in related enterprises set up in overseas economies having better legal and institutional settings for property right protection. Besides, some investors may prefer to conceal their identities by investing through companies set up in offshore financial centres. Capital will then be brought back to host economies in the form of FDI if there are profitable investment opportunities.
- *Expectations on exchange control and exchange rate*: Some economies have control of financial movements and exchange rate. Expectations on changes in exchange control and exchange rate may generate round-tripping for greater flexibility in foreign exchange management.
- *Accessing better financial services*: Financial markets of some economies are not well developed. Enterprises resident in these economies have to access overseas financial markets for better financial services, such as listing of companies in overseas stock markets. The funds raised will be brought back to host economies in the form of FDI. Round-tripping may occur as part of this process.

470. As such, round-tripping of funds flowing between subsidiaries, associates or fellow companies have to be recorded as FDI transactions/positions. For the local economy, they appear as FDI assets for the local funds channelled to routing economies, and as FDI liabilities for the subsequent return of the funds to the local economy. For the routing economy, they appear as FDI liabilities for the funds received from the local economy, and as FDI assets for the return of these funds to the local economy.

471. It may be argued that these round-tripping funds lead to an overstatement of the genuine magnitude of FDI. The *Benchmark Definition* recommends therefore separate supplementary breakdowns when this phenomenon affects significantly FDI data of a country. From the point of view of the routing economy, round-tripping may be partly

linked with "capital in transit " transactions /positions; in this case, the *Benchmark Definition* recommends that round-tripping that takes the form of "capital in transit" would be excluded from the key FDI statistics but separately distinguished. From the point of view of each local economy, the geographical breakdown according to the Ultimate Host Country (UHC) and the Ultimate Investing Country (UIC) could provide users with very interesting information.

1.3. Investment funds

472. The *Benchmark Definition* recommends that, when a collective investment institution (CII) has voting power in a non-resident entity of 10% or more, this relationship should be considered as direct investment. Similarly, when a non-resident enterprise has voting power in a CII of 10% or more, this relationship should be considered as direct investment. More specifically, investment in, and investment by, hedge funds, private investment funds and distressed funds should be included in FDI data if the standard 10% threshold is met.

473. Some concerns have been expressed about the inclusion in FDI of the investments in and by retail mutual funds and master/feeder funds. Although recognising the relevance of such concerns, the *Benchmark Definition* recommends that these investments should not be an exception to the "10%" rule. A more detailed discussion of this issue may be found in Annex 8 which discusses collective investment institutions.

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

474. In many developing or transition economies, the government requires the payment of an agreed amount of money by direct investors for the right to undertake a direct investment in the host economy. Often, but not always, these operating or concession rights are related to the extraction of natural resources. In transition economies, compilers refer to these payments as "bonuses". They are legal transactions and should not be associated with poor governance.

475. The *Benchmark Definition* recommends that such bonus payments should be recorded as "direct investment: equity " when there is an intention to establish a direct investment enterprise (such as in the case of a contractual arrangement between the investor and the government).[65]

1.5. Other borderline cases

476. In the process of globalisation of economic activities, cross border transactions are carried out that at first glance may be regarded as foreign direct investment when in fact they do not meet the criteria. For example:

a) An enterprise undertakes to build for a foreign client, usually a government, a complete manufacturing plant, to provide technical know-how, and to manage and operate a plant for a number of years, without an ongoing on-site managerial presence and without other criteria for the existence of a direct investment enterprise being met. It has complete control over day-to-day operations and receives a management fee, paid either in cash or in goods produced by the plant.

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

However, the enterprise has no equity stake in the plant and is performing a cross-border service.

b) An enterprise has a long-term contract with a foreign company, provides it with technical know-how, and has considerable influence over the quality and quantity of output. The enterprise may provide a loan to the foreign company and sometimes will have a member on the company's board. However, there is no equity stake. It is once again a cross-border service.

c) Some host countries have made agreements with a number of foreign enterprises where the host country supplies factory accommodation, electricity, staff accommodation, administration and labour. The foreign enterprise supplies all production machinery, fixtures and fittings for the building and production materials, and is responsible for the initial training of the labour force. The foreign enterprise then pays an agreed piecework rate for each item produced. Where the production machinery and fixtures and fittings remain the property of the foreign enterprise, there is technically a direct investment branch, though the branch's profits will be zero. There is no direct investment interest if the machinery becomes the property of the host country.

d) Some professional firms operate much like a multinational firm, but do not hold equity in one another. For example, unrelated (in an equity sense) accounting or management consulting firms may operate globally under a single name, refer business to one another and receive fees in return, share costs (or facilities) for such items as training or advertising, and may have a board of directors to plan business strategy for the group. This is not direct investment, and would be difficult or impossible to account for as such, but it does have much in common with direct investment.

e) Other cases might include foreign sales and representative offices, as well as foreign stations, ticket offices, and terminal or port facilities of domestic airlines or ship operators. Such offices or activities can be treated as direct investment only if they meet the requirements of residence and the attribution of production in an economy as described in Chapter 3.

2. List of exclusions from FDI

2.1. Transactions/positions/income between related financial intermediaries

477. The *Benchmark Definition* recommends that all inter-company flows – with the exception of those pertaining to equity finance – between certain types of related financial intermediaries should be excluded from foreign direct investment (FDI) transactions and positions. Deposits and other amounts lent by a financial intermediary to its financial intermediary subsidiary or associate located abroad, as well as deposits and other borrowings between such companies, should be classified as "other investment" rather than direct investment. A similar treatment applies to investment between fellow enterprises which are financial intermediaries. Debt securities between related financial intermediaries are classified as "portfolio investment ".

478. On conceptual grounds, permanent debt between selected related financial intermediaries would appear to qualify as direct investment. However, the *Benchmark Definition* recommends that, on grounds of practicality and statistical significance, it should instead be recorded as either portfolio investment or other investment, depending on the instrument.

479. The definition of the scope of enterprises included under "financial intermediary" should be equivalent to the System of National Accounts (SNA) definitions. The SNA classifies financial corporations under three categories, namely *financial intermediaries*, *financial auxiliaries* and *other financial corporations*. Financial intermediaries are institutional units that incur liabilities on their own account for the purpose of acquiring financial assets by engaging in financial transactions on the market. Financial auxiliaries are institutional units principally engaged in serving financial markets, but that do not take ownership of the financial assets and liabilities they handle. Other financial corporations are institutional units providing financial services, where most of their assets or liabilities are not available on open financial markets.

480. The financial corporations sector can be divided into nine sub-sectors according to its market activity and the liquidity of its liabilities (see Box A.3.1 below). Hence, non-equity transactions/positions (and investment income) between two related financial intermediaries, as they are described and numbered in Box A.3.1, that are part of 2) deposit-taking corporations; 3) money market funds (MMFs); 4) non-MMF investment funds or 5) other financial intermediaries, except insurance corporations and pension funds, would be excluded from FDI. While they are financial intermediaries, insurance corporations and pension funds are not treated in the same manner as other financial intermediaries for the purposes of this exclusion.

481. The following Table A.3.1 summarises the transactions/positions included in or excluded from FDI statistics for financial corporations (taking account of the particular treatment of FDI-related financial intermediaries):

Table A.3.1. **Overview of transactions/positions included in and excluded from FDI**

INVESTOR	INVESTEE	Financial intermediaries		Financial auxiliaries	Captive financial institutions and money lenders
		Except ICPFs	ICPFs		
Financial intermediaries Deposit-taking corporations, MMFs, non-MMF investment funds, other financial intermediaries (except ICPFs)	Equity finance	Included	Included	Included	Included
	Debt (including permanent debt)	**Excluded**	Included	Included	Included
ICPFs	Equity finance	Included	Included	Included	Included
	Debt (including permanent debt)	Included	Included	Included	Included
Financial auxiliaries	Equity finance	Included	Included	Included	Included
	Debt (including permanent debt)	Included	Included	Included	Included
Captive financial institutions and money lenders	Equity finance	Included	Included	Included	Included
	Debt (including permanent debt)	Included	Included	Included	Included

2.2. Financial derivatives

482. A financial derivative contract is a financial instrument that is linked to another specific financial instrument or indicator or commodity and through which specific financial risks (such as interest rate risk, foreign exchange risk, equity and commodity price risk, etc.) can be traded in their own right in financial markets. There are two broad types of financial derivatives: forwards (including futures and swaps, other than gold swaps) and options. Financial derivatives are excluded from FDI statistics.

Box A.3.1 **SNA: classification of financial corporations**

1. Central bank

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

2. Deposit-taking corporations except the central bank

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

3. Money market funds (MMF)

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

4. Non-MMF investment funds

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

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

Other financial intermediaries except insurance corporations and pension funds consists of financial corporations and quasi-corporations which are engaged in providing financial services by incurring liabilities, in forms other than currency, deposits or close substitutes for deposits, on their own account for the purpose of acquiring financial assets by engaging in financial transactions on the market. It is a feature of a financial intermediary that operations for both sides of the balance sheet are carried out in open markets.

6. Financial auxiliaries

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

7. Other financial corporations (Captive financial institutions and money lenders)

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

8. Insurance corporations (IC)

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

9. Pension funds (PF)

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

ANNEX 4

Framework for Direct Investment Relationships

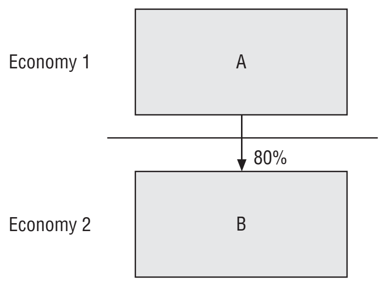
483. This annex presents the Framework for Direct Investment Relationships (FDIR) the preferred method for identifying the extent and type of direct investment relationships. It also provides information on two alternatives to the FDIR – the Participation Multiplication Method (PMM) and the Direct Influence/Indirect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

1. Framework for Direct Investment Relationships

484. The Framework for Direct Investment Relationships (FDIR) includes in direct investment all subsidiaries and associates of an investor.

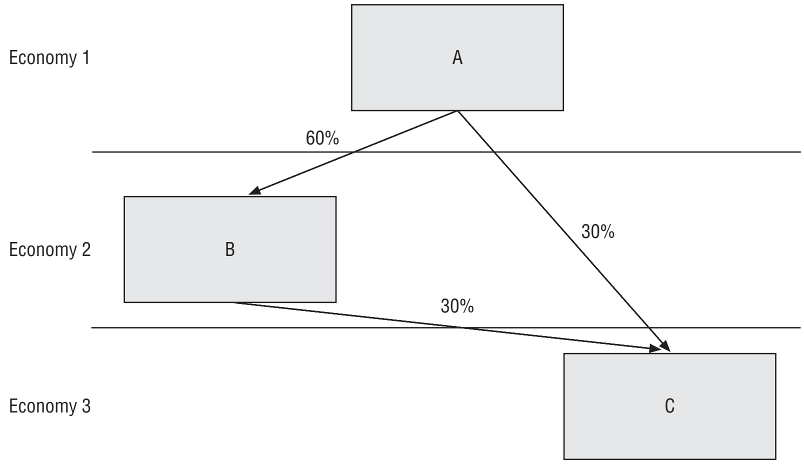
- A *subsidiary* is an enterprise in which an investor owns more than 50% of the voting power. In Figure A.4.1, B is a subsidiary of A.

Figure A.4.1. **Subsidiary (example 1)**



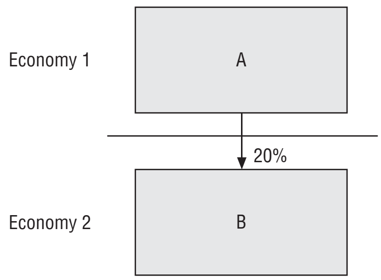
- Where an investor and its subsidiary(s) combined own more than 50% of the voting power of an enterprise, the owned enterprise is also regarded as a subsidiary of the investor. In Figure A.4.2, C is a subsidiary of A.

Figure A.4.2. **Subsidiary (example 2)**



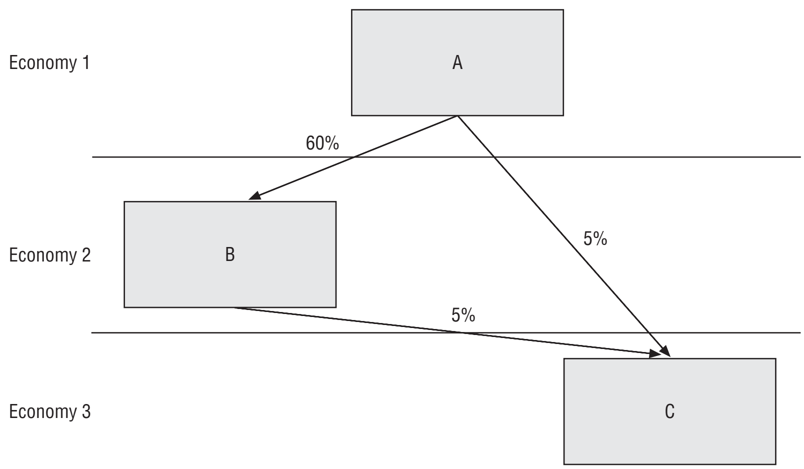
- An *associate* is an enterprise in which an investor owns at least 10% and no more than 50% of the voting power. In Figure A.4.3, B is an associate of A.

Figure A.4.3. **Associate (example 1)**



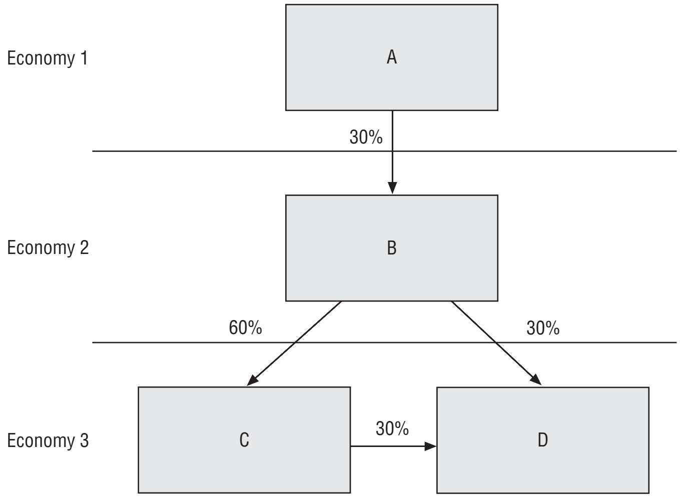
- Where an investor and its subsidiary(s) combined own at least 10% but no more than 50% of the voting power of an enterprise, the owned enterprise is regarded as an associate of the investor. In Figure A.4.4, C is an associate of A.

Figure A.4.4. **Associate (example 2)**



- Where an investor's associate (and its subsidiaries combined) own more than 50% of an enterprise, the owned enterprise is regarded as an associate of the investor. In Figure A.4.5, D is an associate of A.

Figure A.4.5. **Associate (example 3)**



485. The FDIR aims at identifying all enterprises over which the investor has significant influence under the 10% voting power criterion for FDI. In this determination, it is necessary to establish whether each enterprise under consideration is a *subsidiary* or an *associate* of the direct investor, or whether it is *not relevant to FDI* – all three categories when combined being exhaustive and individually mutually exclusive. Those enterprises which are subsidiaries or associates are included in the direct investment relationship, while those categorised as *not influenced* are not included. The FDIR therefore identifies all enterprises over which the investor has significant influence in the context of FDI. For subsidiaries of the investor, the influence is a controlling one; for associates, it is non-controlling.

486. It is considered that the degree of FDI influence that may be exercised through controlling links (where more than 50% of the voting power is held) is not diminished by the existence of multiple links. Thus, an enterprise controlled by a subsidiary or by a group of related subsidiaries (which may also include the investor) is itself regarded as a subsidiary. An enterprise controlled by an associate is also regarded as an associate. The degree of FDI influence that may be exercised through a single or cumulative non-controlling link (where from 10% to 50% of the voting power is held) is diminished by one degree. Thus, an associate of a subsidiary or a group of subsidiaries (which may include the investor) is regarded as an associate. An enterprise which is an associate of another associated enterprise is not, in any FDI sense, influenced by the investor in question, and, therefore, is not included in the FDIR. A chain of ownership is followed until the degree of influence that may be exercised by the investor is diminished to the point where an enterprise can be categorised as not influenced. Under the FDIR, the direct investment relationship extends from an investor to cover all of its subsidiaries and associates.

487. It should be stressed that a particular investor in a chain of ownership within the FDIR may indirectly hold less than 10% (but more than 0%) of an enterprise's voting power; this enterprise should be included in the FDIR as a subsidiary or an associate of the investor if the relevant criteria described in Chapter 3, sub-section 3.4.3 are fulfilled.

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488. The coverage of subsidiaries and associates within the FDIR along what might be termed vertical FDI ownership chains is generally relatively straightforward. However, an enterprise in one economy may be related through the FDIR to another enterprise in the same economy, or in a different economy, without either being a direct investor in the other, but through both being directly or indirectly influenced by the same enterprise in the ownership hierarchy. This "common parent" must be a direct investor in at least one of enterprises in question. Such enterprises can be considered to be related through a "horizontal" linkage within the FDIR – not involving FDI equity of 10% or more – and are called fellow enterprises. Where there is no voting power acquired in a fellow enterprise, or where less than 10% of the enterprise's voting power is obtained, all the investment made by one fellow enterprise in one economy in its fellow in another economy is included in FDI statistics but needs to be distinguished in compiling the data to facilitate the preparation of FDI data on both the asset/liability and directional presentational bases referred to in Section 2.4. Therefore, for a particular compiler, fellow enterprises may be considered as those resident and non-resident enterprises related within the FDIR other than those which have a direct investor-direct investment enterprise relationship (*i.e.* under the 10% or more voting power criterion) with one another. It is likely that many fellow enterprises will be direct investment enterprises in their own right but, clearly, some will not. For example, if a resident direct investor, A, has a direct investment enterprise abroad, B, as well as a resident subsidiary, C, then C, by definition, is not a direct investment enterprise of A, but B and C are fellow enterprises within the FDIR covering A, B and C.

489. In identifying the extent of a direct investment relationship from an investor, B, which is an associate of another investor, A, other enterprises which are in a direct investment relationship with enterprise B but are not in a direct investment relationship with enterprise A may be identified.

490. In summary, under the FDIR the direct investment relationship extends in both directions along an ownership chain from an enterprise to cover all of its subsidiaries and associates and all of the investors within the FDIR for which the enterprise is a subsidiary or an associate. It also covers "across chain" relationships. Where more than one ownership chain originates from the same direct investor, all entities in all chains are in a direct investment relationship with one another. Note that some of the links in a chain may be within one economy.

491. It must be stressed that in compiling FDI statistics, direct investment is only recorded when there is a financial transaction or position between entities in different economies that are in a direct investment relationship (including fellow enterprises). However, it should also be noted that the residence of units is not a feature of the definition of subsidiaries and associates for FDI purposes. The FDIR may include within the relationship enterprises that are resident in the same economy.

2. Participation Multiplication Method

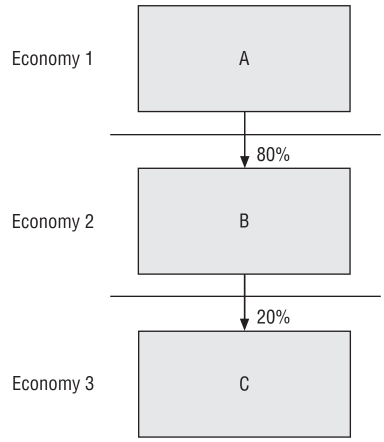
492. The Participation Multiplication Method (PMM) includes in direct investment all enterprises in which an investor has voting equity participation of at least 10%.[66] The calculation of participation percentage is based on a straight multiplication and summation of direct and indirect participation percentages.

493. More specifically, an indirect participation in a given enterprise at the bottom of a chain of ownership is calculated by taking the investor's participation in the first enterprise,

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

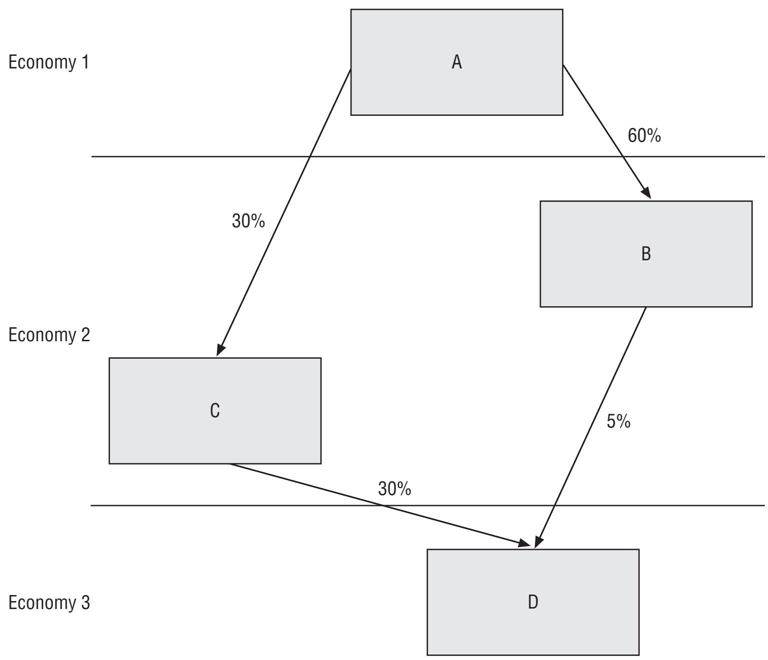
multiplied by the first enterprise's participation in the next enterprise, multiplied by the corresponding percentages for all other intervening enterprises in the chain, multiplied by the last intervening enterprise's participation in the given enterprise. In Figure A.4.6 according to this method, A has a 16% participation in C (20% of 80%). Because this participation is at least 10%, A and C are regarded as being in a direct investment relationship.

Figure A.4.6. **Participation Multiplication Method (example 1)**



494. If the investor's interest is held through more than one participation chain, then the percentages of direct and indirect participation in all chains are summed to determine the investor's total participation percentage. If the combined direct and indirect participation percentage is less than 10% in an enterprise in another economy, then that enterprise is not considered to be in a direct investment relationship with the investor. In Figure A.4.7, A holds 3% of D indirectly through B and 9% of D indirectly through C, so A holds a total of 12% of D from its combined holdings through B and C and as a result, D is a direct investment enterprise of A.

