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**Foreign Direct Investment (FDI) and Foreign Affiliates Trade Statistics (FATS)
A Proposal for a Plan of Work and Organisation**

Prepared by Eurostat



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Working Group

Balance of Payments

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Quetelet Room, BECH Building
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Foreign direct investment (FDI) and Foreign affiliates trade statistics (FATS)

Proposal for a plan of work and organisation*

* Website: <http://forum.europa.eu.int/Public/irc/dsis/bop/home>

Executive Summary

Member States are asked to approve:

a. the list of points where further work is needed for FDI

b. the following organisation of the work for FDI and FATS:

- Joint ECB-Eurostat TG reporting both to the ECB WG and BOP WG

This TG will be responsible for the work on “Other Capital FDI”, “Reinvested Earnings”, “Valuation of Stocks”. The results of this work will be communicated to the OECD FDI Workshop and Financial Statisticians WGs.

- Eurostat B5-D TG reporting both to the BOP WP and to the FATS WG of Unit D2(Structural Business Statistics).

This TG will be responsible for the work on group relations and related subjects (point 4 below for FDI) and on FATS.

The ECB will be invited to participate in this TG. The results of this work will be communicated to the OECD WGs “Globalisation” and “Trade in Services”.

- The point on activity classification will be treated by the BOP WP in connection with the OECD FDI Workshop.

Foreign direct investment (FDI) and Foreign affiliates trade statistics (FATS)

Proposal for a plan of work and organisation

This document briefly reviews the current situation with respect to FDI and FATS and proposes a possible organisation for the work to be done.

A FDI

There is a list of points that appear to need further analysis and discussion for achieving a common approach among Member States as concerns concepts, definitions and coverage of FDI statistics. Given the importance in this field of international co-ordination and coherence the list given below draws on items already under discussion in other groups, such as the BP&ER WG and the FDI Workshop of the ECB, the OECD FDI Workshop, and the IMF BoP Committee. A main source is the survey on methodological standards for FDI carried out by the OECD and the IMF (latest revision presented at the FDI Workshop of the OECD held in May 2001). It is proposed that a technical group jointly managed by Eurostat and the ECB should take charge of the work involved in respect to the first three points (other capital direct investment, reinvested earnings and valuation of stocks). The work on group relations, the application of the fully consolidated system and Ultimate Beneficial Owner will be done by another technical group set up by Eurostat and jointly managed by Unit B5 and Directorate D (units D2 – structural business statistics - and D1 – business register). The point on the activity classification will be treated directly by the BoP Working Party in co-ordination with the OECD FDI Workshop. Co-ordination with other international organisations on all subjects will work through the OECD FDI Workshop.

1. The treatment of *Other capital* FDI

In particular: the inclusion of trade credits, of financial leasing and of bonds and money market instruments; the application of the directional principle; the treatment of financial derivatives; the treatment of transactions and positions when financial intermediaries are involved.

As concerns the last point mentioned, at the latest meeting of the OECD FDI Workshop (May 2001) it emerged that the treatment recommended by the IMF and the OECD¹ is possibly not applied in the same manner among Member States. Some Member States representatives also expressed doubts about the principle itself and about its correct interpretation.

2. The extent of recording and principles used for *Reinvested earnings*

In order to harmonise the treatment of this item in the various countries, it is important to follow the evolution of the situation described in the survey on methodological standards for FDI carried out by the OECD and the IMF.

The differences that emerged there are related to the coverage and valuation methods of the statistics on FDI income.

3. Valuation of stocks

The proposal of the ECB to take the stock exchange prices for listed companies and the book value for unlisted companies is considered in the draft of the Eurostat's Regulation². For the definition of book value to be used, see the already advanced discussion in the WG-BP&ER and the related documents.

