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Seventeenth Meeting of the
IMF Committee on Balance of Payments Statistics
Pretoria, October 26–29, 2004

Draft Summary of the Meeting of the OECD Workshop on International Investment Statistics (October 12–13, 2004)

Prepared by the Organisation for Economic Co-operation and Development

WORKSHOP ON INTERNATIONAL INVESTMENT STATISTICS

Draft Summary

12-13 October 2004

1. Adoption of the Agenda

1. The revised agenda of the Workshop on International Investment Statistics (WIIS) was adopted [DAFFE/IME/STAT/A(2004)3/REV1].

2. Approval of the summary record

2. The summary of the WIIS meeting held on 22-24 March 2004 was approved without any amendments [DAFFE/IME/STAT/M(2004)1].

3. Recent FDI Trends and Developments

3. *OECD's analytical work on FDI trends and developments:* The Secretariat presented the types of analytical information required for its on-going work on foreign direct investment (FDI) trends and developments with a view to providing users' perspective to the revision of the *Benchmark Definition of Foreign Direct Investment* (*Benchmark Definition*). In priority two areas were identified as major shortcomings for analysts: inability to segregated financial transactions through Special Purpose Entities (SPEs) and the absence of information on the ultimate beneficiary.

4. *World Investment Report 2004:* The representative from UNCTAD provided a very thorough presentation of the recent *World Investment Report* demonstrating the recent developments which also underlined the user requirements.

4. Revision of the OECD Benchmark Definition of Foreign Direct Investment

5. WIIS considered two documents: "Direct Investment Technical Expert Group (DITEG): Compilation of outcome papers (meeting of 15-17 June 2004) [DAFFE/IME/STAT(2004)22] and Complementary discussion point on issues covered at the first meeting of DITEG" [DAFFE/IME/STAT(2004)22].The group discussed individually outcome papers. The summary of the deliberations is as follows (see Annex 1 for more detailed conclusions):

(i) WIIS maintained, in the definition of direct investment, the current numerical threshold of 10 per cent (as opposed to 20 per cent recommended by the DITEG) and its strict application for statistical purposes to ensure cross-country comparability;

(ii) WIIS postponed the discussion of the "employment criteria" to the discussion on SPEs, in line with DITEG recommendations;

(iii) Pending further clarifications, WIIS endorsed the recommendation of the DITEG that the philosophy of the "Fully Consolidated System" is the most ideal conceptual basis for delineating the FDI relationship. WIIS did not endorse the ranking of alternate methods proposed by the DITEG and postponed the discussion on alternate methods to its April 2005 meeting when additional information will be provided by the OECD Secretariat;

(iv) WIIS endorsed the proposal by the DITEG that SPES should be classified as separate statistical institutional units but stressed that this is only a starting point which, by itself, does not address user problems raised by the current statistical standards relating to SPEs when measuring direct investment. It was also underlined that guidance for improving FDI statistics to address user requirements need to be included in the revised version of the *Benchmark Definition*. WIIS asked the OECD Secretariat to prepare for March 2005 meeting of the DITEG an inventory of SPEs based on national descriptions when there is no legal definition of such entities.

(v) WIIS agreed with DITEG's proposed criteria to identify branches and endorsed the recommendations of the DITEG for the valuation of branches;

(vi) WIIS agreed with the DITEG that the market value is the preferred concept for the measurement of direct investment equity. However, to address the request by compilers for further guidance in methods for approximating market value, in particular for unlisted enterprises, the Secretariat was asked to prepare, in co-operation with the IMF, for April 2005 meeting of WIIS a proposal describing and ranking the various options;

(vii) DITEG did not reach firm conclusions on the complex issue of reinvested earnings.[1] Due to the lack of time required for such a discussion and taking into account that the discussions in other fora on the same subject, WIIS postponed all discussion on reinvested earnings to its meeting in April 2005.

(viii) WIIS agreed that some definitions should be further clarified (see detailed recommendations).

(ix) Delegates were invited to provide by mid-November 2004, written comments on the proposal for bringing together all FDI issues in an appendix to the Balance of Payments Manual.[2]

6. With regard to the proposed outline of the revised Benchmark Definition (see DAFFE/IME/STAT(2004)4/REV1], delegates were invited to provide written comments to the Secretariat by mid-December 2004. The Secretariat will prepare a revised proposal for the April 2005 meeting.