Figure A.4.7. **Participation Multiplication Method (example 2)**



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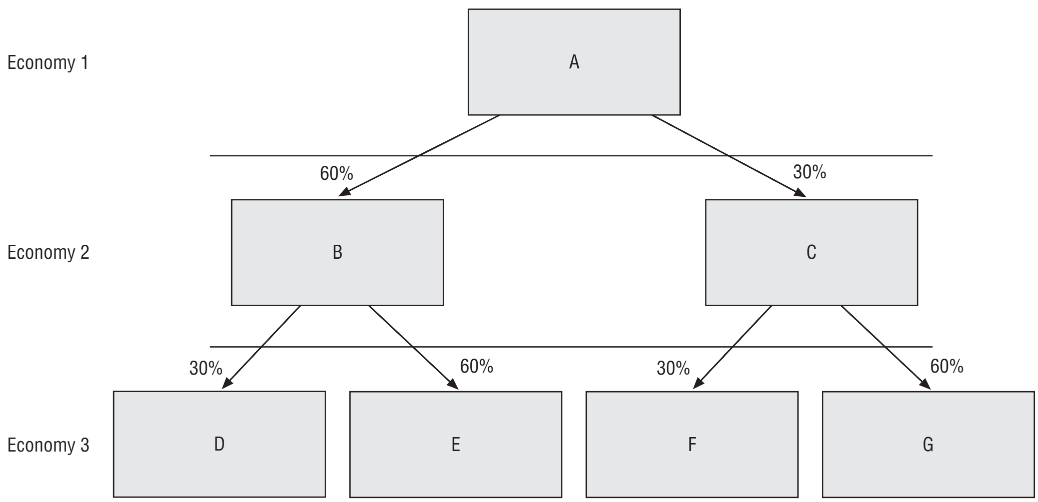
495. It should be noted that under the FDIR, D would not be considered to be in a direct investment relationship with A.

3. Direct Influence/Indirect Control Method

496. The Direct Influence/Indirect Control Method (DIIC) includes in direct investment all enterprises of which the voting power is 10% or more *directly* owned, plus all enterprises that are controlled by them (ownership of more than 50% of the voting power), plus all other enterprises in a continuous chain of majority ownership.[67]

497. This method allows the first link in an ownership chain to be a non-controlling link, but all subsequent links must be controlling links. Thus the DIIC breaks the ownership chain at the second non-controlling link (as in the FDIR) where the first link from the investor is a non-controlling link. On the other hand (and contrary to the FDIR), the DIIC breaks the ownership chain at the first non-controlling link where the first link from the investor is a controlling link. As such, the DIIC will always identify the enterprises in a direct investment relationship as a subset of those identified by the FDIR. In Figure A.4.8 according to this method, B and C are in a direct investment relationship with A and with each other; E and G are also in a direct investment relationship with A (indirectly), B and C and with each other, while enterprise D is only in a direct investment relationship with B and E, and enterprise F is only in a direct investment relationship with C and G.

Figure A.4.8. n**Direct Influence/Indirect Control Method**



498. It should be noted that under the FDIR, A would be in a direct investment relationship with all of the other enterprises except enterprise F.

499. Consistent with the indirect control principles of the FDIR, the DIIC includes in the direct investment relationship cases where combined control is exercised by a number of affiliated enterprises when their first links are controlling links.

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

4. Comparing the three methods

500. Figure A.4.9 presents six different relationships between an indirectly held enterprise and an ultimate investor. These relationships are analysed in Table A.4.1 in terms of whether the indirectly held enterprise is in a direct investment relationship with enterprise A.

Figure A.4.9. **Comparing the three methods**

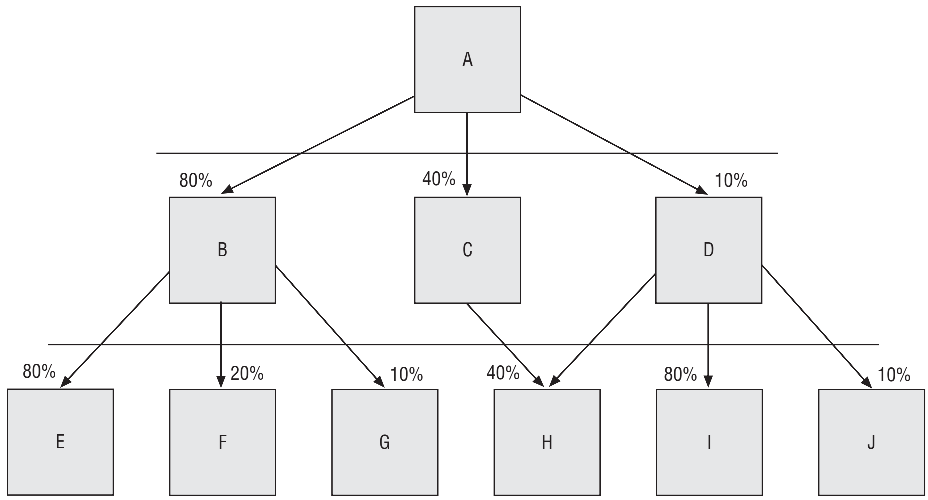


Table A.4.1. **Comparing the three methods**

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

501. From the above examples, it can be seen that the DIIC will always identify a subset of the enterprises in a direct investment relationship as being in that relationship. It does not recognise the relationship between enterprise A and enterprises F and G as being a direct investment relationship. The DIIC will never identify two enterprises as being in a direct investment relationship where none exists according to the FDIR.

502. The PMM may also fail to recognise a direct investment relationship where one exists according to the FDIR; for example, the PMM does not recognise the direct investment relationship between enterprise A and enterprises G and I. Even where a chain of control exists, the PMM may fail to recognise a direct investment relationship between enterprises sufficiently separated in the chain. Unlike the DIIC, the PMM may also identify enterprises as being in a direct investment relationship where none exists according to the FDIR; for example, the PMM considers enterprise H to be in a direct investment relationship with enterprise A.

5. Relationship with enterprise groups

503. Given that other related statistics are using the enterprise group as a basic unit, it is interesting to show how direct investment relationships may relate to enterprise groups. The example below in Figure A.4.10 is offered to help understand these relationships.

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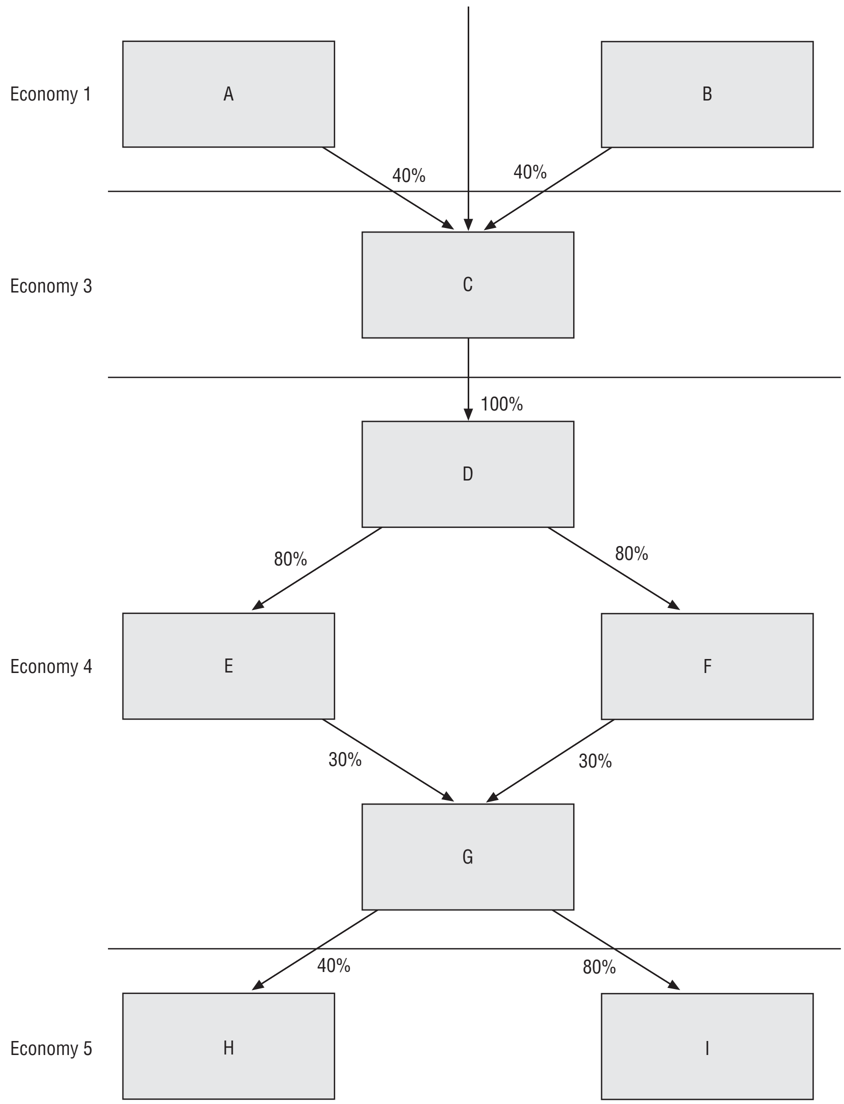
504. In this example, there are three FDI relationships under the FDIR, one global enterprise group and one local enterprise group comprised of the following units:

- FDI Relationship based on A: A, C, D, E, F, G, I (= for PMM and DIIC).
- FDI Relationship based on B: B, C, D, E, F, G, I (= for PMM and DIIC).
- FDI Relationship based on C: C, D, E, F, G, H, I (= for PMM, DIIC excludes G).
- Global Enterprise Group: C, D, E, F, G, I.
- Local Enterprise Group: D, E, F, G.

505. The following points may be noted:

- The purpose of the diagram and the FDI relationships described above is to show direct investment relationships based around different direct investors and how they overlap, but only looking down the investment chain (the "up-the-chain" relationship *e.g.* concerning the inclusion of enterprises A and B in the full FDIR based on enterprise C is ignored for this particular purpose (see Section 7 of this annex);

Figure A.4.10. **FDIR and Enterprise Groups**



- Enterprise H is not in a direct investment relationship with either A or B because, under the FDIR, C is an associate of A, so D is an associate of A, so E and F are associates of A, so G is an associate of A, and H, as it is an associate of an associate, is therefore not influenced by A and is not covered by the FDIR based on A (and similarly for the FDIR based on B).

506. Economies 3 and 4 have to identify all three FDI relationships to fully articulate the potential FDI counterparties that need to be considered in measuring FDI. In the case of economy 4, it is important not to stop at enterprise C, but to also identify the two direct investors, A and B.

507. From the terminology used in the *OECD Handbook on Economic Globalisation Indicators*, one could also note that:

- C is the Ultimate Controlling Parent for D, E, F, G and I.
- C is the parent of D, E, F and G.
- The local enterprise group (D, E, F and G) is the parent of I.

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

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

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

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

- If the resident direct investment enterprise is a subsidiary of the non-resident direct investor, ownership chains from the resident direct investment enterprise are followed past the first associate encountered in a chain and broken when the second associate is reached; while
- If the resident direct investment enterprise is an associate of the non-resident direct investor, ownership chains from the resident direct investment enterprise are broken when the first associate in a chain is reached.

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

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

7. Classifying financial transactions and positions

513. In compiling FDI statistics, any financial transaction or position between entities in a direct investment relationship is classified as a direct investment transaction or position (with the exception of the exclusion from FDI statistics of debt transactions and positions

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between financial intermediaries in a direct investment relationship and for financial derivatives). Only transactions and positions between FDI related enterprises which are resident in different economies are included in FDI statistics.

514. When classifying positions and transactions, all ownership chains of which the resident enterprise is a member have to be considered. The ownership chains are those for which the resident enterprise is treated as the direct investor, and any ownership chains in which the resident enterprise is an associate or a subsidiary. The latter chains are identified by moving up the chain from the resident enterprise, through the first non-controlling link, and stopping at the highest enterprise before the next non-controlling link above that point is encountered. The resident enterprise is then in a direct investment relationship with all enterprises that are in a direct investment relationship with any enterprise above it in an ownership chain. Note that there may be multiple chains and multiple direct investors identified in this process. This may also result in a number of fellow enterprises being identified through going up a chain and coming down another chain originating at the same investor *i.e.* “horizontal” or across-chain links between such fellow enterprises (which may invest in one another but for which such investment involves no voting power or, where it does, it is limited to less than 10% ownership).

515. For example, considering Figure A.4.8 above, direct investment positions and transactions for each economy would be recorded according to FDIR as shown in Table A.4.2.

Table A.4.2. **Classifying financial transactions and positions**

Economy	Resident Enterprise	Record direct investment with
1	A	B, C, D, E, G
2	B	A, D, E, G
	C	A, D, E, F, G
3	D	A, B, C
	E	A, B, C
	F	C
	G	A, B, C

ANNEX 5

Valuation of Unlisted Equity

1. Methods recommended by the *Benchmark Definition*

1.1. Overview

516. The underlying principle for the valuation of equity is the market value of that equity. Listing in an organised market provides a good basis for valuing listed equity. However it can be more difficult to determine a market value for unlisted equity and illiquid listed equity. In any case, if there has been a material change in an enterprise's financial position since the date to which the valuation applies (but before the reference date), an adjustment may need to be made. Examples of such material events include an unexpected decision in a lawsuit, credit downgrade or upgrade, major new invention or mineral find, or bankruptcy.

517. This manual recognises six methods for approximating market value for unlisted equity:

- Recent transaction price.
- Own funds at book value (OFBV).
- Net asset value (NAV).
  - ❖ Including goodwill and intangibles.
  - ❖ Excluding goodwill and intangibles.
- Market capitalization method.
- Present value.
- Apportioning global value.

518. The choice of method depends primarily on having information available to support the application of the method. In practice, one or more of these methods could be ruled out because of a lack of information available to support the application of the method. Among the methods that could be implemented, the primary consideration should be how well the method approximates market value. A further consideration is the stringency of the requirement for symmetric recording by debtors and creditors.

519. Each method is described in more detail below, giving information on what is needed to apply the method and caveats on its use.

1.2. Recent transaction price

520. Unlisted equity may trade from time to time, and recent prices at which the equity exchanged hands may be used. The transaction price must represent an 'arm's length' price between an independent buyer and seller, where neither party is under compulsion or duress to engage in the transaction. More recent transactions are preferable, and it is desirable that the transaction should have occurred within the past year. If the most recent transaction is more than one year old, compilers may wish to consider an alternate method.

Usage: A recent, arm's length transaction price is required.

Caveats: Not often available due to the low frequency of trades in unlisted equity. When a transaction price has been used in the past to value the equity, but the information is becoming dated, a strategy is required to splice the valuation with a valuation calculated from another method.

1.3. Own funds at book value

521. Own funds at book value (OFBV) involves valuing an enterprise at the value appearing in its books following International Accounting Standards. OFBV is based on the books of the direct investment enterprise and can be seen on its balance sheet as shareholder's equity. The definition of OFBV contains paid-up capital, all types of reserves and net value of non distributed profits and losses (including result for the current year). International Accounting Standards require most assets to be revalued on, at least, an annual basis. A capitalisation ratio may be calculated and applied (with or without liquidity adjustments) if sufficient information is available.

Usage: This method may be used where books are kept on the basis of International Accounting Standards, and access is available to the books of the direct investment enterprise.

Caveats: International Accounting Standards prohibit the recognition of certain intangible assets (*e.g.* brands, mastheads, publishing titles, customer lists). Goodwill can only be bought; it cannot be internally generated. Assets in some asset classes (loans, assets held to maturity and non-trading liabilities) may be valued at nominal or historic cost. These will all cause distortion from the market valuation. Calculation of capitalisation ratios requires a reasonably broad stock market with high trading volume, but application of a well-based capitalisation ratio may dampen the impact of the other caveats.

1.4. Net asset value (NAV), including goodwill and identified intangibles

522. Net asset value (NAV) is total assets at current/market value less total liabilities (excluding equity) at market value. Under this valuation method, all financial and non-financial assets and liabilities of the enterprise, including intangible assets, are stated in terms of current period prices. The valuations should be based on very recent appraisals – certainly they must be within the prior year. Appraisals may be conducted by knowledgeable management or directors of the firm, and/or provided by independent appraisers. A capitalisation ratio may be calculated and applied (with or without liquidity adjustments) if sufficient information is available (see market capitalisation method).

Usage: At a minimum, this method requires an asset and liability valuation to be undertaken by the enterprise.

Caveats: NAV provided by an enterprise may exclude some classes of assets (*e.g.*, intangibles), while other assets may be valued using a method that is a distortion from the current market value (*e.g.*, historic cost or nominal value). To the extent that valuations are poor or assets are excluded from the NAV, this method can be a poor approximation of market value and other methods may be more appropriate. Calculation of capitalisation ratios requires a reasonably broad stock market with high trading volume.

1.5. Net asset value (NAV), excluding goodwill and identified intangibles

523. Under this valuation method, all financial and non-financial assets and liabilities of the enterprise, excluding intangible assets, are stated in terms of current period prices. The valuations should be based on very recent appraisals – certainly they must be within the prior year. Appraisals may be conducted by knowledgeable management or directors of the firm, and/or provided by independent appraisers.

524. Note that the difference between this method, and the one immediately above, is that this method excludes, whereas the earlier discussed method includes, goodwill and identified intangibles. However, it is often very difficult to estimate the value of these assets. Compilers who can develop relatively accurate estimates of unquoted equity that include goodwill and identified intangibles are encouraged to do so. Doing so promotes consistency between the estimates for quoted shares (these shares trade at prices that reflect the value of intangible assets) and the estimates for unquoted shares.

Usage: Compilers who cannot accurately provide estimates that include goodwill and identified intangibles may use this method.

Caveat: Goodwill and intangible assets may account for much or most of the current value of many direct investment enterprises. This valuation might not be representative of market value.

1.6. Market capitalisation method

525. This method proposes the use of a capitalisation ratio as the ratio of the stock exchange market capitalisation to "own funds at book value" calculated for the same set of listed companies. In constructing the capitalisation ratio under this method, stock market data for an individual country may be used when the stock market in that country is broad and trading volume is relatively high, and broad regional indexes should be used when these circumstances do not exist. The estimate of market values of direct investment equity in unlisted companies is calculated by multiplying own funds at book value (owners' equity) of unlisted direct investment enterprises by the capitalization ratio [that is, by the stock exchange market capitalisation (numerator) to the own funds at book value of listed companies (denominator)]. Capitalisation ratios developed from broad stock exchange data should be adjusted, or individual ratios should be developed for separate industry groups, if the industries represented in the broad stock exchange for a given economy are not representative of the industry mix of direct investment enterprises located in the same economy. Book values that are based on another set of accounting standards – such as US generally accepted accounting principles – that contain major attributes of International Accounting Standards (inclusion of cumulative reinvested earnings; revaluation of financial instruments in current period prices; and inclusion of cumulative depreciation of plant and equipment, including write-offs of worthless assets) may also be used with the capitalisation ratio method.

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Usage: Useful exercise if the overall enterprises listed in the stock exchange are good representatives of the national industry.

Caveats: Some very large local foreign direct investment unlisted enterprises might represent almost the entire industry. Another strategy is then required to better reflect the market valuation of that enterprise. Apart from this, some other considerations could be seen as caveats of this method, for example, some specialists question the assumption that quoted and non-quoted companies should use the same ratio to own funds. Being quoted in a public market means that a company has to comply with more strict rules, provide more detail information to market participants, etc. Moreover a liquid asset (quoted shares) may have a higher value for the fact of being liquid.

1.7. Present value / price to earnings ratio

526. The value of unlisted equity can be estimated as the present value of the forecast stream of future earnings. This method has at its heart the issue of choosing an appropriate discount rate, which can be inferred from the implicit discount rate obtained for listed equity, and forecasting the future profits. At its simplest, this method can be approximated by applying a market or industry price-to-earnings ratio to the (smoothed) recent past earnings of the unlisted enterprise to calculate a price. In this case, the recent past earnings are used as the basis to forecast the future earnings, and the market price-to-earnings ratio implies the discount rate.

Usage: This method is most appropriate where there is a paucity of balance sheet information but earnings data are more readily available. It also requires an appropriate discount rate or reasonably broad-based price-to-earnings ratio to be calculated.

Caveats: Earnings for an individual enterprise can have a highly irregular component and can be negative (leading to negative equity valuations). As a result, if earnings information over a longer period of time is available, the earnings of the enterprise should be smoothed. If earnings for only one period are available or discount rates or price-to-earnings ratios are based on a narrow market, other methods are preferable.

1.8. Apportioning global value

527. If the equity in a particular direct investment enterprise is unlisted, but the enterprise belongs to a global enterprise group whose equity is listed, the current market value of the global enterprise group can be calculated and apportioned to the operations in each economic territory. The current market value of the global enterprise group should be based on its market price on the exchange on which it is traded, and the apportionment of this value to each economic territory should be based on an appropriate indicator (*e.g.* sales, net income, assets or employment).

Usage: Current market capitalisation of the global enterprise group is required. As such, this method may only be feasible for outward investment. An indicator that is well-correlated with market value and readily available is also necessary. This is more likely to occur in enterprise groups that are horizontally integrated.

Caveats: Weaknesses in the correlation between market value of equity and the variable used for apportioning the global value will lead to distortions – sensitivity to the distortion is greatest when the proportion allocated to an economic territory is small or when different activities take place in different economic territories. In this case, other methods may be preferable. The use for outward investment only may lead to asymmetries in bilateral comparisons.

2. Methods not recommended by the *Benchmark Definition*

2.1. Overview

528. As stated in Chapter 5, there are other methods of valuing equity which are not recommended by this *Benchmark Definition*, however they may be the only methods available to the compiler from the information available to them. These methods include:

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

These are briefly described below.

2.2. Historic or acquisition cost

529. Historic cost as defined here represents the original cost of purchasing a direct investment enterprise, and acquisition cost represents an enterprise's original cost for acquiring major assets and liabilities. These costs are usually based on the books of the investor, and may not reflect cumulative reinvested earnings, current period charges for depreciation, foreign currency exchange rate changes, or the impact of other economic events that may have resulted in substantial changes in the value of direct investment enterprises since their initial establishment or acquisition.

2.3. Accumulation of foreign direct investment equity capital flows

530. Direct investment equity positions could be compiled by accumulating (or summing) direct investment equity capital flows, and perhaps adjusting this amount for changes in foreign currency exchange rates. This method is not recommended for use in the main accounts. It does not take account of cumulative reinvested earnings, depreciation on fixed assets, direct investment enterprise holding gains or losses, and other factors that often will have a substantial impact on current period values of direct investment equity.

2.4. Stock market price index applied to accumulated direct investment equity capital flows

531. Direct investment equity positions could be compiled by accumulating direct investment equity capital flows, adjusted as appropriate for changes in foreign currency exchange rates, and then applying changes in a related stock market price index to this amount. Under this method, changes in stock market indexes for large countries or broad regions would be applied to the direct investment equity position. Country indexes would be used when markets in the individual country are broad and trading volume is relatively high, and broad regional indexes would be used when these circumstances do not exist.