4. The treatment of indirect FDI relationship, group relations, holdings and SPEs. Geographical breakdown according to the Ultimate Beneficial Owner

The increasing importance and complexity of group relations in contemporary economies makes it difficult for compilers to include in statistics transactions and positions related to indirect FDI relationships. On the other hand, the fact that these relations grow in importance also means that very important amounts are likely to be involved. This concerns particularly reinvested earnings generated by indirectly owned affiliated and transactions and positions between 'fellow affiliated' irrespective of the percent of equity held by these enterprises in each other.

¹ Which has been taken up in the proposed Regulation. See Annex I FDI 3.1.7: Intercompany transactions between affiliated financial intermediaries - including SPEs with the sole purpose of serving as financial intermediaries - recorded under direct investment are limited to those transactions associated with equity capital and permanent debt.

² In the Regulation (Explanatory note - FDI Annex I 3) it is also considered that the ESA95 allows imputation of market value to non-quoted shares based on the quoted shares. In this case it is necessary to take into account differences in liquidity and branch of business between listed and unlisted companies.

Looking at the results of the IMF/OECD Methodological Survey, only 3 Member States declared to apply the Fully Consolidated System, whereas 11 Member States declared to apply it “partially” and one Member State did not reply. The need for harmonisation of principles and practices within the EU is therefore apparent. It is important, in particular, to reach an agreement on a uniform extent of application of the Fully Consolidated System that can be considered as satisfactory and as much as possible in line with international practices.

The point on groups is also tightly related to the possibility of identifying the ultimate beneficial owner (UBO) and its country of residence. In the proposal for the Regulation the geographical allocation by UBO is requested only for FDI stocks in the reporting economy and starting from the reference year 2005. According to the IMF/OECD Survey, 8 Member States already calculate inward FDI stocks with UBO and immediate investor allocation. The potential impact of the UBO reallocation on the Intra/Extra-EU aggregates and on their geographical breakdown should be investigated based on the data already existing for these countries. Existing evidence, such as e.g. United States FDI data and a pilot study conducted with eight Member States in the field of Structural Business Statistics for inward FATS, show that considerable shifting may result from the application of the UBO principle. The important share of *offshore centres* (about 5% of FDI liabilities of the Extra-EU were located in one or another country of this group) suggests the same.

5. Classification by activity

The proposed Regulation introduces the ICFA (ISIC Categories for Foreign Affiliates) classification of activities proposed by the new international Manual on Statistics of International Trade in Services. The ICFA classification extends - with respect to the classification used for the Eurostat/OECD FDI questionnaires - the detail on services activities. It is consistent with the NACE Rev1 and provides a link with the EBoPS classification for ITS. The ICFA classification only contains total Manufacturing, but, given that a certain detail on Manufacturing is already transmitted for FDI by countries according to the Vademecum, the already existing sub-categories of Manufacturing have been added for FDI to form Level 3 of the geographical breakdown.

It should be stressed that data on FDI by activity are becoming increasingly important for policy-making and that requests coming from other users increase as long as data accumulates and series become longer. The implementation of the new breakdown on services (proposed for data as from reference year 2004) will require some discussion and work at the technical level among Eurostat and Member States. For example, whether the activity recorded is the resident or non-resident activity.

6. Organisation

Co-ordination with the ECB and with other international organisation is a very important aspect when conceptual and methodological standards are concerned. A joint ECB/Eurostat technical group on FDI (already planned to start in the first half of 2002) would assure at the methodological level the full co-ordination between

Eurostat and the ECB that is already a characteristic of FDI data transmission according to the proposed Regulation. International co-ordination with other institutions would work through the OECD FDI Workshop.

Taking stock of the already existing work (in particular: the results of the WGBP&ER on valuation of stocks and of the ECB FDI Workshop) the group might need be divided in sub-groups according to the different topics. It would report on its work to the WGBP&ER and to the BoP Working Party. The calendar could be differentiated depending on the topic, taking into account existing differences in the state of advancement and in the work still needed to be done.