5. Feasibility Study of a Co-ordinated Direct Investment Survey (CDIS)

7. The IMF presented a progress report on the feasibility study of a co-ordinated direct investment survey (CDIS) requested by the IMF's executive board. The objective of the CDIS is (i) to collect comprehensive information, with geographical detail, on the stock of direct investment assets and liabilities for use in the compilation or improvement of international investment position statistics on direct investment capital; and (ii) to exchange the bilateral data.

8. International organizations expressed their support to this initiative. WIIS participants were invited to provide by written procedure their comments to the questions raised in document DAFFE/IME/STAT(2004)23 by mid-November 2004.

1. See Outcome papers #5A and #5B, DAFFE/IME/STAT(2004)21, page 13.

2. See Outcome papers #6 and #19, DAFFE/IME/STAT(2004)21, page 16.

Other business

9. The Secretariat circulated for information the preliminary findings for OECD countries of the IMF/OECD Survey of Implementation of Methodological Standards for Direct Investment (SIMSDI) 2003 [DAFFE/IME/STAT(2004)6].

10. A document by the European Central Bank was circulated for information on "International Accounting Standards and valuation of direct investment equity stocks" [DAFFE/IME/STAT/RD(2004)7]. WIIS comments are welcome before the meeting of DITEG in December 2004.

11. Dates of next meetings

DITEG:

6-9 December 2004, in Washington D.C.

7-11 March 2005, in Paris.

WIIS: *26-29 April 2005, in Paris*

ANNEX 1

DELIBERATIONS OF WIIS ON THE RECOMMENDATIONS OF DITEG (JUNE 2004)

Direct Investment: 10 per cent threshold of voting power/equity ownership, employment[3]

1. Recommendations of Direct Investment Technical Expert group (DITEG):

(i) to maintain the definition that foreign direct investment (FDI) is evidenced when there is a significant degree of influence by the direct investor over the direct investment enterprise;

(ii) to change from 10 per cent to 20 per cent the threshold used in the definition of direct investment; and

(iii) to maintain the strict application of the numerical threshold;

(iv) to defer the considerations for adding an employment criterion to the definition of FDI to a later discussion on Special Purpose Entities;

(v) to further clarify the definition of: "ordinary shares" and "voting rights", "subsidiary", "associate", and "branch".

2 Deliberations of the Workshop on International Investment Statistics (WIIS – of the OECD Investment Committee):

1. WIIS discussed at length the recommendations of the DITEG on the definition of foreign direct investment and agreed

(i) to maintain the current 10 per cent threshold, thus not endorsing the recommendation of DITEG to change the threshold to 20 per cent;

(ii) To maintain the strict application of the 10 per cent threshold with a view to achieving cross-country comparability of FDI statistics,

(iii) To postpone the discussion of the so-called "employment criteria" to the discussion of Special Purpose Entities (SPEs).

(iv) To support the proposal to further clarify the definition of: "ordinary shares" and "voting rights", "subsidiary", "associate", and "branch", in co-ordination with the definitions used for the System of National Accounts (SNA)

Definitions endorsed by WIIS:

> ***Foreign direct investment*** "reflects the objective of obtaining a lasting interest by a resident entity in one economy ('direct investor') in an entity resident in an economy other than that of the investor ('direct investment enterprise'). The lasting interest implies the existence of a long-term

3. DITEG issue #2: outcome paper [DAFFE/IME/STAT(2004)21, page 8] and issues paper [DAFFE/IME/STAT(2004)19/REV1, page 35) and background document [DAFFE/IME/STAT(2004)19/ADD1/REV1, page 47].

relationship between the direct investor and the enterprise and a significant degree of influence on the management of the enterprise. Direct investment involves both the initial transaction between the two entities and all subsequent capital transactions between them and among affiliated enterprises, both incorporated and unincorporated" (§5 OECD *Benchmark Definition*).

Foreign direct investor "is an individual, an incorporated or unincorporated public or private enterprise, a government, a group of related individuals, or a group of related incorporated and/or unincorporated enterprises which has a direct investment enterprise – that is, a subsidiary, associate or branch – operating in a country other than the country or countries of residence of the foreign direct investor or investors" (§6 OECD Benchmark Definition).