532. This method is similar to "accumulation of foreign direct investment equity capital flows", except that it includes an adjustment for changes in stock market price indexes. This method is not recommended for use in the main accounts. It does not take account of depreciation of fixed assets, direct investment enterprise holding gains or losses, and other

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factors that often will have a substantial impact on current period values of direct investment equity. (To some extent, this method does take account of cumulative reinvested earnings, because a stock market price index will tend to rise due to reinvestment of earnings by companies included in the index. However, the earnings and reinvested earnings of companies in the index may be poorly correlated with the earnings and reinvested earnings of direct investment enterprises.)

2.5. Book value

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

534. For countries that begin their valuation process via the collection of book value information, the *Benchmark Definition* recommends that the books of the direct investment enterprise serve as the starting point. International comparability of direct investment earnings and direct investment positions is only possible if both the investing and host countries use the same set of books as their starting point for deriving estimates of market values.

535. The books of the direct investment enterprise are usually more comprehensive than those of the direct investor. This is because, under tax and financial accounting rules followed by most countries, the books of the direct investment enterprise will typically reflect current period earnings and reinvested earnings. In contrast, the books of direct investors may not reflect the current period earnings or reinvested earnings of their direct investment enterprises, particularly in the case where ownership interests are less than 20% (these investments are frequently carried at cost on the investor's books).

ANNEX 6

Reinvested Earnings and Reinvestment of Earnings

1. Definition

536. In a relationship between a direct investor and a direct investment enterprise (DIE), the net current earnings of a DIE that are not distributed as dividends to the shareholders (or the equivalent in the case of quasi-corporate enterprises) are deemed distributed, as investment income, to the direct investor (DI), proportionate to its (their) holdings of shares (or equivalent) in the DIE.[68] As this is an imputed transaction, a counterpart imputation (of equal value but opposite direction) is required in the financial account representing the reinvestment of the funds back into the DIE. The income imputation is referred to as *reinvested earnings* (RE) (Box A.6.1), while the financial account entry is referred to as *reinvestment of earnings income*, to differentiate it from the income transaction.

Box A.6.1 **Reinvested earnings on direct investment**

The net[69] operating surplus/deficit of the DIE

plus:

property income receivable[70] and current transfers receivable

minus:

property income payable [including dividends payable to DI(s)],[71] current transfers payable,[72] including current taxes payable on the income, wealth, etc., of the direct foreign investment enterprise, but excluding withholding taxes[73] and taxes on holding gains.

times

the DI's (DIs) share of the DIE's equity (or equivalent)

equals

Reinvested earnings payable

68. That is, shares on issue for an incorporated enterprise, or the equivalent for an unincorporated enterprise. Where the shares issued (or equivalent) differ from voting power, the same principle for the distribution of dividends should be used. For the most part, it is the DI's percentage holding of shares on issue (or equivalent) that determines the ratio under which reinvested earnings are deemed distributed, not the level of voting power.
69. *Net* in this context refers to net of charges for consumption of fixed capital.
70. For a DIE, the property income receivable includes reinvested earnings from any DIE in which it is a DI.
71. Including branch profit remittances.
72. Capital transfers *e.g.* investment grants received, should not be included.
73. Withholding taxes are deemed to be paid by the non-resident owner, not by the resident entity.

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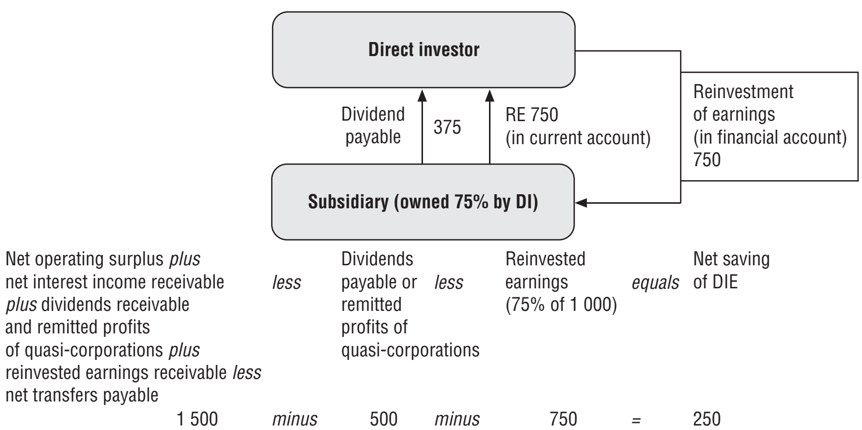
537. It should be noted that RE (and reinvestment of earnings) can be both negative or positive in sign for both the DI and the DIE. Typically, RE will be a debit for income payable by the DIE to the DI, and a credit for such income receivable by the DI (with the offsetting entries for reinvestment of earnings in the direct investment transactions and positions accounts reflecting the opposite directions for these flows). However, if a DIE generates a loss from its current operations (that is, the sum of its operating surplus and its net property income is negative), or if it declares a dividend for more than it has earned in the reference period, a negative debit should be recorded in the Direct Investment Income Account under RE for the DIE (and, correspondingly, a negative credit for the DI). An offsetting negative entry should also be recorded in the Direct Investment Transactions Account (and also be reflected in the Direct Investment Positions Account) of the DIE's economy for the reinvestment of earnings; correspondingly, a positive entry for the same amount should appear in the same accounts of the DI's economy. These entries should be made for both the asset/liability and the directional presentations for both economies. Where a DIE is 100% owned by its DI(s), it will have no net saving of its own, but where there are shareholders not in a FDI relationship with the DIE (whether portfolio investors, if residents of economies other than that of the DIE, or other shareholders who are residents of the same economy as the DIE), the DIE will have savings of its own.

538. To illustrate the recommended treatment, take for example, a direct investment enterprise which is 75% owned by a direct investor and for which the remaining 25% of the equity is held by small investors (resident or non-resident). If the profits (calculated as described) in a reference period are 1 500 units and 500 units in dividends are paid out to all investors, the direct investor's share of reinvested earnings is calculated as 75% of profits (*i.e.* direct investment income on equity amounts to 0.75 x 1 500 = 1 125) less 75% of dividends (*i.e.* 0.75 x 500 = 375) which equals 750. This is shown in diagrammatic form below in Figure A.6.1.

539. The savings of the DIE are therefore 250 *i.e.* 1,500 less 500 dividends less 750 reinvested earnings attributable to the direct investor.

Figure A.6.1. **Example of a DIE with 75% direct investor holdings**



2. Components

2.1. Net operating surplus

540. It is recommended that net operating surplus (NOS) be recorded on the same basis as in the national accounts, that is, all value added from the operations of the enterprise (that is, gross output less intermediate inputs) *less* consumption of fixed capital. NOS does not include property income (receivable or payable) or any realised or unrealised holding gains or losses arising from valuation changes, exchange rate changes, write-offs, etc.

2.2. Net interest income receivable

541. Net interest income receivable is the difference between the accrual, during the current period, of interest receivable on all interest bearing financial assets *less* the accrual, during the current period, of interest payable on all interest bearing liabilities, regardless of whether any payments have been made. Included is all interest payable or receivable to/from DIs and/or DIEs.

2.3. Dividends and distribution of profits of quasi-corporations receivable and payable

542. Dividends are paid to a company's shareholders from its earnings and are recorded in FDI statistics as of the date they are declared payable. Dividends may be declared payable from current period operations, but they may also be financed from other sources *e.g.*, from reserves developed during a longer period or from capital sales or realized capital gains. Dividends may be declared payable even if the enterprise is losing money. For quasi-corporations, remitted profits are treated in the same manner.

2.4. Net current transfers receivable

543. Net current transfers are the difference between current transfers receivable and current transfers payable. They cover all items for which there is no *quid pro quo* of a current nature. Most common are corporate income taxes and other kinds of tax payable, but withholding taxes and taxes on capital gains are not included. These are deemed payable by the shareholders.

2.5. Current Operating Performance Concept

544. *Direct investment income on equity* as defined under the Current Operating Performance Concept (COPC) covers the sum of NOS *plus* net interest receivable *plus* dividend income receivable *plus* reinvested earnings receivable *plus* net current transfers receivable. It does **not** include any realised or unrealised holding gains or losses arising from valuation changes, exchange rate changes, write-offs, etc. See Chapter 4 for the full definition.

3. Accounting practices

545. Accounting practices vary across the world, so it is recommended that direct surveys of both DIEs and DIs be conducted, to obtain the data on the appropriate conceptual basis, as set out in the schematic above. However, in some instances, it may not be possible to conduct direct surveys and recourse may have to be made to other sources of information, most notably, the annual reports of enterprises. However, in many cases annual reports do not include an aggregate that fully complies with the COPC, even though income for the

year is calculated and published with a number of sub-components and sub-aggregates. Accordingly, it will be necessary for the compiler to make calculations in order to transform the published aggregates to the COPC.

546. If, for example, companies publish an aggregate of profit/loss after financial items, the link to COPC will be as follows in Box A.6.2:

Box A.6.2 **Profit/ loss after financial items**

Profit/loss after financial items[74]

Plus share of profits of associates (proportionate to holdings of shares on issue)[75]

Minus Realised capital gains

Minus Unrealised capital gains

Plus Realised capital losses

Plus Unrealised capital losses

Minus Realised exchange rate gains

Minus Unrealised exchange rate gains

Plus Realised exchange rate losses

Plus Unrealised exchange rate losses

Plus Write-down/write offs (excluding consumption of fixed capital as a charge has already been made for this in the calculation of "net profit/loss after financial items")

Minus Any extraordinary or exceptional income included in profit/loss after financial items and not included in the adjustments above

Plus Any extraordinary or exceptional expense included in profit/loss after financial items and not included in the adjustments above

Minus net interest receivable on financial derivative contracts[76]

Plus net interest payable on financial derivative contracts

Minus Current taxes on profit for the period (excluding withholding taxes and taxes on holding gains)

= Income for the period, using the COPC

74. This item is obtainable from company accounts and normally represents, for the reference period, all revenue arising from trading activity including revenue from extraordinary and exceptional items as well as relevant capital or currency exchange gains/losses and interest or other income receivable from financial assets; *less* associated expenses arising from such trading activity including extraordinary and exceptional expenses as well as any interest payable or other expenses on loans or other debt. It is calculated before deduction of any taxes.

75. It is assumed that the profit/loss of controlled enterprises has already been included in the profit/loss after financial items. If this is not the case, it should be included in this line.

76. In compiling FDI income, net interest receivable and payable on financial derivative contracts are not treated as income. This is in line with the balance of payments and national accounts recording of income. The treatment here is to remove them from the books of those enterprise accounts that treat them as if they were income.

547. If there is no sub-aggregate available, the calculations may have to be made from the total profit published (the so-called "all inclusive"), which adds some more variables as in Box A.6.3:

Box A.6.3 **Net profit/loss for the year**

Net profit/loss for the year

Minus Realised capital gains

Minus Unrealised capital gains

Plus Realised capital losses

Plus Unrealised capital losses

Minus Realised exchange rate gains

Minus Unrealised exchange rate gains

Plus Realised exchange rate losses

Plus Unrealised exchange rate losses

Plus Write-downs/Write offs (excluding consumption of fixed capital as a charge has already been made for this in the calculation of "net profit/loss")

Minus Extraordinary income,

Plus Extraordinary expenses,

Minus Other current taxes (excluding withholding taxes and taxes on holding gains)

= **Income for the period, using the COPC**

4. Recording in FDI statistics[77]

548. In principle, income on direct investment is recorded at the time it is earned. However, actual data for the calculation of income are often only available on an annual basis, with a considerable time lag; in the meantime, it is necessary to provide estimates of the net disposable income (COPC) for the current period, often on a quarterly basis. In that case, information should be sought directly from the DIEs and the DIs resident in the economy, from which indicators may be developed to calculate dividends payable and reinvested earnings. These indicators might include estimates of gross and net value added, net income receivable, and net current taxes. In addition, an indication from past practice of dividend payments might also be used – companies often maintain the same dividend payments, regardless of the underlying earnings of the enterprise, for many years. But as both dividends and reinvested earnings are components of income, approximating the totality of dividends and reinvested earnings is more important than approximating the components. While preliminary, and subject to revision, this approach is preferable to merely extending the data for past year(s) to the current period (and dividing by four to provide quarterly estimates), until the information is available from the respondents' complete annual reports and/or tax returns.

5. Consolidation

549. In line with the Framework for Direct Investment Relationships (see Annex 4), the RE of each enterprise "down the ownership" chain should be attributed to each of the direct

77. The recording is identical in the balance of payments.

investors up the chain. Accordingly, if A (Level 1) is owned 100% by B (Level 2), B is owned 50.01% by C (Level 3), and C is 40% owned by D (Level 4), then A's RE represent part of the net investment income of B, and, as a result, they are part of the sources of revenue that form part of the RE that are deemed distributed to C by B, and then as part of B's RE that are deemed distributed to A. See Text Box A.6.4. Where ownership is less than 100%, the proportional ownership should be applied, even when there is more than one DI. This principle applies whether A, B, and C are each in separate economies from D, or are in the same economy, but separate from D.

Box A.6.4. **Calculation of reinvested earnings along a chain of related direct investment enterprises**

	Level 1	Level 2	Level 3	Level 4
Ownership by next level	A	B	C	D
	100 per cent	50.01 per cent	40 per cent	
NOS	200	250	300	350
Minus Corporate taxes payable	–50	–60	–70	–90
Plus Dividends receivable from DIE		+50	+60	+100
Minus Dividends payable to all shareholders	–50	–120	–250	
Plus Reinvested earnings receivable from DIE		+100	+110	+60
Minus Reinvested earnings payable to DI	–100	–110	–60	
Equals Net saving	0	110	90	420
In Direct Investment Transactions and Positions account				
Direct investment liabilities: reinvestment of earnings	+100	+110	+60	
Direct investment assets: reinvestment of earnings	0	–100	–110	–60

Note: The offsetting reinvestment of earnings entries in the direct investment transactions and positions accounts should be reflected in both the asset/liability and directional presentations

550. In the situation where enterprise C owns 50% or less of B, then enterprises A and B are not in a direct investment relationship with enterprise D under the FDIR. As enterprise D is not considered to have significant influence over enterprise B, enterprise D cannot be considered to have significant influence over the earnings distribution and savings decisions of enterprise B. As a result, the reinvested earnings that accrue to enterprise C from enterprise B are not considered part of enterprise C's current operating profit that accrues to enterprise D. The calculation in Text Box A.6.4 would show 16 in reinvested earnings accruing to enterprise D from enterprise C (rather than 60) with 16 being reinvested by enterprise D in enterprise C.

551. Normally, when companies perform elimination of group transactions, they use data on the *total* profits, including holding gains and losses, foreign exchange gains and losses, write offs and write downs, and dividends. It is, therefore, imperative that clear instructions be provided to respondents to enable them to report on the required basis.

ANNEX 7

Special Purpose Entities

1. Introduction

552. The purpose of this Annex is to assist compilers to identify Special Purpose Entities (SPE). The core business of SPEs is to channel funds between entities outside the country where they are established. The identification of SPEs allows foreign direct investment (FDI) compilers to segregate transactions and positions that hardly affect domestic economic activity and do not reflect genuine investment activities in or of the reporting country itself. The role of these SPEs is merely to serve as a financial turn table for enterprises in other countries.

553. Referring to Figure A.7.1 this *Benchmark Definition* addresses problems with the interpretation of FDI figures caused by SPEs as follows:

i) for the standard presentation country B should report separately on transactions and positions of its resident SPEs and non-SPEs;

ii) for supplemental presentations ("looking through non-resident SPEs"),

- ❖ country A is recommended to reallocate its outward investment position in the SPE in country B to C and D by looking through the non-resident SPE in B;
- ❖ country B is recommended to only report for its non-SPE;
- ❖ countries C and D are recommended to reallocate their inward investment positions to country A;

iii) it is suggested that country B produces a matrix linking foreign assets and liabilities of its SPEs in different countries.

554. FDI statistics under points *i)* and *ii)* above are based on the directional principle and should be geographically broken down by country and industry to facilitate the economic analysis of foreign direct investment. National compilers in economies hosting SPEs may wish to provide origin and destination matrices as supplemental information, as they may help to look through SPEs and to track international capital flows.

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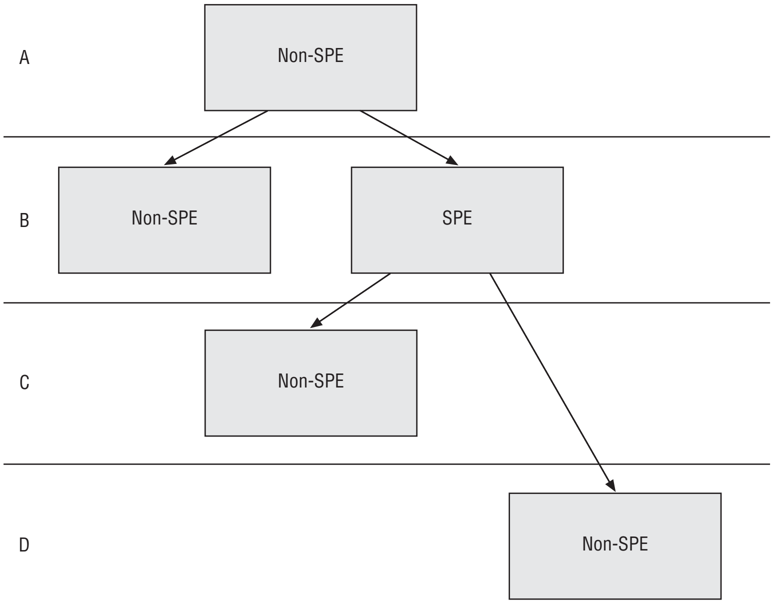
Figure A.7.1. **Direct investment positions held via an SPE**



555. The following sections provide further compilation guidance.

2. Treatment of SPEs

2.1. General principles

556. For standard FDI statistics, broken down by country and industry, it is recommended to provide data on SPEs and non-SPEs separately as described in Annex 2. Compilers are also recommended to look through, on a supplemental basis, *non-resident* SPEs by reallocating reported non-SPE data *vis-à-vis* direct counterparts to the country and industry of the first non-SPE encountered (Chapters 4 and 7).[78] Positions and transactions of resident SPEs are excluded from the supplemental presentation.

2.2. Most common types of SPE relationships

2.2.1. SPEs in direct relationships with non-resident entities

557. Many pass-through entities only have assets and liabilities *vis-à-vis* non-residents. In this case, the classification as an SPE is straightforward. In Figure A.7.2(a), for instance, on the basis of the criteria (*ii* and *iv*) listed in Box A.7.1, enterprise M would be an SPE, as it is an entity that is directly controlled by a non-resident and owns only assets in non-resident enterprises.

2.2.2. Resident chains of pass-through entities

558. The part of a chain of FDI passing through a country may also consist of two or more entities, as is illustrated in Figure A.7.2(b). The resident entity reporting outward investments (enterprise M), owns foreign assets only. At the same time, it is indirectly controlled (via L) by a non-resident parent. Hence, it can be considered as an SPE. However, the entity reporting incoming funds (enterprise L) has no non-resident assets. It has

78. In Figure A.7.1, an enterprise in country A holds an equity position in its SPE in B, a (pure) holding company without any employment. This SPE has invested the total amount of the funds received from A in its affiliates in C and D. The enterprise in A also holds an equity position in a non-SPE in B.

Box A.7.1. **General criteria to assist compilers to identify SPEs**

An enterprise is usually considered as an SPE if it meets the following criteria:

i) The enterprise is a legal entity,

a) Formally registered with a national authority; and

b) subject to fiscal and other legal obligations of the economy in which it is resident.

ii) The enterprise is ultimately controlled by a non-resident parent, directly or indirectly.

iii) The enterprise has no or few employees, little or no production in the host economy and little or no physical presence.

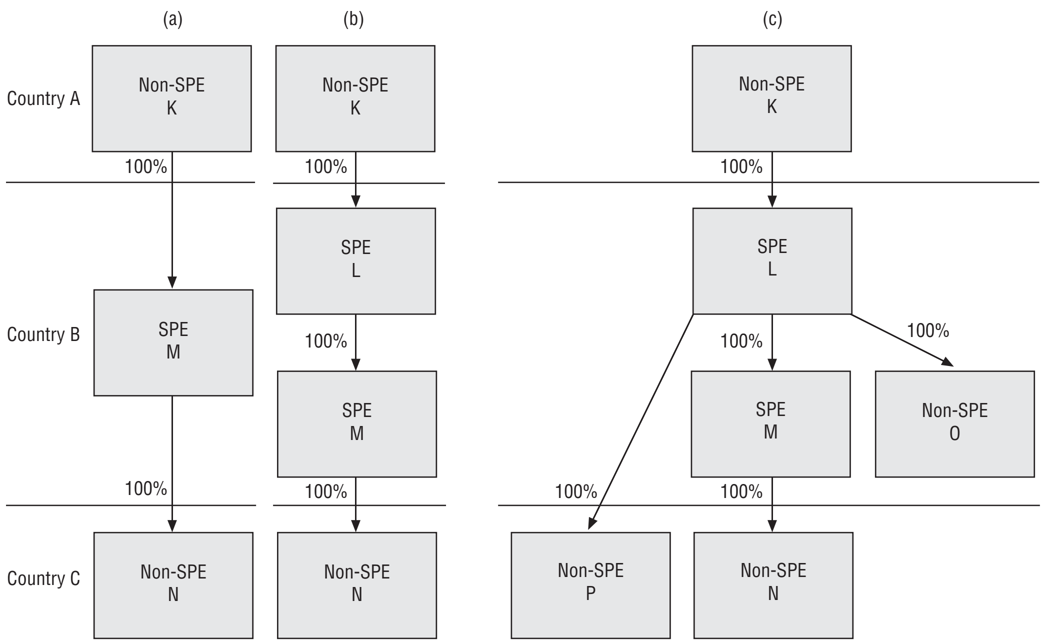
iv) Almost all the assets and liabilities of the enterprise represent investments in or from other countries.

v) The core business of the enterprise consist of group financing or holding activities, that is – viewed from the perspective of the compiler in a given country – the channelling of funds from non-residents to other non-residents. However, in its daily activities, managing and directing local operations plays only a minor role.

invested in the next entity down the chain (enterprise M, which is another resident entity in the same economy B). Hence, enterprise L does not meet criterion *iv*), according to which almost all assets should be non-resident assets. Therefore, on the basis of a strict interpretation of the above criteria, enterprise L could not be considered as an SPE. At the same time, however, it is clear that the domestic assets of L in M are assets in an entity that has no economic links with the domestic economy. In consequence, compilers are recommended to consider enterprise L as an SPE and to look through it, given that its assets are indirectly owned *non-resident* assets.

