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Eighteenth Meeting of the
IMF Committee on Balance of Payments Statistics
Washington, D.C., June 27–July 1, 2005

Principles for Classification by Industry

Prepared by Eurostat

I. DIRECT INVESTMENT TECHNICAL EXPERT GROUP (DITEG)
II. OUTCOME PAPER (DITEG) # 27

April 8, 2005

1. Topic: Principles for classification by industry (according to direct investor or direct investment enterprise).

2. Issues: See DITEG Issue Paper # 27 by Eurostat (December 2004).

3. Recommendations:

(i) From the terminological point of view, DITEG was of the opinion that the methodology should refer to a "classification by industrial activity" rather than to an "industry sector classification". The latter expression, contained in the present methodology, may give rise to confusion with the classification by institutional sector.

(ii) DITEG agreed that the methodology should refer to the categories of the United Nations International Standard Industrial Classification (ISIC). In particular, DITEG was of the opinion that the methodology should recommend, as a minimum requirement, a classification by industrial activity as reflected in ISIC *sections* in force at the time of the data compilation.

(iii) Based on analytical arguments, DITEG agreed to maintain the present recommendation of the methodology, namely that FDI statistics by industrial activity should refer, if possible, to the activity of the direct investment enterprise and to the activity of the direct investor, for both inward and outward statistics. The Group recommended that data be compiled at least according to the activity of the direct investment enterprise in both cases (inward and outward investment).

(iv) Concerning the specific problem of the classification of holding companies, the present FDI methodology in the *Benchmark Definition* recommends that holding companies be considered financial corporations, even though the investments that they hold may be in other industries[1]. Including all holding companies that are SPEs, regardless of the activities that the holding companies' subsidiaries may be involved in, in the financial sector had been rejected by DITEG at its December 2005 meeting[2]. More specifically,

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[1] See the OECD *Benchmark Definition* for FDI, 3rd edition, paragraph 117. This treatment may be compared with *1993 SNA*. Para. 4.100 which indicates that a holding company should be classified as financial "if the preponderant type of activity of the group of corporation as a whole is financial". The inference that could be drawn is that where the predominant activities of the group are non-financial, the holding company should be classified as non-financial. But note that the *SNA* refers here to the classification of the holding company corporation itself, exclusive of its subsidiary corporations, whereas the *BD* refers to the classification of the (consolidated) Direct Investment Enterprise, including subsidiary corporations.

[2] See Outcome paper #9, point 4 (ii), December 2004 DITEG meeting.

DITEG concluded at its December 2004 meeting that, in cases where the holding company owns other companies in its same economy, the "holding company is to be classified according to whichever industrial activity of its subsidiaries dominates in the resident economy. This may result in a holding company being classified as a financial corporation (when most of the group's activities in its same economy are in the financial sector), or as a non-financial corporation (when most of the group's activities in its same economy are in the non-financial sector). Some delegates confirmed this opinion during the March 2005 DITEG meeting, while other delegates were in favour of classifying all Direct Investment Enterprises that contain a holding company at the top of the organizational structure in its country of operation to Financial Intermediation. It was also noted that DITEG, at its December 2005 meeting, had recommended that the definition of "financial intermediation" needed to be modified to take account of the activities of holding companies as their activities may not meet the current definition of financial intermediation.

(v) DITEG also took note that the present discussion on the revision of ISIC, according to the provisional documents available at the time of DITEG meeting (mid-March 2005), may seem to go in the opposite direction as the conclusions of Outcome paper #9 (2). ISIC proposed revision seems to show a preference for classifying "holding companies" in Financial Intermediation irrespective of the activity of the subsidiaries controlled.

4. Rejected Alternatives:

DITEG rejected the proposal of creating in the new methodology a specific list of ISIC activities dedicated to FDI statistics.

5. Questions for the IMF Committee on Balance of Payments (the Committee) and the OECD Workshop in International Investment Statistics (WIIS)

(i) Do the Committee and the WIIS agree that the methodology should refer to a "classification by industrial activity" rather than to an "industry sector classification"? See 3(i) above

(ii) Do the Committee and the WIIS agree that the methodology should recommend, as minimum requirement, a classification by industrial activity as reflected in ISIC? See 3(ii) above.