Foreign direct investment enterprise is "defined as an incorporated or unincorporated enterprise in which a foreign investor owns 10 per cent or more of the ordinary shares or voting power of an incorporated enterprise or the equivalent of an unincorporated enterprise.

"The numerical guideline of ownership of 10 per cent of ordinary shares or voting stock determines the existence of a direct investment relationship. An effective voice in the management, as evidenced by an ownership of at least 10 per cent, implies that the direct investor is able to influence or participate in the management of an enterprise; it does not require absolute control by the foreign investor" (§7 and §8 OECD *Benchmark Definition*).

3 Underlying arguments for the choice of the numerical threshold:

(i) *Arguments in favour of the 10 per cent threshold which was supported by the majority of the countries:*

a) *To ensure consistency between policy analysis and statistical analysis.* OECD members' practice has been and continues to be the use of 10 per cent threshold in the design of FDI legislations and portfolio investment regulations. It is also a benchmark recommended by the OECD Investment Committee in the context of adherence and compliance with the OECD Code of Liberalisation of Capital Movements (which is binding on members). A change from 10 per cent to 20 per cent would modify the consistency between past and future policy practices and would also complicate the evaluation by governments of their FDI policy performance using data which would not be based on the same definition of investment.

b) *To ensure consistency between tax analysis and statistical analysis:* Countries that tax residents on their worldwide income typically provide foreign tax credits in respect of foreign tax on foreign-source income in order to avoid double taxation. For portfolio investors, double taxation relief is typically limited to foreign withholding tax. In contrast, direct investors are typically provided foreign tax credits in respect of not only foreign withholding tax but also underlying foreign corporate income tax on distributed profits. For most OECD countries that tax residents on their worldwide income, the distinction between portfolio and direct investment is 10 per cent of votes and/or value.

c) *To ensure consistency between trends in corporate governance practice and statistical analysis*: A change from 10 per cent to 20 per cent would not be in harmony with trend changes in ownership structure and corporate governance in OECD countries, which provide for increased accountability of management *vis-à-vis* shareholders in general and enhanced opportunity for minority shareholders to influence management's decisions

d) To ensure consistency with the efforts of emerging economies for implementing FDI statistical systems according to international standards: Training programmes were put in place for these economies recommending the use of 10 per cent. A change in the threshold will slow down training for and the implementation of such systems.

e) To ensure historical consistency in FDI statistics.

(ii) *Arguments in favour of the 20 per cent threshold which was supported by some countries:*

a) *To ensure consistency between International Account Standards (IAS) and FDI statistics*: The IAS recommends the use of 20 per cent or more of the voting power to identify "significant influence". However, the IAS allows a flexible approach as the 20 per cent is not an absolute cut-off. The arguments in favour of adopting a 20 per cent threshold for FDI statistics is solely on practical grounds. The proposal was supported by some countries on the grounds that using for FDI statistics the same threshold used for the IAS will facilitate the task of respondents avoid adding additional reporting burdens. However, it was also recognized that rules for FDI statistics should not be aligned systematically to those of the IAS.

(iii) *Other arguments for 10 per cent or 20 per cent*

a) some other countries indicated that they can produce the statistics either on 10 per cent or 20 per cent basis;

b) a threshold of 10 per cent, as opposed to 20 per cent, will limit the number of exceptional cases which may arise by the strict application of a numerical threshold;

c) any decision on the FDI threshold will have an impact on portfolio investment statistics as well.

d) 10 per cent is one of the world-wide known standards;

e) changing the threshold from 10 per cent to 20 per cent will require substantial efforts to train respondents.

INDIRECT FDI RELATIONSHIP AND ALTERNATIVES TO THE FULLY CONSOLIDATED SYSTEM[4]

Recommendations of Direct Investment Direct Investment Technical Expert group (DITEG):

(i) DITEG recommended that the Fully Consolidated System (FCS be maintained as the conceptual reference in the updated version of the manuals. However, DITEG recognised the difficulty in applying the FCS and the difficulties encountered by reporters to understand its rationale, all the more as it does not coincide with the rules governing the accounting consolidation process.