Figure A.7.2. **Examples of chains of SPEs**

(enterprises L and M do not have any assets in addition to those indicated)



2.2.3. Mixed groups of SPEs and non-SPEs

559. A resident enterprise, directly owned by a non-resident enterprise, may also hold, in the same (domestic) economy, both SPEs and operating subsidiaries [see Figure A.7.2(c)].Whether the resident enterprise (L), should be considered as an SPE depends on the composition of its balance sheet. Although it is directly controlled by a non-resident enterprise, its assets are partially non-resident and partially resident. The assets include investments in a resident enterprise (non-SPE) as well as non-resident assets, which it holds directly in non-resident enterprise (P) and indirectly in non-resident enterprise (N). The relative weight of foreign and domestic assets determines whether L should be classified as a SPE or as a non-SPE.[79]

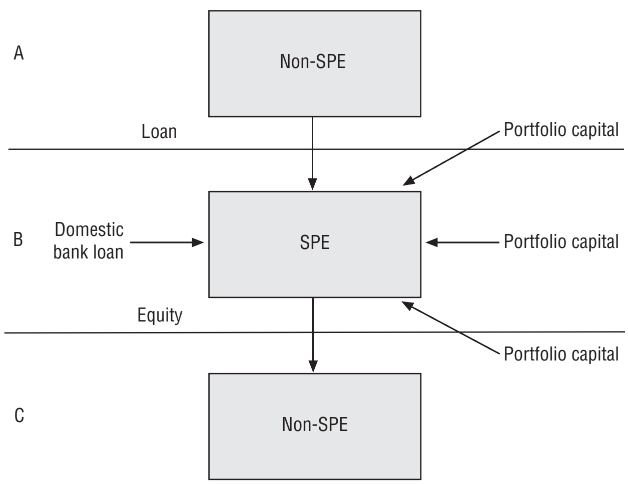
560. From the above examples it may be concluded that for an appropriate treatment of enterprises owned by non-residents, and related with each other in chains or groups, compilers may want to use additional criteria depending on national circumstances. In the case of resident chains of entities, compilers should take into account whether assets in resident entities, such as those of L in M, are really relevant to the domestic economy. If not, these enterprises would be considered as potential SPEs.

3. Analytical consistency

561. New recommendations included in this *Benchmark Definition* improve the quality and comprehensiveness of geographical and industry breakdowns. More specifically, it is recommended that a compiler looks through non-residents SPEs and reallocates positions and transactions with non-residents SPEs to the countries and industries of the first non-SPEs further up or down the FDI ownership chain. This recommendation is consistent with and complementary to the recommendation to segregate FDI figures reported by resident SPEs and to present them in separate breakdowns by country and industry.

562. In Figure A.7.3, for instance, the compiler in country A should reallocate to country C the outward inter-company loan provided to the SPE, the immediate counterparty, in

Figure A.7.3. **The transformation of capital by SPEs**
(the links in the chain of FDI shown below represent 100% ownerships)



79. In the Netherlands, for instance, the Dutch National Bank for its FDI statistics would classify L as an SPE if the domestic assets of L (in O) were less than 10 per cent of total assets.

country B. In practice, country A is not effectively investing in country B but in country C. Likewise, the compiler in country C should reallocate to A the extension of equity capital, *i.e.* inward FDI capital flows from B. Otherwise the geographical breakdown would erroneously suggest that country B is investing in country C, whereas it is actually country A where a non-SPE recorded a genuine outward direct investment.

563. It should be noted that as country A and C both look through country B, the amount of FDI transacted from country A no longer needs to be equal to the amount arriving in country C. This difference should not be interpreted as an inconsistency between outflows of A and inflows of C. It simply reflects the intermediary role of the SPE between entities in a multinational enterprise. For instance, SPEs may take up additional bank loans or raise capital in financial markets as additional financing for outward investments which may exceed inward investments, as is illustrated in Figure A.7.3. The inward and outward direct investments reported by the SPE in country B are not necessarily of equal amounts; hence, the same argument is true for the corresponding outward and inward direct investments reported by A and C.

564. The fact that country A reports outward *loans* provided to country C, whereas country C reports inward *equity* coming from country A, should not be considered as an inconsistency either. This difference too merely reflects the intermediary role of SPEs and their finance transformation activities. For instance, in Figure A.7.3 the SPE in country B has simply transformed the nature of the direct investment capital that it received from its parent, in country A, by applying the incoming *loan* for *equity* investment in country C. The possibility of this type of difference is inherent to the segregation of SPEs in order to reduce the overstatement (inflation) of FDI data and the distortions of geographical and industry allocations.

4. Origin and destination matrices

565. The reallocation to first non-SPE countries contributes to more meaningful FDI statistics. In some cases it may be difficult for reporters or compilers to look through non-resident SPEs. Therefore, this issue is referred to the research agenda (see Annex 13) for a complete set of recommendations. However, in the meantime, the practical recommendations provided could be useful to compilers.

566. It would be desirable if compilers could also rely on information provided by the SPE countries themselves. This *Benchmark Definition* therefore suggests that each country hosting a significant number of SPEs provides supplemental information on the specific linkages between the inward and outward positions of its SPEs. Normally these linkages cannot just be derived from a geographical breakdown of the data reported by resident SPEs. For instance, Figure A.7.4 does not facilitate the identification of where the capital

Figure A.7.4. **Asset and Liability Positions of country X *vis-à-vis* direct counterpart countries reported by resident SPEs of X**

Country	Assets	Liabilities
A		80
B	120	20
C	60	
D	30	
E	90	40
F		160
	300	300

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provided by country B to country X has been invested by the SPEs in X. Likewise it is impossible to determine which country provided the financial means for the investments by X's SPEs in B. In both cases the difficulty relates to the fact that there are (too) many origins and destinations.

567. At the level of individual SPEs, however, the number of origins and/or destinations may be limited. For individual SPE a pro-rating approach could be applied (Figure A.7.5). If, for instance, in the Figure A.7.5, 80 per cent of the liabilities of SPE1 represent equity capital invested by country A, one could reasonably assume that 80% of the assets in country C are financed by inward capital from A (80% of 60 is 48).

Figure A.7.5. **Linking inward and outward positions of individual resident SPEs of a country X**

All SPEs

Assets		Liabilities	
	Country		Country
120	B	120	A
60	C	60	B
30	D	30	E
90	E	90	F
300		300	

SPE1

Assets		Liabilities	
	Country		Country
60	C	80	A
30	D	20	B
10	E		
100		100	

A ==> C 48
A ==> D 24
A ==> E 8

B ==> C 12
B ==> D 6
B ==> E 2

SPE2

Assets		Liabilities	
	Country		Country
120	A	40	E
80	B	160	F
200		200	

E ==> B 24
E ==> C 16

F ==> B 96
F ==> E 64

568. Similar calculations can be made for all SPEs, where after the results (the arrows in Figure A.7.5) can be summed up and presented in an origin and destination matrix (ODM as in Figure A.7.6).

Figure A.7.6. **An origin and destination matrix showing estimated international linkages via resident SPEs in country X**

SPEs		Origin countries				
		A	B	E	F	Total liabilities
Destination countries	B			24	96	120
	C	48	12			60
	D	24	6			30
	E	8	2	16	64	90
	Total assets	160	20	20	160	300

569. An ODM provides information on assets and liabilities of resident SPEs broken down by country. It also provides an indication of the way the funds invested in these entities by different source countries have been distributed across different destination countries. Users of FDI statistics could consult the above matrix for a better insight in the real counterparties of *e.g.* country B if the compiler of FDI for country B was not able to look through country X.

ANNEX 8

Collective Investment Institutions

1. Description of collective investment institutions

570. The term *collective investment institution* (CII) generally refers to incorporated investment companies and investment trusts, as well as unincorporated undertakings (such as mutual funds or unit trusts), that invest in financial assets (mainly marketable securities and bank deposits) and/or non-financial assets using the funds collected from investors by means of issuing shares/units (other than equity). Other terms referring to CIIs may also be used, *e.g. collective investment scheme, collective investment vehicle, collective investment undertaking,* and in certain cases, *investment fund*. The CII can be open-ended or closed-ended. If open-ended, there is no limit to the number of shares/units on issue and the shares/units can be, at the request of the holders, repurchased or redeemed directly or indirectly out of the undertaking's assets. If closed-ended, the number of shares/units on issue is fixed and investors entering or leaving the fund must buy or sell existing shares. The shares/units can be quoted or unquoted. The CII may pay periodic dividends, capitalise the income or a combination of those approaches, depending on the terms set out in its prospectus.

571. CIIs may be constituted: *i)* under the law of contract (as common funds managed by management companies), or *ii)* under trust law (as unit trusts), or *iii)* under a statute (as investment companies), or *iv)* otherwise with similar effect. Some CIIs invest in other similar vehicles (*e.g.* "funds of funds"). It should be noted that occupational pension funds are not CIIs; they are part of the insurance companies and pension funds subsector.

572. The prospectus also sets out the investment policy or strategy of the CII in terms of the types of financial instrument or other assets to be acquired (such as bonds, equities, real estate) and their geographical (*e.g.*, Asian, American, European, emerging markets) or currency make-up, or any other investment strategy. CIIs may have different objectives. For example, some CIIs may target capital growth and be generally characterised as "growth" funds, whereas others may be structured to produce a regular stream of income, through interest and/or dividends and be characterised as "income" funds. The prospectus indicates whether the CII can undertake any leveraging activity and how it might do so (*e.g.*, through straight borrowing, through repurchase agreements, or by using financial derivatives). The terms and conditions for redemption (for open-ended schemes) or the means of sale (for closed-ended schemes) are also set out in the prospectus.

573. CIIs are generally "brass plate" enterprises and are managed by professional investors who may offer a variety of funds with their own market orientation and who make investment decisions on behalf of investors. Administration, management, custodial

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and trustee services may be provided to the CIIs by separate service providers, some of whom may be located in different jurisdictions. For example, a CII may be domiciled or registered to operate in one country and may be managed by a service provider in another country with custodial services being located in a third country. The location or domicile of a CII may be decided by its promoter in the context of optimising its tax liabilities or of utilising preferential securities regulation arrangements in the process of asset-management. Cross-border transactions may, and frequently do, occur.

574. At the outset, CIIs may be classified broadly into two main categories: *a)* ordinary or retail type entities and *b)* other types of CII. The ordinary/retail type CII may in turn be a contract type or a corporate type. A contract-type retail CII is generally a mutual fund or unit trust or similar vehicle (see further details below) while a corporate-type CII may be an investment trust or a corporation acting as an investment vehicle. In both cases, the assets acquired tend to be highly liquid and investment subscriptions (and, later, redemptions) are made by a large number and variety of investors. The investments are made generally in order to gain a short-term interest, via contract-type or corporate-type investment trusts, in portfolio securities. There may be significant diversification of the asset classes, for example, mainly by country/economic zone, by type of financial instrument (equity, bonds, money market instruments, derivatives, etc.).

575. There is a variety of other types of CII which cannot be considered as retail in nature. The investors into these CIIs can vary from private households to corporate entities and the asset classes acquired can also vary considerably from liquid to illiquid types. Their legal structures, trading practices, investment policies and operations generally need to be considered by compilers in order to decide the classification for balance of payments statistical purposes of the entities involved and their investment and other economic transactions.

576. A number of different types of financial institution fall within the scope of the description collective investment institution (CII).[80] Included are:

- Investment funds.
- Mutual funds.
- Unit trusts.
- Variable capital companies.
- Investment limited partnerships.
- Feeder/master funds, umbrella funds/sub-funds, funds of funds.
- Hedge funds.
- Professional investor funds.
- Private equity funds.
- Distressed funds.
- Property and real estate funds.
- Money market funds.

80. The types of collective investment institutions described in this annex are for readers' information and mainly based on editors' experiences, thus details or names of each type as well as legal structures etc. could be different among countries.

577. It must be stressed that the examples of CII listed above can exist under the same or different labels in different countries. The name or label used may give some indication of the type of scheme or of its type of investment orientation, or of the main objective of the investment vehicle used (*e.g.* venture fund, futures and options capital protected fund, bond fund, balanced fund, growth fund, index fund, sector fund, international or regional funds, junk bond fund). However, caution is needed in interpreting from its title or label what a CII is and how it operates. Within the European Union (EU) and under its relevant legislation, a certain type of CII is known as a UCITS *i.e.*, an *undertaking for collective investment in transferable securities*. It may be authorised by any of the EU national financial regulatory authorities to offer its units for sale to members of the public in other member states of the EU without the requirement for further authorisation in those other countries.

578. An investment fund (IF) is a CII which issues shares (if a corporate structure is used) or units (if a trust structure is used) to the public, and which invests the capital raised in financial and/or non-financial assets.

579. A mutual fund (MF) can be defined as an entity that issues shares or units, which are purchased by investors. The basic scheme of a MF is quite common in many other CIIs. The subscriptions collected may be invested in different types of asset (non-financial as well as financial) and the investors may receive either regular income or, at redemption, holding gains (or losses) or a combination of both. The MF can be open-ended or closed-ended and the shares/units can be quoted or unquoted.

580. A unit trust (UT) operates as a CII established under a trust deed made between the fund's management company and its trustee. The legal structure of a unit trust may vary between countries but, in general, it would appear that the trustee acts as the legal owner of the fund's assets on behalf of the group of investors who are each entitled to an undivided beneficial interest in the fund. Similar to shareholders in an investment company, the unit holders are entitled to attend and vote at meetings on matters affecting the fund. The trust deed is the primary legal document which constitutes the trust and it sets out the various rights and obligations of the trustee, the management company and the unit holders.

581. A variable capital company (VCC) is normally set up to invest its funds and property with the aim of spreading investment risk. It is managed by a management company for the benefit of its shareholders who enjoy limited liability status. The characteristics of VCCs are that they can repurchase their own shares and that the issued share capital must at all times be equal to the net asset value of the underlying assets.

582. An investment limited partnership (ILP) is a partnership of two or more persons having as its principal business the investment of its funds in financial and non-financial assets of all kinds and consisting of at least one general partner and at least one limited partner. The limited partner is equivalent to the shareholder in a company whilst the general partner is generally the equivalent of the management company in a unit trust. The ILP generally does not have an independent legal existence in the way that a company does. All of the assets and liabilities belong jointly to the individual partners in the proportions agreed in the partnership deed. Similarly the profits are owned by the partners.

583. Feeder/master funds (FF, MaF), umbrella funds (UF) and funds-of-funds (FoF) are set up with one of the main objectives being the facilitation of access by investors to greater asset diversification than would be available through the more conventional CIIs. All types

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of structures exhibit the characteristic that one fund invests in one or more other funds. The arrangement must meet the statutory regulatory requirements of the authorities where the funds are domiciled (*i.e.* legally registered). In this context, the different funds in a particular investment arrangement may be domiciled in different jurisdictions and may also have different legal structures. In general, the country of registration of the entity concerned is taken to be the country of domicile of the fund.

584. Hedge fund (HF) is a term that covers a heterogeneous range of CIIs, typically involving high minimum investments, light regulation, and a wide range of investment strategies that tend to involve assets which are highly illiquid. The range of strategies include: hedging against market downturns, investing in asset classes such as currencies or distressed securities, and utilising return-enhancing tools such as leverage, derivatives, managed futures and arbitrage (*e.g.* bonds, stocks and risk arbitrage). Many HFs target consistency rather than magnitude of return as their primary goal.

585. A professional investor fund (PIF) is a fund authorised to require a relatively high level of minimum subscription from eligible investors. Borrowing restrictions applied to other more usual CIIs may also be relaxed.

586. A private equity fund (PEF) is established to enable partnerships of qualifying individual investors or groups consisting of up to 100 qualifying individual investors to participate. Such funds can include venture capital funds, as well as buying-out funds, whose investors tend to be mainly institutional investors acquiring and selling shares in order to gain a long-term interest through participation in the control or management of an enterprise for a specified period to enhance its value.

587. Distressed funds (DF) are established to invest at deep discounts in equity, debt, or trade claims, of companies undergoing or facing bankruptcy or reorganisation.

588. In a property or real estate fund (PF or REF), the term property is generally defined as a freehold or leasehold interest in any land or building, with a specified minimum un-expired lease period. Partly paid shares may be issued.

589. A money market fund (MMF) is a very special type of CII. It issues shares or units to the public that are, in terms of liquidity, close substitutes for deposits, and it invests the proceeds primarily in low risk short-term money markets instruments (treasury bills, certificates of deposit, and commercial paper), MMF shares/units, as well as in bank deposits and instruments that pursue a rate of return that approaches the interest rates of money market instruments. In some jurisdictions and depending on their set-up constraints, some MMFs are classified as monetary financial institutions.[81]

590. In general on the liability side, investment into CIIs involves the pooling of the investments of a number of investors so that the units/shares acquired by each individual account for a very small proportion (generally much less than 10%) of the total number of units/shares issued by the scheme. There are some CIIs, however, which may have a small number of investors (*e.g.* property/real estate funds, private equity funds, distressed funds) and the investors in individual cases may contribute sizeable proportions (more than 10%)

81. Monetary financial institutions cover two types of entities: *a)* credit institutions whose business is to receive deposits or other repayable funds from the public and to grant credit for their own account, and *b)* other financial institutions whose business is to receive deposits or close substitutes for deposits from entities other than monetary financial institutions and to grant credit for their own account or to make investments in securities.

of the overall capital invested. A CII may have resident investors, non-resident investors or a mixture of both.

591. On the assets side, a CII can invest in both resident and non-resident financial securities or other assets. There tends to be very little or no concentration of the pooled investment into significant proportions (10% or more) of the shares issued by individual enterprises which are acquired by the CII.

592. It should be noted that occupational pension funds (*i.e.* those schemes sponsored by employers on behalf of their employees) are generally not regarded as collective investment institutions. The main reasons for this are: firstly, the liabilities of occupational pension funds tend to be long-term and are in the form of insurance technical reserves; the liabilities of CIIs are in the form of equities, shares or units. Secondly, there are very rigid conditions concerning the encashment by investors (employees principally) of their pension funds *e.g.* the assets of these funds generally cannot be realised by the individual investor until he/she reaches a certain (retirement) age. An investor in a CII can cash in his/her investment whenever desired.

2. Categorisation of investment into a CII and by a CII under direct investment

593. The classification of CIIs can differ across countries for a number of reasons *e.g.* in the context of differences in permissible legal structures, in taxation systems or in securities investment legislation, and their classification according to functional type of investment category can present difficulties. Whether different types of CIIs, which have different features or economic natures, should be recorded as portfolio investment (PI) on either or both the inward and outward sides, regardless of the percentage of equity ownership, has been debatable. Opinion has been divided on whether the 10% voting power criterion for direct investment should be applied for the categorisation of both the assets and liabilities of CIIs. However, in line with other international recommendations, the *Benchmark Definition* recommends that, when an investor in one economy acquires at least 10% of the voting power in a CII in another economy, this investment should be regarded as direct investment. Similarly, when a CII own at least 10% of the voting power of a non-resident entity, this relationship should also be considered as direct investment. More precisely, investment in, and investment by, CIIs such as mutual funds, feeder/master funds, hedge funds and distressed funds, should be included in FDI data if the standard 10% threshold is met.

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ANNEX 9

Mergers and Acquisitions (M&A) Type Transactions as a Part of FDI Statistics

1. Introduction

594. Analysis of Foreign Direct Investment (FDI) is important due to its impact on the production, employment, value added, etc., of the host economy. Distinguishing FDI by its type will help to refine this analysis as the purchase/sale of existing shares *versus* purchase/sale of newly issued shares will usually have significantly different results regarding their economic impact (see Chapter 2). The focus of this annex concerns practical recommendations on the compilation of FDI statistics to show investment in the form of Mergers and Acquisitions (M&A) type transactions, and, more specifically, purchase/sale of existing shares.

595. "Mergers" and "acquisitions" are two terms used by many interchangeably in spite of the fact that they do not relate to same types of operations. It is useful to distinguish them. A *merger* occurs when two (or more) companies agree to merge into a new single company rather than remain separated for creating business synergies. An *acquisition* is the purchase of existing shares issued by another company for increasing ownership or control level by the acquiring company. For more details on the nature of mergers and acquisitions, refer to Box A.9.1.

596. In order to avoid possible confusion due to terminologies which are commonly used, some clarification is necessary. For M&A type transactions, this *Benchmark Definition* refers to:

i) Purchase/sale of existing shares by the direct investor/direct investment enterprise (as opposed to purchase/sale of newly issued shares);

ii) The *equity* component of FDI inflows and outflows (but not to *reinvestment of earnings* and debt instruments); an analysis of M&A type transactions is not meaningful for FDI position statistics.

597. Therefore, statistics covered in the *Benchmark Definition* under M&A type transactions as a part of FDI relate to purchase/sale of existing shares by the direct investor /direct investment enterprise, with the ownership of 10% or more of the voting power of an enterprise (the necessary condition to establish a direct investment relationship). In other words, M&A type transactions as a part of FDI include changes for both minority ownership and control: *i)* significant influence (purchase/sale of shares in the range of 10% to 50%); and *ii)* controlling ownership (purchase/sale of shares of more than 50 per cent). Moreover, making a distinction between "mergers" and "acquisitions" will not impact directly the statistics on financial transactions but may have an impact, if the data are analysed in tandem with AMNE statistics.

Box A.9.1. **Mergers, acquisitions and divestment**

A *merger* refers to the combination of two or more companies to share resources in order to achieve common objectives. A merger implies that, as a result of the operation, only one entity will survive and frequently occurs following an acquisition (an acquisition is to be described later). In business, there are several types of mergers:

1. *Statutory merger* relates to the business combination where the merged (or target) company will cease to exist. The acquiring company will assume the assets and liabilities of the merged company. In most cases, the owners of merged companies remain the joint owners of the combined company.
2. *Subsidiary merger* relates to an operation where the acquired company will become a subsidiary of the parent company. In a reverse subsidiarymerger, a subsidiary of the acquiring company will be merged into the target company.
3. *Consolidation* is a type of merger which refers to a business combination whereby two or more companies join to form an entirely new company. All companies involved in the merger cease to exist and their shareholders become shareholders of the new company. The terms consolidation and mergers are frequently used interchangeably. However, the distinction between the two is usually in reference to the size of the combining companies. Consolidation relates to an operation where the combining firms have similar sizes while mergers generally imply significant differences.
4. *Reverse merger* is a deal where the acquiring company ceases to exist and merges into the target company. If a company is eager to get publicly-listed in a short period of time, it can buy a publicly-listed company and merges into it in order to become a new public corporation with tradable shares.
5. *Merger of equals* is a type of merger when companies involved are of similar sizes.

Based on the motivation of investors, mergers are usually referred to as following:

1. *Horizontal merger* occurs when two competitors combine, *i.e.* two companies having the same activity (*e.g.*, two companies in defence industry). Such a combination may result in an increased market power for the merged company and, consequently, may be opposed by antitrust regulators.
2. *Vertical merger* is the combination of two companies with complementary activities such as those having a buyer-seller relationship (*e.g.*, an operation between a pharmaceutical company and a company which specialises in the distribution of pharmaceutical products).
3. *Market-extension merger* occurs between two companies selling the same products in different markets.
4. *Product-extension merger* occurs between two companies selling different but related products in the same market.
5. *Conglomerate merger* relates to all the other types of transactions, *i.e.* when two companies do not have a specific relationship and are usually in different lines of business (*e.g.*, a tobacco company merging with a food company).

