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OECD Benchmark Definition of Foreign Direct Investment
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

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

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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.

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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.

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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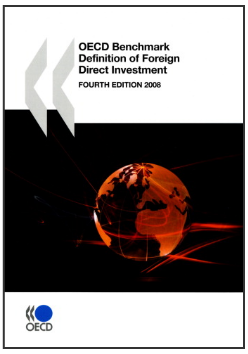

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