(ii) As alternative methods, DITEG recommended alternative methods to the FCS as follows:

a) "10/50" per cent method as the closest to the FCS;

b) "10" per cent method as an approximation to the FCS.

(iii) DITEG agreed that the narrow definition limited to direct ownership links should be rejected on the grounds that it would significantly diminish the analytical value of FDI figures.

Deliberations of the Workshop on International Investment Statistics (of the OECD Investment Committee):

WIIS discussed at length the recommendation of the DITEG on indirect FDI relationship and the alternatives to the FCS and WIIS

(i) agreed that the general philosophy of the FCS reflected the most ideal conceptual basis for delineating the scope of the FDI relationship. Nevertheless, WIIS requested additional clarifications on the rules for the implementation of the FCS as well as on the description to the users of the statistics. Pending these clarifications, WIIS endorsed the recommendation of the DITEG;

(ii) agreed on the acceptability of alternative methods "10/50 per cent" method and the "10 per cent" method. However, it deferred the decision for the alternative method(s) which will be included in the *Benchmark Definition* and to deal with it in the drafting phase;

(iii) asked the OECD Secretariat to prepare a documentation to clarify the pending practical questions and to include comprehensive examples and descriptions for it April 2005 meeting;

(iv) agreed to reject the narrow definition related to direct relation only.

4. DITEG issue #3: outcome paper [DAFFE/IME/STAT(2004)21, page 10] and issues paper [DAFFE/IME/STAT(2004)19/REV1, page 43] and background document [DAFFE/IME/STAT(2004)19/ADD1/REV1, page 53].

SPECIAL PURPOSE ENTITIES AND HOLDING COMPANIES[5]

Recommendations of Direct Investment Direct Investment Technical Expert group (DITEG):

(i) SPEs should be recognised as separate statistical units resident in the economies in which they are located in those instances where they are established in different economies from the enterprise that created them.

(ii) The physical presence is not necessary for an SPE to be considered a resident in the economy in which it is incorporated/registered, noting that SPEs should not be "looked through".

(iii) SPEs should be identified separately on the basis of their own national definitions while, realistically, it is not possible to develop an internationally agreed definition within the limited time allowed.

Deliberations of the Workshop on International Investment Statistics (of the OECD Investment Committee):

WIIS discussed at length the recommendation of the DITEG on SPEs and holding companies and agreed that:

(i) SPEs should be recognised as separate statistical units resident in the economies in which they are located in those instances where they are established in different economies from the enterprise that created them. However, WIIS stressed that this is only a first step but does not address the user problems raised for FDI statistics which include SPEs according to current statistical standards.

(ii) The physical presence is not necessary for an SPE to be considered a resident in the economy in which it is incorporated/registered, noting that SPEs should not be "looked through".

(iii) SPEs should be identified separately on the basis of their own national definitions used by national compilers. As a contribution to the work of the DITEG, the OECD Secretariat, in consultation with the WIIS' Management Group, will improve the inventory of SPEs according to the national descriptions when there is no legal definition of such entities. This documentation will be provided to DITEG for its March 2005 meeting.

(iv) WIIS stressed the analytical importance of the issues raised by SPEs in FDI statistics and endorsed the statement that recommendations need to be included in the next edition of the *Benchmark Definition* on how to measure FDI in such a way to reflect user requirements and asked DITEG to pursue this matter.

5. DITEG issue #9: outcome paper [DAFFE/IME/STAT(2004)21, page 17] and issues paper [DAFFE/IME/STAT(2004)19/REV1, page 99] and background document [DAFFE/IME/STAT(2004)19/ADD1/REV1, page 160].

CRITERIA FOR IDENTIFYING BRANCHES[6]

Recommendations of Direct Investment Direct Investment Technical Expert group (DITEG):

(i) DITEG recommended that all the criteria listed in the issues paper are to be considered indicative but none is essential for the existence of a branch:

a) engage in significant production of goods and services;

b) plan to operate the business indefinitely or a long period of time;

c) have a substantial physical presence;

d) maintain a complete and separate set of accounts of local activities (i.e., income statement, balance sheet, transactions with the parent enterprise);

e) pay income taxes to the host country;

f) Receive "funds for enterprise work for the enterprise account".