An *acquisition* is a transaction between two parties based on terms established by the market where each company acts in its own interest. The acquiring company purchases the assets and liabilities of the target company. The target company either becomes an associate or a subsidiary or part of a subsidiary of the acquiring company.

1. *Take-over* is a form of acquisition where the acquiring firm is much larger than the target company. The term is sometimes used to designate hostile transactions.
2. *Reverse take-over* refers to an operation where the target company is bigger than the acquiring company. However, mergers of equals (in size or belonging to the same sector of activity) may also result in a hostile take-over.

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Box A.9.1. **Mergers, acquisitions and divestment** *(cont.)*

A *divestment (de-merger)* refers to the selling of the parts of a company due to various reasons: a subsidiary or a part of a company may no longer be performing well in comparison to its competitors; a subsidiary or a part may be performing well but may not be well positioned within the industry to remain competitive and meet long-term objectives; strategic priorities of a company to remain competitive may change over time and lead to divestment; loss of managerial control or ineffective management; too much diversification may create difficulties thus lead the parent company to reduce the diversification of its activities; the parent company may have financial difficulties and may need to raise cash; a divestment may be realised as a defence against a hostile take-over. Corporate divestment can be conducted in different ways:

1. *Corporate sell-off* is the sale of a subsidiary to buyers which are other companies in most cases.
2. *Corporate spin-off* occurs when the divested part of the company is floated on a stock exchange. The newly floated company is separately valued on the stock exchange and is an independent company. The shares in the newly listed company are distributed to the shareholders of the parent company who thereafter own shares of two companies rather than one. Through such an operation they increase the flexibility of their portfolio decisions.
3. *Equity carve-out* is similar to corporate-spin off but the parent retains the majority control. This form has the advantage of raising cash for the divestor.
4. *Management buy-outs (MBO) and buy-ins (MBI)* is a case that the buyer is the manager of the company that is being sold off. In the case of an MBI, a private company is bought by the management.

598. *Other types of FDI* are calculated as a residual, *i.e.* as the difference between total equity and M&A type transactions representing new investments. They include "Greenfield" investment (*ex nihilo* investment), extension of capital and investment for financial restructuring (investment for debt repayment or loss reduction). Greenfield investment and extension of capital increase the total assets of resident enterprises and, therefore, directly impact on production, etc. However, investment for financial restructuring does not usually have the same impact as either the greenfield or extension of capital types.

2. Compilation and recording of transactions

2.1. General principles

599. In order to provide internationally comparable FDI by type and to solve the practical issues involved in feasibility, it is essential to apply simple but, at the same time, objective criteria for recording the transactions. The breakdown is introduced to distinguish M&A type transactions and other types of FDI. The main focus is the "purpose" and "final destination/use" of investments (see chart). As a further refinement, it is analytically useful to identify whether the equity ownership is more (or less) than 50% after recording the transaction. Such data remains fully comparable with FDI statistics while basic principles are the same.

600. In order to limit additional reporting burden on respondents, limit the costs for compilers and ensure consistency with overall FDI statistics, it is recommended that these additional details be collected as an extension of regular data collection processes (*e.g.*, annual FDI surveys).

Box A.9.2. **Components of M&A type transactions as a part of FDI**

Foreign direct investment

Gross investments and divestments by non-residents

Investment in equity	Divestment in equity
Of which:	*Of which:*
M&A type transactions (purchase of existing shares in resident companies by non-residents)	M&A type transactions (sale of existing shares in resident companies by non-residents)
i) country and	*i)* country and
ii) industry	*ii)* industry
Other types of FDI (calculated as residual)	Other types of FDI (calculated as residual)

Gross investments and divestments by residents

Investment in equity	Divestment in equity
Of which:	*Of which:*
M&A type transactions (purchase of existing shares in non-resident companies by residents)	M&A type transactions (sale of existing shares in non-resident companies by residents)
i) country and	*i)* country and
ii) industry	*ii)* industry
Other types of FDI (calculated as residual)	Other types of FDI (calculated as residual)

Note: The above presentation relates to the conceptual framework by country and industry classifications. For data dissemination, data may be disseminated at higher level of aggregation if limited by confidentiality.

601. The number of transactions could be significant while their analytical relevance may be limited due to the small size of individual transactions. To limit the costs in proportion to the analytical relevance, compilers may apply an additional threshold.

602. Information compiled on country and industry classifications as suggested in the following chart, allow presenting M&A type transactions by country and industry. Information on M&A (including information on ultimate host/ultimate investor) are often well-known and disseminated in companies' press releases, specialised financial press, research papers, materials from the stock exchanges, or private databases. Compilers practically could refer to such information if they could not collect sufficient information from reporters.

2.2. Data collection as a part of FDI surveys

603. Respondents could be asked to provide additional information regarding the type of FDI as a part of regular FDI surveys. The questions would relate to both investment (I) and divestment (D) to determine net amounts for M&A type transactions. Related inquiries are outlined.

604. Following notes are provided as a guide to FDI compilers for M&A type transactions:

Q-1: *Was the purpose of the transaction to "purchase (or sell) existing shares" for the acquisition (or the disposal and reduction) of an equity stake in a direct investment enterprise in (or from) the immediate counterpart country?*

This question intends to determine whether the purpose of the transactions is to purchase (or sell) existing shares [or not] from the immediate[82] counterpart country.

1. If the answer is YES then the transaction is potentially an M&A type transaction with further information required to make a final determination [see Q-3]; or
2. If the answer is NO, then the respondent is requested to provide additional information on the purpose of the transaction [see Q-2]

Q-2:*Was the purpose of the transaction to "purchase (or sell) existing shares" for the acquisition (or the disposal and reduction) of an equity stake in a DIE in (or from) another economy?*

1. If the answer is YES, then the funds are passing through a direct investment enterprise (*e.g.*, a Special Purpose Enterprise (SPE) or an operational subsidiary) to their final destination and will not remain in the direct investment enterprise acting as the intermediary. The transaction is potentially an M&A type transaction with further information required to make a final determination [see Q-3]; or
2. If the answer is No, the transaction is greenfield investment, extension of capital or investment for financial restructuring. Then investigation will stop at this point and the transaction is identified as other type of FDI.

Q-3: *Did the transaction financed by an equity injection from an enterprise in another economy? Or Did the transaction finance an equity withdrawal to an enterprise in another economy?*

1. If the answer is YES, then the funds are passing through an intermediary in the country and are classified as other' on the basis that they are pass-through funds or capital in transit; or
2. If the answer in NO, then the transaction is an M&A type transaction and additional information is requested [see Q-4 and Q-5].

Q-4:*What is the country and the industry of the DIE in which an equity stake was purchased (or sold)?*

The respondent is requested to provide additional information on the country and the industry of the DIE (after looking through any entity through which the capital may transit).

Q-5*: Is the total percentage of ownership after the transaction more than 50%?*

The respondent is requested to provide additional information whether the percentage of ownership after the transaction will be more than 50 per cent. The information would help compilers to build an additional series for control.

Note: Share buy-back (one form of divestment) is not applied to the flow chart, since its treatment was deferred to the research agenda for further consideration.

82. "Immediate" counterpart refers the first country/enterprise outside the compiling economy.

Chart A.9.1. **Flow chart to identify Mergers and Acquisitions transactions within FDI – Investments**

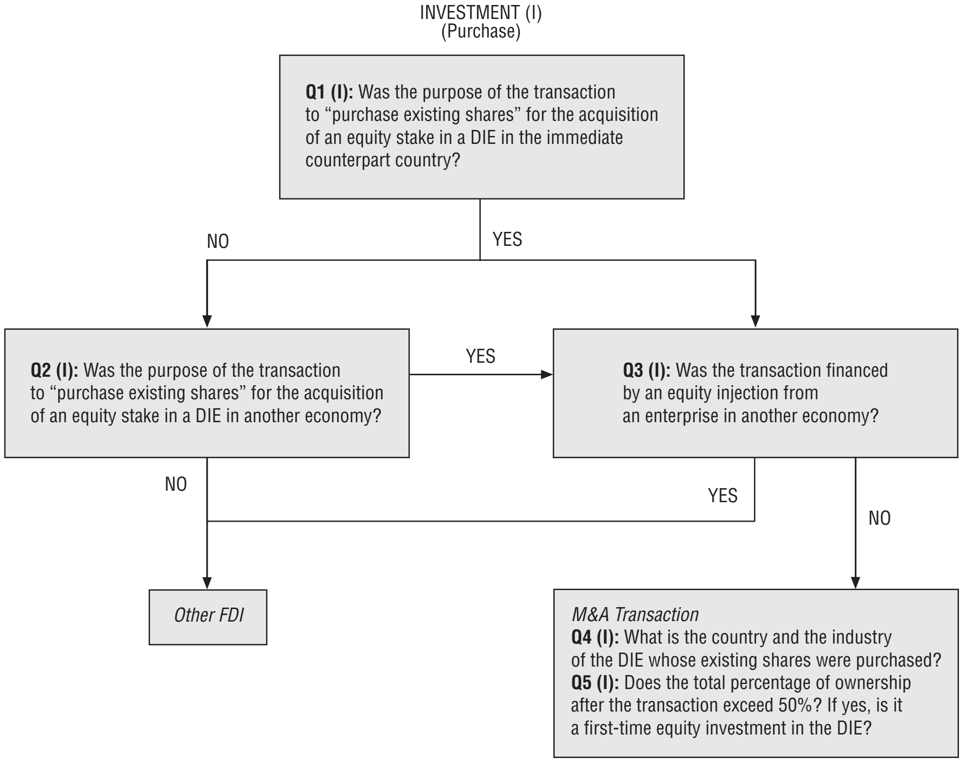

Chart A.9.2. **Flow chart to identify Mergers and Acquisitions transactions within FDI – Disinvestments**

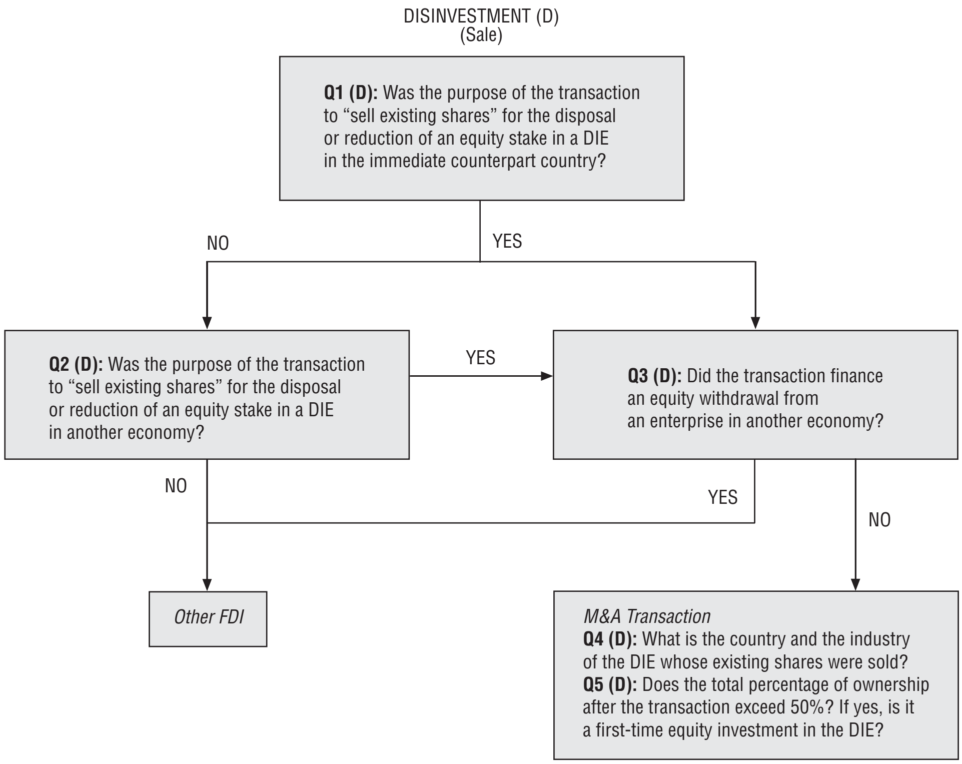

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Table A.9.1. **Examples of transactions**

FDI – Equity	
of which:	
M&A type transactions	
	• An investor (in economy A) purchases existing shares issued by a target company (in economy B) from its shareholders. • An investor (in economy A) establishes a subsidiary holding company (in economy B) to purchase existing shares issued by a target company (in economy B or C) from its shareholders.
Other types of FDI	
Greenfield investment	• An investor (country A) establishes a subsidiary company (country B). • An investor (country A) establishes a subsidiary holding company (country B) to establish a sub-subsidiary company (country B or C).
Extension of capital (for expanding business operations)	• An investor (country A) purchases shares newly issued by an existing subsidiary company (country B) for expanding its business operations. • An investor (country A) purchases shares newly issued by an existing subsidiary holding company (country B) to purchase shares newly issued by a sub-subsidiary company (country B or C) for expanding its business operations.
Investment for financial restructuring	• An investor (country A) purchases existing shares issued by an existing subsidiary company (country B) for debt repayment or loss reduction. • An investor (country A) purchases shares newly issued by an existing subsidiary holding company (country B) to subscribe existing shares issued by an existing sub-subsidiary company (country B or C) for debt repayment or loss reduction.

3. Practical examples

605. This section provides some examples to illustrate various investment patterns and their recording by country and industry. It also provides comparison for recording M&A type transactions as a part of FDI and M&A statistics by private sources.

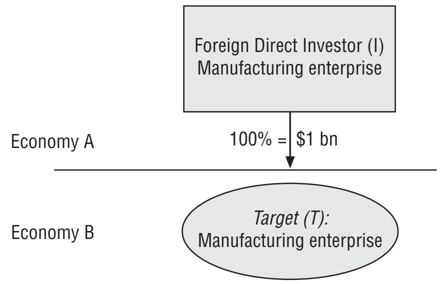
3.1. Practical examples (M&A with the capital only provided by a direct investor)

606. There are many instances where the funds for FDI transactions are provided either through SPEs (*e.g.* holding companies) newly established for the purpose of the investment, or through existing entities. If such funds are recorded according to the immediate counterpart, the results would be misleading not only when distinguishing FDI by type but also for the country and industry classifications. In other words, for transactions effected through SPEs, instead of recording them as M&A type transactions, they would be considered either as an increase in equity (extension of capital) if they are channeled through existing SPEs or as greenfield investments if they are channeled through newly created SPEs. Such recordings will distort the analytical information. Therefore, *the Benchmark Definition recommends that FDI statistics by type for M&A be compiled according to the final use of the investment.*

Figure A.9.1. **Direct M&A**

Description: A direct investor (I) in Country A purchases all the existing shares of a target company (T) in Country B for US$1bn.

Classification: FDI Equity, "M&A type transactions " by using information on the final use of invested capital, *i.e.* purchase of all existing shares.

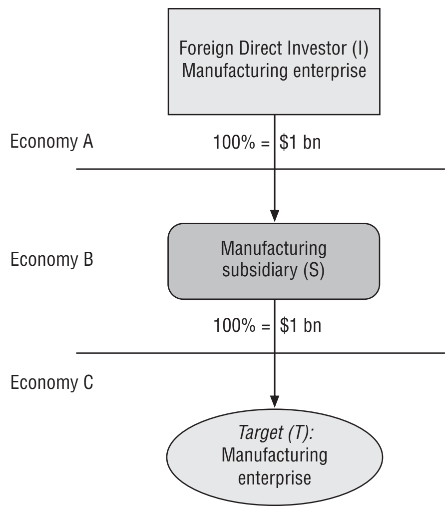


Reporting country	*FDI equity outflows*	*FDI equity inflows*
Country A	**Amount:** $1 bn. **Type of FDI:** M&A **Partner Country:** "B" **Industry:** Manufacturing	–
Country: B	–	**Amount:** $1 bn. **Type of FDI:** M&A **Partner country:** Country "A" **Industry classification:** Manufacturing

Figure A.9.2. **M&A through an operational subsidiary in a third country**

Description: An investor (I) in Country A transfers US$1bn. to its manufacturing subsidiary (S) in Country B mandated to acquire all the existing shares in a manufacturing company (T) in Country C on behalf of its parent in Country A.

Classification: FDI Equity, "M&A type transactions " by using information on the final use of invested capital, *i.e.* purchase by Country A of all existing shares. Both Country A and Country C look through the operational subsidiary which transits the funds.



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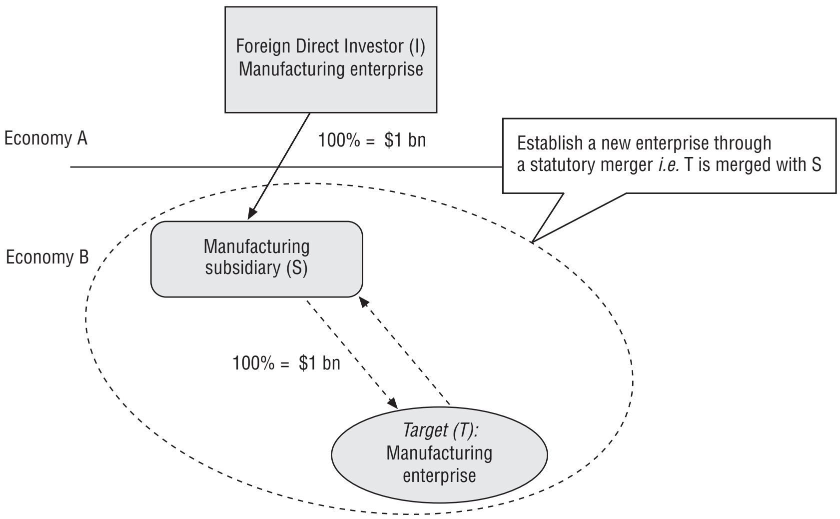
Reporting country	*FDI equity outflows*	*FDI equity inflows*
Country A	**Amount:** $1 bn. **Type of FDI:** M&A **Partner country:** "C" **Industry:** Manufacturing	–
Country: B	**Amount:** $1 bn. **Type of FDI:** Other **Partner country:** "C" **Industry:** Manufacturing	**Amount:** $1 bn. **Type of FDI:** Other **Partner country:** "A" **Industry:** Manufacturing
Country: C	–	**Amount:** $1 bn. **Type of FDI:** M&A **Partner country:** "A" **Industry:** Manufacturing

Figure A.9.3. **Direct statutory merger**

Description: An investor (I) in Country A sets up a manufacturing subsidiary (S) in Country B. I invests US$1 bn. in S. The subsidiary then merges with a manufacturing company (T) in Country B by purchasing all the existing shares of this target company, which ceases to exist as a result of the merger.

Classification: FDI Equity, "M&A type transactions " by using information on the final use of invested capital, *i.e.* purchase by Country A of all existing shares.

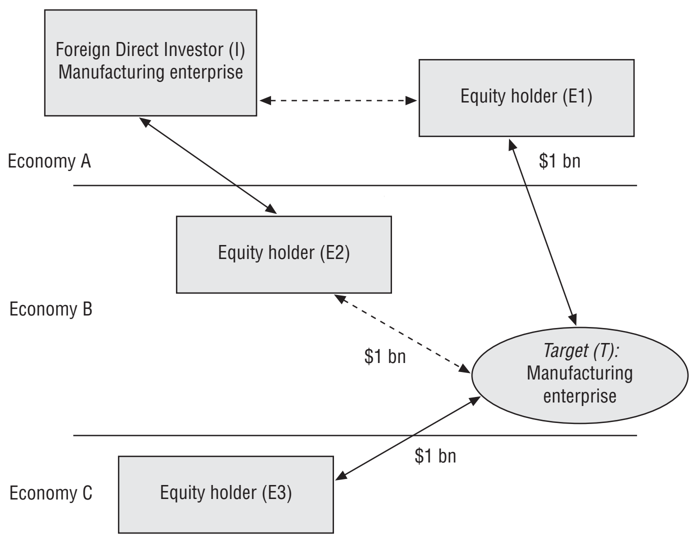


Reporting country	*Direct Investment Equity Outflows*	*Direct Investment Equity Inflows*
Country A	**Amount:** $1 bn. **Type of FDI:** M&A **Partner Country:** "B" **Industry:** Manufacturing	–
Country: B	–	**Amount:** $1 bn. **Type of FDI:** M&A **Partner Country:** "A" **Industry:** Manufacturing

Figure A.9.4. **Direct equity swap**

Description: A company (T) in Country B has 3 shareholders (E1, E2 and E3), one from each of countries A, B and C. Each of their 33.3% shareholdings is valued at US$1 bn. An investor (I) in Country A acquires all of these shares by means of a share – for-share' swap, using US$3 bn. of its own newly issued shares. As a result of the transactions, each of the former shareholders of Company T has become a shareholder in I and each own less than 10% of I's shares. Resident-to-resident transactions by investors in Countries A and B in enterprises in their respective countries are excluded from the scope of the exercise as they do not represent cross-border transactions.

Classification: FDI Equity, "M&A type transactions " by using information on the final use of invested capital, *i.e.* purchase by Country A of all existing shares.



	FDI equity transactions		Portfolio investment*	
Reporting country	***Outflows***	***Inflows***	***Net acquisition of financial assets***	***Net incurrence of liabilities***
Country A	**Amount:** $2 bn. **Type of FDI:** M&A **Partner Country:** "B" **Industry:** Manufacturing	–	–	**Amount:** $2 bn. **Partner Country:** "B" = $1 bn. "C" = $1 bn.
Country: B	**Disinvestment = Inflow** **Amount:** $1 bn. **Type of FDI:** M&A **Partner Country:** "C" **Industry:** Manufacturing	**Amount:** $2 bn. **Type of FDI:** M&A **Partner Country:** "A" **Industry:** Manufacturing	**Amount:** $1 bn. **Partner Country:** "A"	–
Country: C	–	**Amount:** $1 bn. (Divestment) **Type of FDI:** M&A **Partner Country**: "B" **Industry:** Manufacturing	**Amount:** $1 bn. **Partner Country:** "A"	

* Purchase/sale of shares by an investor with less than 10% ownership of voting power are recorded as portfolio investment (one component of financial account under Balance of Payments Statistics)

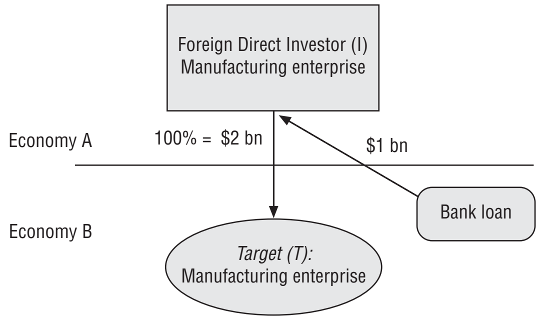
3.2. Practical examples (M&A where financing is provided by a direct investor and a local bank)

607. When a M&A transaction is partly financed by capital from a local bank, there is a major difference between recording M&A transactions as a part of FDI and M&A statistics of commercial sources.. Users and compilers should pay attention to such differences when analyzing M&A data.