As concerns the subject of groups and indirectly owned direct investment enterprises, it was already stressed during previous meetings that the involvement of people working in business statistics (business registers) would be important. The same goes for the Technical Group on FATS proposed to be set up in co-ordination with the business statistics data collection for inward FATS (see below). Although there is not a complete correspondence of the domains covered (in FATS, only directly or indirectly majority-owned affiliates are covered), the problems related to identification of group structures and UBO are in many ways similar for FDI and FATS. Another possibility to be investigated is the use of the results of private commercial databases. For these reasons, it is proposed that this work be done by the newly created technical group on FATS (see below), organised by Eurostat B5 and D2.

The point related to the activity classification only concerns Eurostat (not the ECB). It could therefore be treated outside the technical groups, through the BoP WP and the OECD FDI Workshop.

B FATS

As explained in the proposed Regulation and in its explanatory notes, FATS collect data on the operations of majority-owned foreign direct investment enterprises. They refer to variables such as turnover, employment, number of enterprises, imports/exports, value added, gross fixed capital formation, with geographical and activity breakdowns. As such, FATS are a necessary source of information for any user interested in analysing the effects of foreign direct investment, both for policy purposes and for analytical purposes. The need and demand for FATS data for the EU has very strongly increased since recent years, particularly after the surge in EU FDI that started in 1997 and more generally together with the general debate about the effects and causes of globalisation. The Commission needs FATS data in relation with the General Agreement Trade in Services for conducting the negotiations and following up their results. FATS data are also needed for other policies, such as employment policies.

Admittedly, supply of FATS statistics for the EU has thus far left this increasing demand largely unsatisfied. The fact that data series for the activity of US foreign affiliates exist since many years makes this shortage even more visible. The reasons for this delay appear to be mainly linked to two factors. In the first place, FATS statistics have started being developed relatively recently by most Member States. In

the second place, due to limited budgets and to other existing priorities, resources devoted to FATS have been insufficient. A third element important for inward FATS has to do with the subdivision of work in Member States statistical institutions: in some Member States, it is the Balance of Payments compiler who collects inward FATS, in other it is the Industrial Statistics department. This has clearly made it more difficult to carry on common work at the EU level for the development of these statistics.

The proposal presented here with the regulation takes account of these elements. A medium/long term time-horizon is considered for the actions to be undertaken. The first transmission dates proposed are reference year 2004 for inward FATS and 2005 for outward FATS (data are transmitted at T+18). The details of the work plan involved can be discussed at a later stage, if this general direction of work is accepted.

For inward FATS, Eurostat proposes that full co-ordination with Structural Business Statistics (SBS) is conducted through a new Technical Group on FATS, that would gather all the various units involved in the compilation of statistics at the national and at the EU level. The work of the group would start in 2002 and should also assure coherence with other international organisations such as the OECD. The technical group would examine the various problems involved, including the legal aspects, and propose solutions. The approach is based on the following elements:

- Complete concordance between the two collections at the conceptual/definitional level.
- The SBS collection requires data with very detailed NACE Rev. 1 breakdown by activity. More variables are needed than those required by Units B5. On the other hand, imports and exports are not collected for SBS inward FATS.

From the Balance of payments/Trade in services point of view, the important aspect is in the relations with the geographical and activity breakdowns used for FDI and ITS. On the one hand, the same detail for the geographical breakdown as FDI is required. On the other hand, the activity breakdown (the same as that used for FDI) is simplified and the adoption of the ICFA classification allows for a link with the ITS classification. This also permits to limit confidentiality problems, reducing at the same time the volume of data transmitted. As said above, fewer variables than in SBS are required, but including imports and exports.

Outward FATS only concern the Balance of Payments domain. Here it should be pointed out that not all Member States collect at present outward FATS data, although the number of those who collect data has increased in recent times and Eurostat now receives data from eight Member States. Outward FATS can be treated by a sub-body of the technical group and in co-operation with the OECD, that collects the same information.