(i) DITEG agreed that an absence of an income statement and a statement of assets and liabilities would make the collection of data for a branch very difficult.

(ii) The group agreed that physical presence is not required for financial institutions.

(iii) DITEG recommended further clarification of the criteria in the new manuals.

Deliberations of the Workshop on International Investment Statistics (of the OECD Investment Committee):

WIIS reviewed the recommended criteria of the DITEG for identifying branches and agreed that:

(i) all the criteria listed above are to be considered indicative but none is essential for the existence of a branch:

(ii) an absence of an income statement and a statement of assets and liabilities would make the collection of data for a branch very difficult;

(iii) physical presence is not required for financial institutions;

(iv) further clarification of the criteria in the new manuals is useful.

6. DITEG issue #10: outcome paper [DAFFE/IME/STAT(2004)21, page 19] and issues paper [DAFFE/IME/STAT(2004)19/REV1, page 19].

VALUATION OF DIRECT INVESTMENT EQUITY[7]

Recommendations of Direct Investment Direct Investment Technical Expert group (DITEG):

(i) Market valuation is the preferred concept for the measurement of direct investment equity, and that this concept needs to be maintained and stressed in the updated standards.

(ii) International organizations (IMF and OECD) should provide more guidance and information on options for measuring market values, particularly for measuring the market value of equity in unlisted companies. DITEG provided a list of methods but did not go any further for qualifying and/or ranking these methods.

(iii) The broad use of historic cost or acquisition price was rejected.

(iv) Accumulating balance of payments flows to estimate direct investment equity on an annual basis was rejected.

Deliberations of the Workshop on International Investment Statistics (of the OECD Investment Committee):

WIIS reviewed the recommended criteria of the DITEG for valuing direct investment equity and:

(i) Agreed that market valuation is the preferred concept for the measurement of direct investment equity, and that this concept needs to be maintained and stressed in the updated standards.

(ii) Agreed as not acceptable the broad use of historic cost or acquisition price.

(iii) Agreed, in principle, as not acceptable accumulating balance of payments flows to estimate direct investment equity on an annual basis. Nevertheless, WIIS noted that this may be the only possibility offered by developing countries' statistical systems.

(iv) Asked IMF and OECD secretariats to prepare jointly an inventory of methods for approximating market value with special focus on unlisted companies and to propose a ranking of these methods [to be prepared for the April 2005 meeting of WIIS and for the next meeting of the IMF BOPCOM]. The list should find ways and means for accommodating, if possible, the statistical systems of developing countries (see point iii).

7. DITEG issue #1A: outcome paper [DAFFE/IME/STAT(2004)21, page 5] and issues paper [DAFFE/IME/STAT(2004)19/REV1, page 19] and background document [DAFFE/IME/STAT(2004)19/ADD1/REV1, page 5].

VALUATION OF BRANCHES[8]

Recommendations of Direct Investment Direct Investment Technical Expert group (DITEG):

(i) All assets, including intangible assets, should be included in the valuation of branches. The value of a branch is to be defined as being the "sum of all assets, including intangible assets, as well as financial and non-financial assets, less debts and financial derivatives in a liability position".

(ii) The term "net worth of the branch" is not favoured and should be replaced by an alternative term. DITEG did not support the term "net equity" as a replacement but proposed "equity in branches" or "branch equity" as alternatives.

(iii) Acknowledged practical difficulties of identifying ownership of certain intangible assets and agreed that guidance on this issue should be provided in the revised manuals.

Deliberations of the Workshop on International Investment Statistics (of the OECD Investment Committee):

WIIS reviewed the recommendations of the DITEG for the valuation of branches and agreed that:

(i) All assets, including intangible assets, should be included in the valuation of branches. The value of a branch is to be defined as being the "sum of all assets, including intangible assets, as well as financial and non-financial assets, less debts and financial derivatives in a liability position".

(ii) The term "net worth", may be conflicting with its use in the SNA context and expressed its preference for "net asset value" as an alternative terminology.

8. DITEG issue #1B: outcome paper [DAFFE/IME/STAT(2004)21, page 7] and issues paper [DAFFE/IME/STAT(2004)19/REV1, page 3].