Figure A.9.5. **Direct M&A with capital procured by a local bank**

Description: An investor (I) in Country A contracts a US$1bn. bank loan in Country B to complement US$1 bn. of its own resources to acquire a US$2bn. manufacturing company (T) in Country B.

Classification: "M&A type transactions " by using information on the final use of invested capital, *i.e.* purchase by Country A of all existing shares.



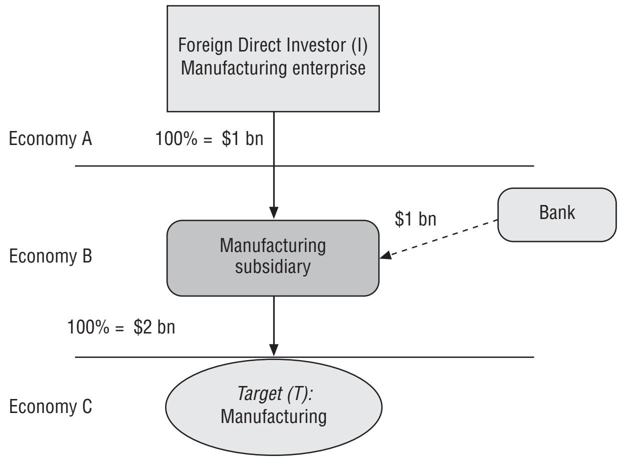
Reporting country	*M and A as part of FDI and other investment transactions*		*M&A statistics* (commercial sources)
	FDI equity outflows	*FDI equity inflows*	
Country: A	**Amount:** $2 bn. **Type of FDI:** M&A **Partner Country:** "B" **Industry:** Manufacturing	–	**Amount:** $2 bn. for M&A type transactions **Partner country:** Country B
Country: B	–	**Amount:** $2 bn. **Type of FDI:** M&A **Partner Country:** "A" **Industry:** Manufacturing	**Amount:** $2 bn. for M&A type transactions **Partner country:** Country A
	Other Investment, Net acquisition of financial assets *	*Other Investment*,* *Net incurrence of liabilities*	
Country: A	–	**Amount:** $1 bn. **Partner Country:** "B"	
Country: B	**Amount:** $1 bn. **Partner Country:** "A"	–	

* Loans between an enterprise and an unaffiliated bank are recorded as other investment (one component of financial account under the Balance of Payments Statistics).

Figure A.9.6. **M&A through an operational subsidiary in the third country with capital borrowed from a local bank**

Description: An investor (I) in Country A provides US$1bn. to its manufacturing subsidiary (S) in Country B. In addition to this financing, S borrows US$1 bn. from a local bank in Country B and acquires all the existing shares in a manufacturing company (T) in Country C for US$ 2bn.

Classification: FDI equity. "M&A type transactions " by using information on the final use of invested capital, *i.e.* purchase by Country A of all existing shares.



Reporting country	M and A as part of FDI transactions		M&A statistics (commercial sources)
	FDI equity outflows	*FDI equity inflows*	
Country: A	**Amount:** $2 bn. **Type of FDI:** M&A **PartnerCountry**: "C" **Industry:** Manufacturing	–	**Amount:** $2 bn. for M&A type transactions **Partner country:** "C"
Country: B	**Amount:** $2 bn. **Type of FDI:** Other **PartnerCountry**: "C" **Industry:** Manufacturing	**Amount:** $1 bn. **Type of FDI:** Other **PartnerCountry:** "A" **Industry:** Manufacturing	–
Country: C	–	**Amount:** $2 bn. **Type of FDI:** M&A **PartnerCountry**: "A" **Industry:** Manufacturing	**Amount:** $2 bn. for M&A type transactions **Partner country:** "A"

Note: $1 b bank loan is a resident to resident transaction for Country B and is therefore not shown in this table.

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3.3. Comparison of data

Box A.9.3. Comparison of M&A type transactions as a part of FDI with M&A statistics by private sources

	M&A type transactions as a part of FDI	M&A statistics by private sources
Objective	To analyze M&A transactions as a subcategory of cross-border invest-ments in the form of FDI.	To analyse different types of business combinations of domestic, cross-border and a mixture of both.
Methodology	**Include:** ● Classifying transactions by direction: outward and inward FDI ● Purchase/sale of existing shares ● Amount reported corresponds to cross-border equity transactions between residents and non-residents which qualify as FDI (*i.e.* ownership of at least 10 per cent of voting power) ● International standards provide unified methodology and compilers are asked to provide metadata on deviations **Exclude** ● Debt instruments (inter-company loans) ● Reinvestment of earnings ● Non cross-border transactions ● Pass-through funds through SPEs	**Include:** ● Purchase of existing shares (acquisition or mergers of existing companies) ● Amount reported represents the total purchase of existing shares (including purchase of less than 10 per cent of voting power) ● Unified methodology is not available across various sources **Exclude** ● All types pass-through transactions and recording is for genuine target and genuine investor ● Divestments (when a resident company is sold by a non-resident owner to another company in a third country, the only transaction to be recorded by private sources is the acquisition by the third country)
Breakdowns	Main breakdowns based on the same concepts as FDI: ● by country (geographical allocation) ● by industry (ISIC)	● A large number of details are available such as: name of an investor/a target company, date of contract/transaction, percentage of shares purchased/sold, types of shares purchased/sold, amount of a transaction (total amount of shares purchased or total enterprise value), and method of payment ● Country and industry classifications are based on the ultimate host/investing enterprise.
Data sources	Statistical surveys, ITRS administrative information and other officially published sources	Press releases, specialized financial press, research papers, materials from the stock exchanges, and surveys/reports undertaken for statistical purposes.

ANNEX 10

Ultimate Investing Country

1. Reallocating positions to the ultimate investing country

608. Standards in this *Benchmark Definition* recommend allocating Foreign Direct Investment (FDI) transactions and positions by partner country and by industry for data presented on a directional basis (see Chapter 4 for an explanation of FDI presented on a directional basis). Hence, these items are attributed to the country of the immediate counterparty and the industry of the immediate counterparty for outward FDI.

609. In the case of inward FDI, the following presents a general example of how positions can be attributed to the country of the ultimate investor(s) in the resident direct investment enterprise.

610. The ultimate investor, for this purpose, is the enterprise that has control over the investment decision to have an FDI position in the direct investment enterprise. As such, the ultimate investor controls the immediate direct investor. It is identified by proceeding up the immediate direct investor's ownership chain through the controlling links (ownership of more than 50% of the voting power) until an enterprise is reached that is not controlled by another enterprise. If there is no enterprise that controls the immediate direct investor, then the direct investor is effectively the ultimate investor in the direct investment enterprise.

611. The country in which the ultimate investor is resident is the ultimate investing country (UIC) for the investment in the direct investment enterprise. It is possible that the ultimate investor is a resident of the same economy as the direct investment enterprise. This is an example of round-tripping.

612. In order to transform from the standard presentation by country using the directional principle to the supplemental UIC presentation, the entire FDI position that is attributed to the country of residence of the immediate direct investor is reallocated to the UIC. Where there is more than one immediate direct investor in a direct investment enterprise, the entire inward FDI position of *each* immediate direct investor is reallocated to the respective UICs based on the ultimate controlling parent (UCP) of *each* of the immediate direct investors. This method ensures that the levels of direct investment into a country according to the standard presentation and according to the supplemental UIC presentation are the same.

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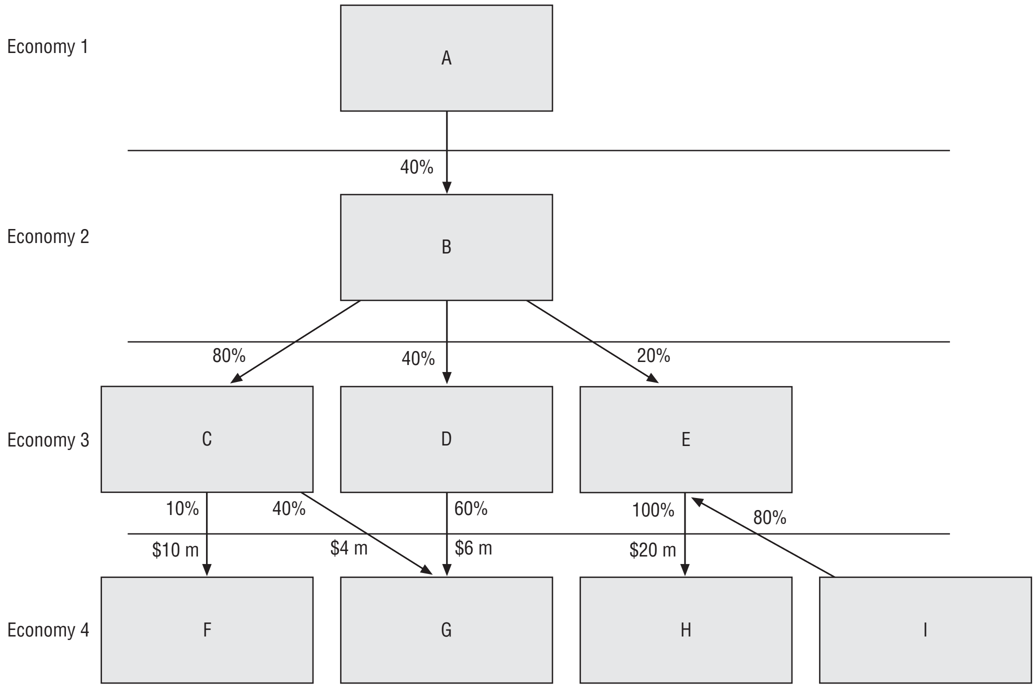
2. An illustration of the reallocation process

613. Diagram A.10.1 below illustrates a number of relationships for direct investment enterprises in economy 4.

Diagram A.10.1. **Utimate investing country**



614. According to the standard presentation by country (on an immediate investor basis), Economy 4 would show $40 m of inward FDI positions from Economy 3. According to the supplemental presentation of inward positions by UIC:

- the $10 m investment from C into F would be reallocated to Economy 2 as enterprise B is the ultimate investor in enterprise F (as the UCP of enterprise C);
- the $4 m investment from C into G would be reallocated to Economy 2 as enterprise B is the ultimate investor in enterprise G (as the UCP of enterprise C);
- the $6 m investment from D into G would remain allocated to Economy 3 as enterprise D is the ultimate investor in enterprise G (no enterprise exerts control over enterprise D, so enterprise D is its own UCP); and
- the $20 m investment from E into H would be reallocated to Economy 4 as enterprise I is the ultimate investor in enterprise H (as the UCP of enterprise E).

615. The supplemental presentation for Economy 4 would record $14 m inward FDI from Economy 2 as the UIC, $6 m inward FDI from Economy 3 as the UIC, and $20 m inward FDI from Economy 4 as the UIC (round-tripping). No investment in Economy 4 is reallocated to Economy 1 as enterprise A is not the UCP of any of the immediate direct investors in Economy 4.

616. From this example, it can be seen that the entire immediate direct investment position is reallocated to the UIC – the percentage ownerships in the chain of control above

the immediate direct investor do not affect the value recorded. It can also be seen that where a direct investment enterprise has multiple direct investors (for example, enterprise G), the investment from each immediate direct investor is reallocated to the respective UICs based on the UCP of each of the immediate direct investors.

3. Experience of the United States

617. The table below shows as an example the foreign direct investment position in the United States at year-end 2004 both by country of immediate investor (the standard presentation) and by UIC (the supplemental presentation). It can be observed in this table that some of the direct investment into the United States has the United States as the UIC, providing evidence of round-tripping from the United States back into the United States.

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Table A.10.1. **Foreign direct investment of the united states by immediate and ultimate investor**

Positions at year-end 2004

	By country of immediate partner		By country of ultimate investor	
	Millions of dollars	Per cent	Millions of dollars	Per cent
All countries	**1 526 306**	**100.0**	**1 526 306**	**100.0**
Canada	**133 761**	**8.8**	**139 904**	**9.2**
Europe	**1 078 287**	**70.6**	**977 346**	**64.0**
Austria	3 720	0.2	2 627	0.2
Belgium	11 285	0.7	11 750	0.8
Denmark	5 450	0.4	4 005	0.3
Finland	5 509	0.4	6 990	0.5
France	148 242	9.7	149 436	9.8
Germany	163 372	10.7	171 683	11.2
Ireland	21 153	1.4	9 426	0.6
Italy	7 421	0.5	15 745	1.0
Liechtenstein	310	0.0	397	0.0
Luxembourg	107 842	7.1	8 813	0.6
Netherlands	167 280	11.0	139 952	9.2
Norway	3 136	0.2	2 604	0.2
Spain	5 669	0.4	7 102	0.5
Sweden	23 853	1.6	19 389	1.3
Switzerland	122 944	8.1	58 691	3.8
United Kingdom	251 562	16.5	366 024	24.0
Other	29 539	1.9	2 710	0.2
Latin America and Other Western Hemisphere	**85 864**	**5.6**	**110 690**	**7.3**
South and Central America	26 295	1.7	21 818	1.4
Brazil	1 286	0.1	3 188	0.2
Mexico	7 880	0.5	11 451	0.8
Panama	10 707	0.7	34	0.0
Venezuela	5 548	0.4	5 662	0.4
Other	874	0.1	1 483	0.1
Other Western Hemisphere	59 569	3.9	88 872	5.8
Bahamas	1 179	0.1	74	(*)
Bermuda	8 442	0.6	74 040	4.9
Netherlands Antilles	4 749	0.3	2 080	0.1
United Kingdom Islands, Caribbean	24 243	1.6	10 523	0.7
Other	20 956	1.4	2 155	0.1
Africa	**1 611**	**0.1**	**1 839**	**0.1**
South Africa	356	(*)	995	0.1
Other	1 255	0.1	845	0.1
Middle East	**8 200**	**0.5**	**17 811**	**1.2**
Israel	4 107	0.3	8 559	0.6
Kuwait	1 238	0.1	1 439	0.1
Lebanon	1	(*)	357	(*)
Saudi Arabia	(D)	(D)	4 716	0.3
United Arab Emirates	24	0.0	1 772	0.1
Other	(D)	(D)	969	0.1
Asia and Pacific	**218 583**	**14.3**	**260 459**	**17.1**
Australia	28 083	1.8	34 730	2.3
Hong Kong	1 709	0.1	29 895	2.0
Japan	176 906	11.6	180 451	11.8
Korea, Republic of	4 212	0.3	4 224	0.3
Malaysia	335	(*)	951	0.1
New Zealand	814	0.1	543	0.0
Philippines	25	(*)	101	0.0
Singapore	1 801	0.1	2 472	0.2
Taiwan	3 227	0.2	4 961	0.3
Other	1 470	0.1	2 131	0.1
United States	…	…	18 256	**1.2**

* Less than 0.05 per cent.

D: Suppressed to avoid disclosure of data of individual companies.

ANNEX 11

Specific Features of FDI Statistics in the Context of Currency and Economic Unions

1. Introduction

618. Currency Unions (CUs) and Economic Unions (EcUn) play an increasingly important role in the world's economy. This Annex summarises the specific features of the compilation and uses of CUs/EcUns' Foreign Direct Investment (FDI) statistics.

1.1. Definition of currency and economic unions and corresponding territories[83]

619. For statistical purposes, a CU is defined as a union to which two or more economies belong and that has a regional central decision making body, commonly a currency union central bank (CUCB), endowed with the legal authority to conduct a single monetary policy and issue the single currency of the union. A CU is established by means of a formal intergovernmental legal agreement (*e.g.* a Treaty).

620. The economic territory of a CU consists of the economic territory of the CU economies that comprise the CU, plus the CUCB. Any other regional organizations that comprise the same or a subset of the same economies are included in the CU.

621. For statistical purposes, an Economic Union (EcUn) is a union to which two or more economies belong. EcUns are established by means of an intergovernmental legal agreement among sovereign countries/jurisdictions with the intention of fostering greater economic integration. In an economic union some of the legal and economic characteristics associated with a national economic territory are shared among the different countries/jurisdictions. These elements include 1) the free movement of goods and services within the EcUn and a common tax regime for imports from non-EcUn countries (free trade zone); 2) the free movement of capital within the EcUn; 3) the free movement of (individual and legal) persons within the EcUn. Also in an EcUn, specific regional organizations are created to support the functioning of the EcUn under points 1) to 3). Some form of cooperation/coordination in fiscal and monetary policy usually exists within an EcUn.

622. An EcUn territory consists of the economic territory of the member countries/ jurisdictions and the regional institutions that comprise the same or a subset of the same economies.

83. See BPM6.

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1.2. Specific issues arising for the FDI statistics of the currency/economic union

623. The concept of FDI statistics does not differ per se for currency or economic unions, taken as a single economic entity, from that of individual countries. As other subscriptions to the capital of international organizations, the subscription to the CUCB, or to regional organizations is not recorded under direct investment even though these contributions may exceed 10% of the voting shares of these institutions.[84] Furthermore, specific legal status may exist for groups of companies in CUs or EcUns, as illustrated by the "European Company Status". Such arrangements may have consequences on national FDI statistics, *e.g.* by facilitating the transfer of assets and activities across countries, but the involved FDI cross-border[85] transactions and positions would be recorded according to the standard methodology as described in this *Benchmark Definition*.

624. The compilation of FDI statistics could be similar to that of individual countries, if a specific data collection were performed on the basis of the residency within the union. However, such an approach may duplicate the data collection with the national statistics, still necessary in such situations (if only because various key national policies, *e.g.* tax policies, are under the national responsibility, within such unions). In this context, currency and economic unions' FDI statistics are usually based on the sources used for the compilation of national FDI statistics. This raises a number of specific compilation issues, which this Annex intends to briefly describe.

2. The contributions to the currency/economic union FDI statistics cannot be identical to national data

2.1. Need to compile "extra currency/economic union" stocks and flows in each participating country

625. In principle net direct investment stocks and flows (*i.e.* assets minus liabilities) for the currency/economic union could be compiled as the aggregation of the national data of the members of the union, plus those of the institutions of the union. However, this approach would not allow the compilation of assets and liabilities for the currency/economic union because transactions between countries belonging to the union would be included on both sides. Furthermore, it would be subject to distortions in case of asymmetric recording of positions/transactions within the currency/economic union. In this context, currency/economic union FDI has to be compiled as the sum of its residents' positions/transactions *vis-à-vis* non-residents of the union (thereafter: "extra" positions/transactions), plus those of the institutions of the union.

2.2. Need for specific treatments

2.2.1. Sector and industry attribution

626. A legal entity resident in one economy is always a separate institutional unit if one or more of its owners is resident in another economic territory.[86] In case all its owners were

84. According to BPM6 Appendix on currency unions, subscriptions to CUCBs should be recorded under other investment.
85. It is worth noting that cross-border refers to the CU/EcUn as a whole. Intra-CU/EcUn transactions and positions are not relevant for the FDI statistics of the CU/EcUn, although they still are for the FDI statistics of CU/EcUn member countries.
86. BPM6.

resident in another economy, the sector of this entity would be defined only according to its own characteristics.

627. However, when compiling FDI statistics for the currency/economic union as a whole, such entities having all of their owners in other countries of the union would in principle be treated as resident of the same economy (*i.e.* the CU or EcUn) and, thus, become ancillary to their parent. As such, they would be allocated to the institutional sector of their parent company. It is recognised, though, that this reclassification may raise significant practical difficulties, and would need a close cooperation between compilers in the countries involved.

628. This *Benchmark Definition* recommends that when the enterprise is part of a local enterprise group, the industry classification be that of the local enterprise group's primary activity. The primary activity of the "local group" at the level of a CU/EcUn may however be different from the primary activity of the "local group" at national level. Although it might be, in principle, possible to construct the FDI statistics of a CU/EcUn according to the primary activity of the "local group" at the level of a CU/EcUn, the loss of valuable detailed information and the increase in the error due to reclassifications of potentially substantial amounts would render such statistics for the CU/ EcUn significantly less useful.

2.2.2. Determination of the Ultimate Investing Country

629. The identification of the Ultimate Investing Country (UIC), as recommended by this *Benchmark Definition*, has to be performed only with respect to positions held with immediate counterparts outside the CU/EcUn, in order to avoid duplications.

630. As an example, an investment from a country A to a country Z may be performed, by means of a single investment chain, via entities resident in countries B and C, both in the same CU/EcUn (and to which neither A nor Z belongs). It may be expected that national statistics in country B and C would both identify the UIC as country A and the ultimate host country as country Z. However, for the CU/EcUn FDI statistics, the position *vis-à-vis* A should be reported only once, and that *vis-à-vis* Z should also be reported once. One approach to ensure this outcome is that UIC positions would only be reported in Cu/EcUn union statistics if they refer to extra positions from the point of view of the immediate counterpart; in the example, only B would report the UIC as country A.

2.2.3. Application of the extended directional principle

631. The application of the extended directional principle requires determining the resident or non-resident status of ultimate parents from the perspective of the Union.

2.3. Need for enhanced cooperation between the members of the currency/economic union

2.3.1. Need to coordinate compilation practices

632. International statistical standards intentionally provide only a set of core definitions and concepts, and leave some flexibility to national compilers to define their compilation methods and detailed compilation practices, and adapt them to their specific environment. For instance, this *Benchmark Definition* allows for several approaches regarding the valuation of non-quoted shares. While countries not belonging to a CU/EcUn may define their compilation practices independently from other countries, although still taking on board the interest of international comparability of the data, those belonging to

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a EU/EcUn have to coordinate closely in order to produce meaningful FDI data for the Union as a whole.

633. Similarly, data "excluding resident Special Purpose Entities (SPEs)", and, separately, data on resident SPEs, may be meaningful only if based on a common definition of SPEs for all members of the Union.

2.3.2. Need to coordinate the recording of large transactions /positions

634. As explained above, aggregated FDI statistics are usually compiled from the data collected by national compilers. Beyond the close coordination of compilation practices, the data quality of the union's FDI requires the coordination of the recording of some large transactions (and resulting positions) involving several countries. For example, a company in a country A may disinvest from a country B, belonging to a CU/EcUn, to invest in another country C of the same CU/EcUn (country A is not a member). While such a development should have no impact on the FDI statistics of the CU/EcUn, it may be important in practice to coordinate the recording of the corresponding transactions/positions of countries B and C, in order to ensure that they are compiled in exactly the same way (especially in terms of timing).

