

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 Affiliates 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).

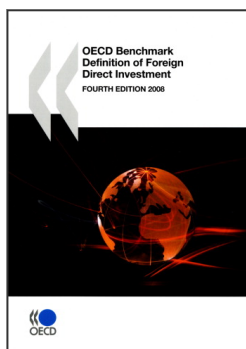
1.5. Organisation of the *Benchmark Definition*

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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