635. This coordination is not straightforward as national statistical confidentiality rules usually do not allow national compilers to share confidential information with statistical bodies outside their national borders. To facilitate the maintenance and improvement of data quality through data checking, the establishment of an appropriate statistical data confidentiality regime is desirable at least and probably essential. Such a regime would ideally address the sharing and protection of confidential data both *i)* among national compilers and *ii)* between national compilers and the CU/EcUn compilers in order to enable the compilation of consistent and reliable aggregated Union's statistics.

3. Usefulness of FDI data regarding currency/economic unions

636. While national FDI statistics still play a prominent role for policy-makers in the countries participating to such unions, where tax and/or some other policies are still defined at national level, FDI statistics for such CU/EcUns are important to contribute to the overall assessment of the benefits of the Union and the conduct of its policy, in particular the decisions made *e.g.* with respect to trade, competition or labour rules. The analysis of the developments of globalisation within and outside the Union, or the determinants to GDP growth for the Union as a whole may also strongly benefit from information on inward FDI.

4. Identification of currency/economic unions by partner economies

637. Other economies may find it analytically useful to identify certain currency and/or economic unions among their partners. Corresponding data should be equal to the sum of positions/transactions *vis-à-vis* the countries belonging to the corresponding CU or EcUn, plus possibly institutions of the CU or EcUn where appropriate.

638. In case the composition of the CU or EcUn would change over time, compilers may decide either to show back data only according to the latest composition of the CU/EcUn, or to show the CU/EcUn according to its composition at each point in time, and to take the changes in composition into account by means of a reclassification.

ANNEX 12

Examples of Foreign Direct Investment Data Collecting and Reporting Methods

639. This annex discusses some examples of the foundations needed to compile foreign direct investment (FDI) data via a survey system. These include data sources, survey design, need for a Business Register, mail-out procedures, data capture, compilation and dissemination practices, legal aspects, timeliness and revision practices.

1. Data sources:

1.1. Questionnaires

640. Statistical questionnaires often constitute the core source of information and are used to obtain information on direct investment from businesses involved in direct investment activities. Depending on the frequency of release of FDI results, quarterly or annual questionnaires can be used. Questionnaires requesting information on the consolidation used by the reporting entities when reporting their operations are also a very useful tool to assess the scope of the reported data. In collecting the data using a survey approach it is generally preferable to have the operation conducted on a statutory basis.

1.2. Administrative data

641. Data gathered from Governments' bodies are often useful to complete the data collected by the questionnaires. Local investment review agencies can also provide a good source of financial data to complement mailing lists of companies. Catalogues showing corporate structures of companies (*e.g.* Who Owns Whom) can also constitute reliable indexes to adequately populate a frame of enterprises likely to be involved in FDI.

1.3. Monitoring of the financial press

642. Monitoring financial information from the business community as published in the financial press is often very important both to highlight the occurrence of and to better assess important FDI transactions. Human resources (*i.e.* financial analysts) need to be devoted to review systematically the financial press. On occasion, it can be necessary to estimate an FDI transaction without making contact with the company because of official release constraints.

1.4. Bilateral sources

643. Reconciliation of data between partner countries can be conducted to validate and try to harmonize one another's statistics. This exercise can be done on a regular basis and

is often very valuable in assessing the quality of direct investment data. The IMF's Coordinated Direct Investment Survey (CDIS) will be an important source of bilateral data for reconciliation purposes.

2. Survey design

644. Survey design expertise is essential to better assess the proper layout and wording of the questionnaires in relation to respondents. Linkages with accounting terms and financial statements of companies greatly facilitate the completion of questionnaires by respondents.

2.1. Respondents' relations

645. Contact with respondents should be maintained on a regular basis, particularly for the large, complex enterprises. Given the complexity of FDI and the complexities of the structures and operations of many multinational enterprises, it is essential that such contact be maintained at as high a level as possible on both sides on an ongoing basis. In this context, company visits by the compiler are very beneficial to both sides and a team devoted to maintain a good effective working relationship with companies is important. In sourcing data and in efforts to ensure the quality of the FDI results, access to audited company accounts (including management accounts) is crucial and should be pursued vigorously.

2.2. Business Register (BR):

646. A frame of enterprises is needed to incorporate and maintain the list of those included in the FDI survey(s). It has to be designed specifically to include the necessary information for FDI requirements, but, of course, a comprehensive business register may be used for other surveys or other statistical purposes.

647. Here are some examples of procedures that can provide broad indication on how to maintain a Business Register suited for FDI. When an enterprise is identified, via a newspaper article or any other sources, the precise information about the name and the address of the enterprise should be loaded into the mailing list.

648. The characteristics and details of the enterprises should then be included in the business register and a determination should be made on the basis of the relevant information whether it should be surveyed for FDI purposes. The business register should also includes historical information about the enterprise from the first time it was surveyed as well as any details of any changes (*e.g.* whether it changed name, address, activity, or ownership or even ceased operations). Here are some of the basic components of a business register:

- Enterprise ID (unique identifier).
- Enterprise name.
- Contact person at the enterprise.
- Address of the enterprise.
- Phone number.
- Fax number.
- Type of enterprise (*e.g.* private corporation or public enterprise).
- Economic activity and Industrial code.

- Institutional sector.
- Country of control code.
- Number of persons engaged.
- Turnover.
- Size of balance sheet.
- FDI Analyst (compiler responsible for the enterprise).
- Type of questionnaire(s) sent.
- Mailing status (yes or no).

649. The business register should be maintained on an ongoing basis and reflect any updates necessary due to births, deaths or changes applied to an enterprise. Therefore, each time a change is made to an enterprise, it should be reflected in the frame and kept for future reference. The information gathered from surveys, administrative sources or from the financial press is used to build and maintain up to date the business register.

2.3 Mail out and follow-up procedures

650. Examples of some key elements to be incorporated in mailing procedures are listed below. This information could be maintained in a separate related database – a survey management system (*i.e.* linked to the main register via the enterprise identification number):

- Enterprise identification (unique identifier).
- Response status (mailed, received, in contact, remail, exempt, removed).
- Date mailed.
- Date remailed.
- Date received.
- Date of first follow-up.
- Date of second follow-up.
- Date of third follow-up.
- Date of fourth follow-up.
- Date removed.
- Queries to enterprise (date, matter, contact, outcome, etc.).
- Non-response/quality of response.
- Imputation necessary [Y or N].
- Legal enforcement; etc.

651. If an enterprise does not return its questionnaire(s) within a certain time period, it is often appropriate to send a number of reminders indicating that their questionnaires are still outstanding.

652. If the respondent requires more time to complete the questionnaire, the information is to be noted so that the respondent is not sent reminders. In some cases, it may be necessary for compilers to pursue legal enforcement where a survey is mandatory.

653. Summary counts of questionnaires mailed, received and the percentage outstanding should be easily retrievable from the response log file.

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3. Data capture and procedures

3.1. Data capture

654. Systems can be put in place to automate the data capture of the questionnaires received (spreadsheets or web systems). This function can improve considerably the quality of the data if thoroughly carried out. The FDI data captured from questionnaires can then be reviewed by financial analysts. Special efforts should be made with respondents involving large transactions or with missing critical information.

3.2. Procedures

655. To help the analysts in the validation and manipulation of the massive amount of data being captured, a computer system has to be developed. This system should include all the information on the status of the enterprise, on the data being captured and the other sources of information described above. The description of the following procedures provides examples of the main functions to process the information.

3.3. Validation of data

656. This procedure validates the information after the data capture process. An essential part in the validation of the data is the edit function built in the system. This edit function should follow pre-programmed automatic procedures that can identify erroneous data entries and build an error message file to be corrected.

657. Another function should allow the analyst to browse and correct the data when further research, outside of the system, justifies such a correction. In this context, audited company accounts data can be very helpful as can other related information supplied to the same compiling authority or to another public authority, industry body, etc.

3.4. Imputation and estimation

658. When conducting a survey, it is normal for some enterprises not to have responded at the time that estimates need to be compiled. Values need to be imputed for these respondents. The imputation process can use information from previous responses from the enterprise, responses from similar enterprises, and information from the financial press and other data sources.

659. It is also common not to send questionnaires to all enterprises known to be involved in FDI relationships. The information collected from selected enterprises may be used to represent the entire population of resident direct investors and direct investment enterprises. This can involve the application of weights (*i.e.* grossing or scaling factors) to reported data. Alternatively, an under coverage adjustment may be based on data from other sources for the non-selected enterprises.

3.5. Assessment of the quality of the data

660. The initial estimates of direct investment need to undergo several updates and have to be validated to try to minimise under-coverage in the resulting estimates. The response rate needs to be assessed regularly especially for respondents involved in many and/or large FDI transactions.

3.6. Dissemination

661. As the data need to be reported at the enterprise level, the analyst has to be able to generate reports according to very specific analysis needs. For publication purposes the data need to be available by country, by industry, by sector (*e.g.* public enterprise or private corporation) and one can see the multitude of reports that will be needed for comprehensive analysis of the FDI data.

3.7. Official releases and publications

662. Direct investment data can be released in a very aggregated form (*e.g.* as part of the Balance of Payments program) but also on a more disaggregated basis as requested by this *Benchmark Definition*.

3.8 Special requests

663. The systems need to provide flexibility to be able to tabulate any combination of country, industry and characteristics of direct investment that can be requested.

3.9. The legal aspects

664. A legal authority is needed to ensure that the statistical information is collected: it is compulsory in many countries for the enterprises to complete and return the questionnaires being sent to them by statistical authorities. Enterprises that refuse or neglect to do so may be guilty of an offence and may be subject to legal enforcement procedures.

665. Statistical legislation is generally necessary to protect confidentiality of the data provided. Such legislation normally prohibits the disclosure of information relating to any individual person, business or organization. Very strict rules need to be applied to protect the direct, indirect or inadvertent disclosure of confidential information. These legal protections are very important as they not only reassure the respondents concerning the security of the information they provide but also can engender a positive response culture. A good level of confidence established with the enterprises in regard to the protection of their data will have a positive impact on the response rate.

3.10. Timeliness and revision practices

666. After estimates referring to a certain period (for transactions) or time point (for positions) are published, it is possible that further information will become available that would cause revisions to the original estimates. This information may result from improved data from respondents, improved compilation processes or other investigations into the data. A balance needs to be found between providing the most accurate information to analysts and lowering analysts' confidence in the data through too-frequent or large revisions. Any compilation system will need to assess the time lag between the survey process and the data dissemination as well as the revision practices.

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ANNEX 13

Research Agenda

667. At the time of publishing this edition of the *Benchmark Definition*, there were a number of issues requiring further investigation. These issues have been placed on a research agenda with investigations to be undertaken to progress their resolution (to the extent possible). As results become available from these investigations, they will be released in a managed process as addenda to the *Benchmark Definition*. The appearance of an issue on the research agenda does not guarantee that recommendations in the *Benchmark Definition* will change as a result of further investigation. Consequently, compilers should not presume the results of any investigations on the research agenda, but should await the publication of an addendum on the outcomes. The topics to be investigated are first categorised under the following five headings.

1. Capital in transit.
2. Ultimate investing/host country.
3. Special items related to FDI transactions/position.
4. Globalisation.
5. Other items.

1. Capital in transit

668. *Identifying non-resident Special Purpose Entities (SPE)*: This *Benchmark Definition* recommends that countries report on a supplemental basis FDI looking through non-resident SPES. Recognising the difficulties and in the absence of an agreed methodology, such data delivery was identified as supplemental in spite of its high analytical relevance. Some countries have practical methods for looking through non-resident SPEs. Annex 7 provides some assistance to compilers in determining the existence of SPE-type entities pending the future development of a pragmatic methodology.

669. *Updating the typology of SPEs as appropriate*. Given the changing nature of financing patterns of multinational enterprises, OECD does support the view to find a universal definition of SPEs. However, OECD will be attentive if any work is conducted in other fora to find a universal definition. The criteria described in Chapter 6 to guide compilers will be revised if and when new structures are established by MNEs for financing direct investment.

670. *Segregating capital transiting through operational affiliates of multinational enterprises (MNE)*: In addition to SPEs, MNEs also invest via their operational subsidiaries abroad. Segregating these funds passing through the enterprise from its other business is currently

not possible. More work will be necessary to develop a comprehensive methodology to isolate such transactions /positions.

671. Exploring the usefulness and feasibility of *a register for SPEs*.

2. Ultimate investing/host country

672. *FDI positions allocated according to ultimate host country*. Guidance on FDI inward positions according to ultimate investing country/industry (UIC) is provided in Chapter 4 and Annex 10. However, this *Benchmark Definition* does not provide any guidance or methodology for outward investments according to ultimate host country (UHC). The concept will be clarified in view of its importance in the analysis of the ultimate destination of FDI.

673. *Round tripping* refers to domestic funds which leave a country and return back as foreign direct investment. Such operations could be put in place for multiple reasons, for example as tax benefits, money laundering, etc. The research work will attempt to answer questions such as: should such investments be included in FDI statistics: and how could they be segregated?

3. Special items related to FDI transactions/position

674. Some of the concepts/recommendations included in this *Benchmark Definition* may benefit from further refinements or practical examples:

i) *Extended directional principle*: further examination of the deflation of FDI and clarification of the methodology for the identification of the ultimate controlling parent.

ii) Acquiring voting power without purchasing equity (*e.g.* swaps, repurchase agreements).

iii) Equity and debt transactions /positions between financial institutions.

iv) Treatment of negative equity.

v) Time of recording for reinvested earnings on the same basis as the payment of dividends.

vi) Multi-territory enterprises and the treatment of income flows and changing identification of the parent.

vii) Developing *a reference survey* to assist compilers. Such a sample survey would complement the methodological and practical information provided in the *Benchmark Definition*.

viii) Special studies on FDI by type of entity: investment funds; hedge funds; private equity funds; sovereign wealth funds; use of derivatives to gain control; stapled securities.

4. Globalisation

675. Activities of multinational enterprises (AMNE) data are closely linked to financial transactions and positions of FDI. They provide information on the impact of investments. Currently, inconsistencies prohibit a sound analysis of the two data sets. OECD has a recognised experience in setting methodological standards for FDI and AMNE statistics as well as in data collection/dissemination. Nevertheless, ample amount of work still remains

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for the reconciliation of these data sets for *i)* methodological reconciliation; and *ii)* analytical reconciliation. Some of the items identified are:

i) Reconciliation of FDI statistics and statistics on the activities of MNE.

ii) Economic definition of FDI stocks.

iii) Hybrid system to identify direct investment relationship.

iv) Further examining FDI by type with particular emphasis on M&As: divestments resulting from buy-backs; greenfield investment; extension of capital; financial restructuring.

v) Explore possible synergies with on-going work on business registers in their development of multinational registers.

5. Other items

676. Several other items of analytical interest were identified for future investigation:

i) *FDI by enterprise size*: Internationalisation of small and medium size enterprises is a current issue. Distinguishing FDI by size of enterprises is required for such analysis.

ii) *Privatisation and FDI*: There is ample interest, in particular for emerging economies, to identify the share of privatisations in FDI (or *vice versa*).

iii) Possible reconciliation of FDI statistics and trade statistics: Trade and FDI are considered to be closely related. However, current data classifications do not allow sound analysis of these two sets of measures of economic activity.

iv) *Sales of patents* as a part of the more general technology transfer analysis and its linkages to FDI.

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Foreign Direct Investment Glossary

Acquisition

An acquisition is a business transaction between unrelated parties based on terms established by the market where each enterprise acts in its own interest. The acquiring enterprise purchases the assets and liabilities of the target enterprise. In some cases, the target enterprise becomes a subsidiary or part of a subsidiary of the acquiring enterprise.

Activity of multinational enterprises

In principle quantitative or qualitative information directly concerning multinational firms could be classified under activity of multinational enterprises. However, within the framework of the OECD *Handbook on Economic Globalisation Indicators,* data on the activity of multinationals covers all economic and industrial data which are not associated with FDI, portfolio or other financial transactions. Data collected by the OECD within the framework of the surveys on the economic activity of multinationals include 18 variables, notably gross output, turnover, value added, number of people in employment, employee compensation, gross operating surplus, gross fixed capital formation, R&D expenditures, number of researchers, total exports and imports, intra-firm exports and imports, and technological payments and receipts.

Affiliated enterprises

Affiliated enterprises are enterprises in a direct investment relationship. Thus, a given direct investor, its direct investors, its *subsidiaries*, its *associates*, and its *branches*, including all *fellow enterprises*, are affiliated enterprises. It is possible for a given enterprise to be a member of two or more groups of affiliated enterprises.

All-inclusive concept

The application of the all-inclusive concept is one of the two main approaches to measuring earnings. The concept is explained in the *International Accounting Standard,* "*Unusual and Prior Period Items and Changes in Accounting Policy*". When earnings are measured on the basis of this concept, income is considered to be the amount remaining after all items (including write-offs and capital gains and losses, and excluding dividends and any other transactions between the enterprise and its shareholders or investors) causing any increase or decrease in the shareholders' or investors' interests during the accounting period, are allowed for. *This concept is not recommended by the Benchmark Definition (see also entry on Current Operating Performance Concept)*.

Ancillary corporation

An *ancillary* corporation is a wholly-owned subsidiary whose productive activities are ancillary in nature: that is, confined to providing services to the parent corporation and/or other ancillary enterprises owned by the same parent corporation. The kinds of services which may be produced by an ancillary unit are transportation, purchasing, sales and marketing, various kinds of financial or business services, computing and communications, security, maintenance, and cleaning. In some cases, the ancillary unit is located in a different economy from the companies it serves. An ancillary corporation is recognized as a separate institutional unit when it is resident in a different economy from that of any of its owners, even if it is not, in practice, autonomous.

Assets, direct investment

Direct investment assets can be ascribed to the following three categories:

1. investment by a resident direct investor in its non-resident direct investment enterprises
2. reverse investment by a resident direct investment enterprise in its non-resident direct investor(s)
3. investment by a resident fellow enterprise in non-resident fellow enterprises.

Asset/liability principle

The asset/liability principle records all FDI financial claims on and obligations to non-residents using the normal balance sheet data showing gross assets and liabilities for positions, and net transactions for each category. The data presented on this basis, while compiled distinguishing the nature of the relationship between the counterparts (according to Framework for Direct Investment Relationships), do not incorporate any offsetting of reverse direct investment transactions or positions in equity or debt between a direct investment enterprise and its direct investor. Similarly, the asset/liability presentation does not incorporate any offsetting of any transactions or positions between fellow enterprises.

Associate, direct investment enterprise

An associate is a direct investment enterprise

1. in which an investor owns directly at least 10% of the voting power and no more than 50%;
2. where an investor and its subsidiaries combined own at least 10% of the voting power of an enterprise but no more than 50%, the enterprise is regarded as an associate of the investor for FDI purposes;
3. where an associate, either as an individual or in combination with its subsidiaries, own more than 50% of an enterprise, this enterprise is regarded for FDI purposes as an associate of the higher level investor.

Balance of payments

The Balance of Payments is a statistical system through which economic transactions occurring during specific time periods between an economy and the rest of the world can be summarised in a systematic way. The IMF *Balance of Payments and International Investment Manual* provides conceptual guidelines for compiling balance of payments statistics according to international standards.

Book value Book value is a term that broadly encompasses many different accounting methods. It represents the values that appear on the books of an enterprise. It could represent the values on the books of direct investors or on the books of direct investment enterprises.

Branch, direct investment enterprise A branch is any unincorporated direct investment enterprise in the host country fully owned by its direct investor. Thus, this term encompasses branches as commonly defined – *i.e.* formally organised business operations and activities conducted by an investor in its own name – as well as other types of unincorporated operations and activities.

All or most of the following features should be present for a branch to be recognised:

1. undertaking or intending to undertake production on a significant scale based in the territory for one year or more in a territory other than that of its head office:
   - ❖ if the production process involves physical presence, then the operations should be physically located in that territory. Some indicators of an intention to locate in the territory include purchasing or renting business premises, acquiring capital equipment, and recruiting local staff;
   - ❖ if the production does not involve physical presence, such as in some cases of banking, insurance, or other financial services, the operations should be recognised as being in the territory by virtue of the registration or legal domicile of those operations in that territory;
2. the recognition of the operations as being subject to the income tax system, if any, of the economy in which it is located even if it may have a tax-exempt status.

Business register A business register is a list of enterprises or establishments maintained by countries to assist in the compilation of their business statistics generally and which can identify those enterprises involved in foreign direct investment and therefore help in the compilation of these statistics.

Centre of predominant economic interest An institutional unit has a *centre of predominant economic interest* in an economic territory when there exists, within the economic territory, some location, dwelling, place of production, or other premises on which or from which the unit engages and intends to continue engaging, either indefinitely or over a finite but long period of time, in economic activities and transactions on a significant scale. The location need not be fixed so long as it remains within the economic territory. In most cases, it is reasonable to assume that an institutional unit has a predominant centre of economic interest in the territory if the unit has already engaged in economic activities and transactions on a significant scale in the country for one year or more, or if the unit intends to do so.

Collective investment institutions Collective investment institutions (CIIs) are incorporated investment companies and investment trusts, as well as unincorporated undertakings (mutual funds or unit trusts), that invest in financial assets (mainly marketable securities and bank deposits) and real estate using the funds collected from investors by means of issuing shares/units (other than equity). The CII can be open-ended, if there is no limit to the number of shares/units on issue, or closed-ended, where the number of shares/units on issue is fixed. The shares/units can be quoted or unquoted. The CII may pay periodic dividends, capitalise the income or a combination of those approaches, depending on the terms set out in its prospectus. Also referred to as *collective investment scheme, collective investment vehicle, investment fund*.

Conduit A conduit is an enterprise that obtains or borrows funds, often from unaffiliated enterprises, and remits those funds to its direct investor or another affiliated enterprise. Some conduits and holding companies may have a substantial physical presence as evidenced by office building, equipment, employees, etc. Others may have (little) or no physical presence and may exist only as *shell companies*.

Confidentiality In compiling and presenting FDI statistics, compilers in many countries may encounter the possibility of confidential data occurring in the results to be disseminated. Such information generally does not directly identify the entity, *e.g.* the name and address of an enterprise, to which the data relate. However, the particular context in which the data are presented *e.g.* classification by: country of counterpart, activity of enterprise, type of financial instrument as well as cross-classifications of these attributes, may allow users to determine the identity of the entity in question and the value of its activity from the information provided (as well as other information they may have independently available to them). In general, the greater the level of detail in the analyses, as well as the degree of concentration of particular types of enterprises and their activities in a compiling country, the greater the likelihood of confidential data arising. For many countries, national statistical legislation prohibits the direct or indirect disclosure of information relating to a particular individual or entity. Many international organisations also operate statistical confidentiality regimes to ensure that confidential statistical information is not disseminated.

Current operating performance concept (COPC) The current operating performance concept is the concept recommended by the Benchmark Definition to measure direct investment earnings. The concept is explained in the International Accounting Standard, "Unusual and Prior Period Items and Changes in Accounting Policy". When earnings are measured on the basis of this concept, such earnings consist of income from normal enterprise operations before non-recurring items (such as write-offs) and capital gains and losses are accounted for (see also entry on All-inclusive-concept not recommended by the *Benchmark Definition*).

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Debt securities Debt securities include bonds, debentures, commercial paper, promissory notes and other tradable non-equity securities.

Debtor/creditor principle A *debtor* is a person or an entity which has a financial obligation to another person or entity. Conversely, a *creditor* is a person or entity which has a financial claim on another person or entity. Therefore, a debtor has a financial liability to a creditor and a creditor has a financial claim (an asset) on a debtor. For FDI statistical purposes, under the debtor/creditor principle, the FDI assets (both transactions and positions) of the compiling economy are allocated to the economies of residence of the non-resident debtors; its FDI liabilities are allocated to the economies of residence of the non-resident creditors allocated on the basis of the debtor/creditor principle. This principle, recommended by the *Benchmark Definition* as the basis for geographical allocation, differs from the *transactor* principle.

Deposits Typical forms of deposits include savings deposits, term deposits, transferable and non-transferable deposits in local or foreign currencies.

Direct investment (see *Foreign direct investment)*.

Direct investment enterprise (see *Foreign direct investment enterprise*).

Direct investor (see *Foreign direct investor*).

Directional principle Presentation of the FDI data on a directional basis reflects the direction of influence by the direct investor underlying the direct investment: *inward or outward direct investment*. FDI according to directional principle relates to the treatment of *reverse investment* and to the treatment of *fellow enterprises*.

1. Reverse investment
2. Investment between fellow enterprises:
   - ❖ if the ultimate controlling parent is a resident of the compiling economy, then the transactions and positions between the two fellow enterprises are categorised as *outward foreign direct investment*;
   - ❖ if the ultimate controlling parent is not a resident of the compiling economy, then the transactions and positions between the two fellow enterprises are categorised as *inward foreign direct investment*.

Distributed earnings Distributed earnings consist of *dividends* and *distributed branch profits*. Distributed earnings can be paid out of current or past earnings and may result in negative reinvested earnings if the distribution of dividends exceeds total earnings in a particular reference period.

Dividends Dividends are earnings distributed to shareholders from common and participating preferred stock, whether voting or non-voting, according to the contractual relationship between the enterprise and the various types of shareholders, before deduction for withholding taxes. Dividends exclude liquidating dividends and bonus shares (which are dividends in the form of additional shares of stock). These can be recorded on the date they are payable, on the date they are paid, or at some other point in time. The Benchmark Definition recommends recording dividends on the date they are payable.

Economic territory Economic territory is defined as including all the areas under the effective economic control of a single government. Economic territory has the dimensions of physical location as well as legal jurisdiction. With regard to its composition, an economic territory (or economy) consists of all the institutional units that are resident in that territory. The concepts of *economic territ*ory and *residence* are designed to ensure that each institutional unit is a resident of a single economic territory.

The economic territory includes the land area, airspace, territorial waters, including jurisdiction over fishing rights and rights to fuels or minerals. In a maritime territory, the economic territory includes islands that belong to the territory. The economic territory also includes territorial enclaves in the rest of the world. These are clearly demarcated land areas (such as embassies, consulates, military bases, scientific stations, information or immigration offices, aid agencies, central bank representative offices with diplomatic immunity, etc.) located in other territories and used by governments that own or rent them for diplomatic, military, scientific, or other purposes with the formal agreement of governments of the territories where the land areas are physically located.

Enterprise An enterprise is an institutional unit engaged in production. An enterprise may be *a corporation*, *a non-profit institution*, or an *unincorporated enterprise*. Corporate enterprises and non-profit institutions are complete institutional units. An unincorporated enterprise, however, refers to an institutional unit – a household or government unit – only in its capacity as a producer of goods and services.

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

- A *multinational enterprise group* consists of all the enterprises located in different economies and under the control or influence of the same owner wherever located
- An *economy-specific enterprise group* consists of all the enterprises located in the same economy and under the control or the influence of the same owner also located in the same economy. Ownership links

that are external to the economy are not recognised in the formation of *local enterprise* groups.

Equity capital Equity capital comprises: *i)* equity in branches; *ii)* all shares in subsidiaries and associates (except non-participating, preferred shares that are treated as debt securities and included under direct investment, debt instruments); and *iii)* other contributions of an equity nature. Ownership of equity is usually evidenced by shares, stocks, participations, depositary receipts or similar documents. Shares and stocks have the same meaning while depositary receipts are securities that represent ownership of securities by a depositary. This category includes proprietors' net equity in quasi-corporations, as well as shares and equity in corporations. It also includes preferred stocks or shares that provide for participation in the residual value on dissolution of an incorporated enterprise. Reinvestment of earnings comprises the claim of direct investors (in proportion to equity held) on the retained earnings of direct investment enterprises. Reinvestment of earnings represents financial account transactions that contribute to the equity position of a direct investor in a direct investment enterprise.

Establishment An establishment is an enterprise, or part of an enterprise, that is situated in a single location and in which only a single (non-ancillary) productive activity is carried out or in which the principal productive activity accounts for most of the value added.

Exchange rate changes Exchange rate changes reflect the impact that changes in exchange rates have on instruments that are denominated in a currency other than that in which the accounts are compiled. Exchange rate changes may be referred to by enterprises as realised or unrealised exchange rate or foreign exchange gains or losses. They should not be included in the earnings of an enterprise when calculating income flows.

Fellow enterprises An enterprise in one economy may be related through the *Framework of Direct Investment Relationships* – FDIR to another enterprise in the same economy, or in a different economy, without either being a direct investor in the other, but through both being directly or indirectly influenced by the same enterprise in the ownership hierarchy. This "common parent" must be a direct investor in at least one of enterprises in question. Such enterprises can be considered to be related through a "horizontal" linkage within the FDIR – not involving FDI voting power of 10% or more – and are called fellow enterprises. It should be noted, however, that for FDI statistics, only cross-border transactions and positions between FDI-related enterprises should be recorded.

Financial derivatives Financial derivatives are financial instruments that are linked to another specific financial instrument or indicator or commodity, and through which specific financial risks can be traded in financial markets in their own right. The value of a financial derivative is based on the price of an underlying item, such as an asset or index. Unlike debt instruments, financial derivatives do not require the advance of principal amounts that are required to be repaid and do not generate investment income. Financial derivatives are used for a number of purposes including risk management, hedging, arbitrage between markets, and speculation. Financial derivatives are excluded from direct investment.

Financial intermediary

Financial intermediaries consist of *i)* central bank; *ii)* deposit-taking corporations other than central bank (*e.g.* banks); *iii)* money market funds; *iv)* investment funds other than money market funds; *v)* other financial intermediaries, except insurance companies and pension funds; *vi)* insurance corporations and *vii)* pension funds. However, for the purposes of excluding debt between related financial intermediaries, insurance corporations and pension funds are not considered "financial intermediaries".

Financial Lease

A financial lease is a method of financing the purchase of a good by the lessee (as opposed to taking out a loan for the purchase). 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. During the life of the financial lease, the lessor expects to recover most or all of the cost of the goods and carrying charges.

Foreign direct investment (FDI)

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

Foreign direct investment enterprise

A foreign direct investment enterprise is an enterprise resident in one economy and in which an investor resident in another economy owns, either directly or indirectly, 10% or more of its voting power if it is incorporated or the equivalent for an unincorporated enterprise.

The numerical threshold of ownership of 10% of the voting power determines the existence of a direct investment relationship between the direct investor and the direct investment enterprise. An ownership of at least 10% of the voting power of the enterprise is regarded as the necessary evidence that the investor has sufficient influence to have an effective voice in its management.

Foreign direct investor A foreign direct investor is an entity (an institutional unit) resident in one economy that has acquired, either directly or indirectly, at least 10% of the voting power of a corporation (enterprise), or equivalent for an unincorporated enterprise, resident in another economy. A direct investor could be classified to any sector of the economy and could be any of the following:

i) an individual;

ii) a group of related individuals;

iii) an incorporated or unincorporated enterprise;

iv) a public or private enterprise;

v) a group of related enterprises;

vi) a government body;

vii) an estate, trust or other societal organisation; or

viii) any combination of the above.

In the case where two enterprises each own 10% or more of each other's voting power, each is a direct investor in the other.

A direct investor has a direct investment enterprise operating in a country other than the economy of residence of the foreign direct investor.

Framework for Direct Investment Relationships (FDIR) The Framework for Direct Investment Relationships (FDIR) is a generalised methodology for identifying and determining the extent and type of direct investment relationships. The FDIR allows compilers to determine the population of direct investors and direct investment enterprises to be included in FDI statistics.

For a compiling economy, the FDIR identifies all enterprises related to a particular enterprise whether it is a direct investor or a direct investment enterprise or both. For example, within a group, it is possible that a direct investment enterprise itself owns 10% or more of the voting power of another non-resident enterprise, in which case the direct investment enterprise is itself a direct investor in a further direct investment enterprise. The question is therefore whether there is a direct investment relationship between the further enterprise and the original enterprise.

The residence of units is not a feature of the definition of subsidiaries and associates for FDI purposes. The FDIR may include within the relationship enterprises that are resident in the same economy. However, foreign direct investment is only recorded when there is a financial transaction or position between entities in different economies that are in a direct investment relationship (including fellow enterprises).

Holding Companies A *holding company* is a company established to hold participation interests in other enterprises on behalf of its owner. Some *holding* companies may have a substantial physical presence as evidenced by, for example, office buildings, equipment, and employees. Others may have little or no physical presence and may exist only as shell companies.

Immediate host/ investing country Immediate host/investing country is the basis for geographical allocation with respect of the first counterparty.

Income, direct investment Direct investment income is part of the return on the direct investment position; that is, the return on equity and debt investment. Direct investment income consists of *earnings on equity investment* (for example, a resident direct investor 's share in the net income or earnings of its direct investment enterprises) plus *income on debt* between direct investors and direct investment enterprises and between fellow enterprises. Direct investment income payables are calculated in a similar way. Direct investment income is recorded as it accrues. However, as debt instruments involving FDI-related financial intermediaries are excluded from direct investment, so is the debt income between them.

Income on debt Income on debt is interest receivables comprising interest accruing to residents (direct investors, direct investment enterprises and fellow enterprises) on their debt receivables, and interest payables comprising interest accruing to non-residents (direct investment enterprises, direct investors and fellow enterprises) on debt payables. No direct investment interest receivables or payables are recorded when both parties are related financial intermediaries (such as commercial banks, savings institutions, credit unions, mutual funds or finance companies).

Income on equity Income on equity relates to the return of the direct investor on the equity component of the direct investment position. The amounts are based on the direct investor's percentage share (based on their equity share) in the current earnings of the given direct investment enterprise and consist of *distributed earning*s and "*reinvested earnings*".

Indirectly owned direct investment enterprises As a matter of principle, foreign direct investment statistics cover all enterprises in which direct investors have, directly or indirectly, a direct investment interest. This group of enterprises is specified according to the Framework for Direct Investment Relationships (FDIR).

Institutional unit An institutional unit *is an economic entity that is capable, in its own right, of owning assets, incurring liabilities and engaging in economic activities and in transactions with other entities* (*Ref.*: SNA).

Inward direct investment Inward direct investment is investment by a non-resident direct investor in a direct investment enterprise resident in the host economy; the direction of the influence by the direct investor is "*inward*" for the reporting economy. Also referred to as direct investment in the reporting economy.

International standard industry classification – ISIC

The international standard industry classification (ISIC) is the industry classification recommended by the *Benchmark Definition (see also NACE)*.

International transactions reporting system (ITRS)

An international transactions reporting system (ITRS) measures individual balance of payments cash transactions passing through the domestic banks and may also measure 1) individual cash transactions passing through foreign bank accounts of enterprises; 2) non-cash transactions; and 3) stock positions. Statistics are compiled from forms submitted by domestic banks to the compilers and may also be compiled from forms submitted by enterprises to the compiler.

Joint venture

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

Land and buildings

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

Ownership of land and buildings by a non-resident is treated as an equity investment by the non-resident in a resident notional enterprise, which in turn is treated as the owner of the land and buildings. Any rent earned through leasing the land and buildings is recorded as a dividend (income on equity) paid by the notional unit to the direct investor.

Liabilities, direct investment

Direct investment liabilities can be ascribed to the following three categories:

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

ii) reverse investment of non-resident direct investment enterprises in resident direct investors;

iii) investment of non-resident fellow enterprises in resident fellow enterprises.

Listed shares

Listed shares are equity securities that are listed on an organized stock exchange. Their values can, therefore, be determined by multiplying the number of shares held by the direct investor(s) by the most recent bid/ask prices or at the price at which the shares were last traded. In this manner, a market price value of the holdings of the shares held by the direct investor(s) – and thus the value of the share liability of the direct investment enterprise to its direct investor(s) – can be determined.

Usually, the equity securities of only a relatively small portion of direct investment enterprises are publicly traded on organized stock exchanges because most direct investment enterprises are either 100% owned by the direct investor or are held by a small group of investors. (Listed shares are also referred to as *quoted shares)*.

Loans

Loans are financial assets that are created when a creditor lends funds directly to a debtor through an instrument that is not intended to be traded. This category includes all loans and advances (except accounts receivable/payable which are treated as a separate category of financial assets). It also covers the treatment of financial leases and repurchase agreements.

Market value

Market value is the conceptually ideal basis for valuing direct investment transactions and positions. Market valuation places all assets at current prices rather than when last purchased or re-valued, and promotes consistency in the value of assets of different vintages. It also promotes consistency when comparing stocks, transactions and other flows of different enterprises, industries, and countries.

Merger

A merger occurs when two (or more) companies agree to merge into a new single company rather than remain separated for creating business synergies.

Multi-territory enterprise

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

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Nomenclature générale des activités économiques dans les Communautés européennes (NACE) The *Nomenclature générale des activités économiques dans les Communautés européennes* (NACE) is the industry classification of the European Communities (see also ISIC).

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

Non-profit institution (NPIs) Non-profit institutions (NPIs) are legal or social entities, created for the purpose of producing goods and services, whose status does not permit them to be a source of income, profit, or other financial gain for the units that establish, control, or finance them. The motives leading other institutional units (persons, corporations, or governments) to create NPIs are different to those for creating an institution with a profit motive. By convention they produce only individual services but not collective services. The majority of NPIs are non-market producers even though they can be market producers (they are then classified as corporations)

NPIs engaged in non-market production are of two types: *i)* NPIs controlled by governments; and *ii)* NPIs serving households (*i.e.* those providing non-market goods and services to households financed mainly by transfers from non-government sources, namely households, corporations or non-residents).

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

Other accounts receivable/payable Includes advances and deferred payments in respect of exchange of non-produced assets.

Outward direct investment Outward direct investment is investment by a resident direct investor in a non-resident direct investment enterprise; the direction of the influence by the direct investor is "*outward*" for the reporting economy. Also referred to as direct investment abroad.

Partnership Household unincorporated market enterprises also include unincorporated partnerships that are engaged in producing goods or services for sale or barter on the market. The partners may belong to different households. When the liability of the partners for the debts of the businesses is unlimited, the partnerships must be treated as unincorporated enterprises and remain within the household sector since all the assets of the household, including the dwelling itself, are at risk if the enterprise goes bankrupt. However, unincorporated partnerships with many partners, such as some large legal, accounting or architectural firms, are likely to behave like corporations and should be treated as quasi-corporations assuming complete sets of accounts are available for the partnerships. Partnerships whose partners enjoy limited liability are effectively separate legal entities and, as already noted, are treated as corporations.

Positions FDI positions data indicate the levels of investment at a given point in time. Also referred to as "FDI stocks".

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

Quoted shares See *listed shares*.

Reinvestment of earnings/reinvested earnings Reinvestment of earnings/reinvested earnings refer to earnings on equity accruing to direct investors less distributed earnings, proportionate to the percentage ownership of the equity owned by the direct investor(s). Reinvested earnings are included in direct investment income because the earnings of the direct investment enterprise are deemed to be the income of the direct investor (proportionate to the direct investor's holding of equity in the direct investment enterprise), whether they are reinvested in the enterprise or remitted to the direct investor. Because reinvested earnings are not actually distributed to the direct investor but rather increase the direct investor's investment in its affiliate, an entry that is equal to that made in the direct investment income account but of opposite sign is entered in the direct investment transactions account. In the direct investment income account, this transaction is referred to as "reinvested earnings", while in the direct investment transactions account, this transaction is referred to as "reinvestment of earnings".

Residence The residence of an economic entity (or an institutional unit) is determined on the basis of the *economic territory* with which it has the strongest connection determined by its *predominantcentre of economic* *interest*. While some units may have connections with more than one territory, for statistical consistency, there is a need to attribute a single economic territory based on objective and comprehensive criteria.

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

Reverse investment A direct investment enterprise may acquire financial claims in its direct investor. When such claims are not sufficient to establish a second, separate direct investment (*i.e.* do not qualify for the 10% ownership of voting power), the transactions /positions are referred to as *reverse investment* which are recorded as follows:

- for the economy in which the direct investment enterprise is resident: claims on direct investor;
- for the economy in which the direct investor is resident: liabilities to affiliated enterprises.

Within *reverse investment*, direct investment enterprises may raise loans which they on-lend to their direct investor, or may make loans to their direct investor from their own resources, which is also reverse investment. Such loans should be treated as direct investment debt and be included in the direct investment statistics.

Round-tripping Round-tripping refers to the channelling abroad by direct investors of local funds and the subsequent return of these funds to the local economy in the form of direct investment.

Shell company A shell company is a company that is formally registered, incorporated, or otherwise legally organised in an economy but which does not conduct any operations in that economy other than in a pass-through capacity. Shells tend to be *conduits* or *holding companies* and are generally included in the description of Special Purpose Entities.

Special purpose entities (SPE) Multinational enterprises (MNEs) often diversify their investments geographically through various organisational structures. These may include certain types of Special Purpose Entities. Examples are *financing subsidiaries*, *conduits*, *holding companies*, *shell companies, shelf companies and brass-plate companies*. Although there is no universal definition of SPEs, they do share a number of features. They are all legal entities that have little or no employment, or operations, or physical presence in the jurisdiction in which they are created by their parent enterprises which are typically located in other jurisdictions (economies). They are often used as devices to raise capital or to hold assets and liabilities and usually do not undertake significant production.

An enterprise is usually considered as an SPE if it meets the following criteria:

i) The enterprise is a legal entity,

- ❖ Formally registered with a national authority; and
- ❖ subject to fiscal and other legal obligations of the economy in which it is resident.

ii) The enterprise is ultimately controlled by a non-resident parent, directly or indirectly.

iii) The enterprise has no or few employees, little or no production in the host economy and little or no physical presence.

iv) Almost all the assets and liabilities of the enterprise represent investments in or from other countries.

v) The core business of the enterprise consists of group financing or holding activities, that is – viewed from the perspective of the compiler in a given country – the channelling of funds from non-residents to other non-residents. However, in its daily activities, managing and directing plays only a minor role.

Standard data reporting Standard data reporting is obligatory; also referred to as "core data".

Subsidiary, direct investment enterprise A subsidiary is a direct investment enterprise:

i) in which an investor owns more than 50% of its voting power *i.e.* it is controlled by the investor;

ii) where an investor and its subsidiaries combined own more than 50% of the voting power of another enterprise, this enterprise is also regarded as a subsidiary of the investor for FDI purposes.

Supplemental data reporting Supplemental data reporting is not obligatory but strongly encouraged.

Time of recording Time of recording is the date relevant to a particular data item.

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

Transactions (direct investment) Direct investment transactions are *financial flows* and *income flows* between direct investors, direct investment enterprises, and/or other fellow enterprises. Transactions (flows) provide information for FDI activity within a given period of time.

Transactor principle According to the transactor principle, transactions resulting from changes in claims and liabilities are allocated to the country of residence of the non-resident party to the transaction (the transactor) even if this is not the country of residence of the direct investment enterprise or direct investor. This principle differs from the *debtor/creditor* principle that is recommended by the *Benchmark Definition* as the basis for geographical allocation.

Transfer pricing The transaction value for a good or service between related enterprises may not always reflect market values. *Transfer pricing* refers to this distortion between transaction values and market values. It can be motivated by income distribution or equity injections or withdrawals. Where the distortion is significant and data is available to do so, it is recommended that adjustments be made to remove the impact of transfer pricing.

Ultimate investing country The ultimate investing country is a geographical allocation determining the location of the ultimate source of control of the stocks of inward FDI for a reporting economy. It is recommended to compile, on a supplemental basis, inward FDI positions according to the UIC.

Unlisted shares Unlisted shares are a form of equity that is not listed on an organised or public stock exchange. By their nature, a market valuation estimate is not regularly available for unlisted equity and an approximation to the market value is required to measure direct investment. Several methods for approximating market value are acceptable:

- Recent transaction price.
- Own funds at book value.
- Net asset value.
  - ❖ Including goodwill and intangibles.
  - ❖ Excluding goodwill and intangibles.
- Market capitalization method.
- Present value of expected earnings.
- Apportioning market value of global enterprise group to local operation.

Unquoted shares See *unlisted shares*.

Valuation changes Valuation changes reflect changes in the market value of a position due to exchange rate changes or other price changes.

Volume changes The volume of financial assets and liabilities for an economy can change due to either transactions or other changes in volume. The causes of other changes in volume include debt cancellation and write-offs, liquidations, uncompensated seizure, and reclassifications.

Voting power Generally, ordinary shares provide voting power. While voting power is generally obtained through the purchase of equity, it is possible to have voting power that is not in the same proportion as the equity ownership (for example, "golden shares" have greater voting power than other shares). It is also possible to obtain voting power without purchasing equity (for example, through swaps and repurchase agreements).

Index

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OECD Benchmark Definition of Foreign Direct Investment

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Foreign direct investment (FDI) is a major driver of globalisation. As investment patterns of multinational enterprises become more and more complex, reliable and internationally comparable, FDI statistics are necessary for sound decision making. The *OECD Benchmark Definition of Foreign Direct Investment* sets the world standard for FDI statistics. It provides a single point of reference for statisticians and users on all aspect of FDI statistics, while remaining compatible with other internationally accepted statistical standards.

This edition introduces new analytical data breakdowns and statistical treatments that better reflect the realities of today's world economy. The revised *Benchmark Definition* provides methods for classifying different types of FDI (*e.g.*, mergers and acquisitions, greenfield investments) and for identifying the ultimate investor. The new edition now addresses the uses of FDI statistics, including globalisation indicators, and has a chapter on statistics relating to the activities of multinational enterprises.

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