(iii) Do the Committee and the WIIS agree that FDI statistics by industrial activity should refer, if possible, to the activity of the direct investment enterprise and to the activity of the direct investor, for both inward and outward statistics? See 3(iii)

(iv) In relation to the industrial classification of holding companies, what is the opinion of the Committee and the WIIS with respect to their classification in financial intermediation? That is, should a Direct Investment Enterprise be considered a holding company (and therefore a financial institution) when the corporation at the top of the organizational structure is a holding company, regardless of the activities of the enterprises that it owns in the same resident economy,), or should it be classified to the predominant activity of the rest of the group, resident in the same economy as the holding company? See 3(iv) above.

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IMF COMMITTEE ON BALANCE OF PAYMENTS STATISTICS AND OECD WORKSHOP ON INTERNATIONAL INVESTMENT STATISTICS

DIRECT INVESTMENT TECHNICAL EXPERT GROUP (DITEG)

ISSUES PAPER (DITEG) # 27

PRINCIPLES FOR CLASSIFICATION BY INDUSTRY

(ACCORDING TO DIRECT INVESTOR OR DIRECT INVESTMENT ENTERPRISE)

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DIRECT INVESTMENT TECHNICAL EXPERT GROUP

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I. Current international standards for the statistical treatment of the issue

1. The *BPM5* does not refer to the industrial classification of FDI statistics. The OECD *Benchmark Definition of Foreign Direct Investment (Benchmark Definition)* treats the classification of FDI by industry in paragraphs 48-51, under the title "Industry sector classification".

2. The *Benchmark Definition* recommends that, where feasible, the direct investment enterprise be analysed both by its industrial activity in the host country and by the activity of its direct investor.

3. The *Benchmark Definition* recommends that countries should as a minimum provide an industrial analysis which corresponds to the nine major divisions in the United Nations International Standard Industrial Classification (ISIC).

4. Concerning the activity of the direct investor, the *Benchmark Definition* recommends that the economic activity should be the main activity of the direct investor and all its subsidiaries and related companies in its country of residence.

5. For the activity of the direct investment enterprise, the recommendation of the *Benchmark Definition* is more articulated:

> i) when unconsolidated data exist for directly and indirectly owned direct investment enterprises, the activity should be the main activity of each enterprise for which data are available;

ii) when only consolidated data are available, the activity should be the main activity of the direct investment enterprise and all its subsidiaries and related companies.

6. However, paragraph 117 of the *Benchmark Definition* says that holding companies are considered financial corporations even though the investments that they hold is in other industries.

II. Concerns/shortcomings of the current treatment

7. The use of the term "sector" ("Industry sector classification") can create confusion with the classification by institutional sectors.

8. The reference to the ISIC nine major divisions appears to be incorrect. In the ISIC, the highest level of the structure is called *section*, while the *division* is the second level in the hierarchy of the structure. In the present version of the ISIC (Rev. 3.1) there are 17 sections (from A to Q) and 99 divisions[1].

9. The recommendation to record, where feasible, the activity of both the direct investment enterprise and of its direct investor covers all possible cases. However, in practice, the majority of compilers record the activity of the resident entity (direct investment enterprise, for inward FDI; direct investor, for outward FDI)[2]. As it is said in IMF-OECD (2003, p. 20), this can create difficulties for bilateral comparisons when the activity of the direct investment enterprise is different from the activity of the direct investor.

10. Concerning holding companies, differently from paragraph 117 of the *Benchmark Definition,* ISIC Rev. 3.1 gives two possibilities:

i) class 6599, *Other financial intermediation n.e.c.* (included in section J - Financial intermediation), contains the *activity of financial holding companies*;

ii) class 7414, *Business and management consultancy activities* (included in section K - Real estate, renting and business activities) contains the *activity of management holding companies.*

III. Possible alternative treatments

11. To avoid confusion with the breakdown by institutional sector, it is advisable to change the title to something like "industrial activity classification".

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[1] See the following website: http://unstats.un.org/unsd/cr/registry/regcst.asp?Cl=17&Lg=1. A revision of the ISIC is presently under discussion at the United Nations.

[2] See pages 20-21 in IMF-OECD (2003), and table 14 in Appendix I of the same publication.

12. Alternative possible treatments in respect to the concerns mentioned in points 8-10 are proposed below.

Content of the list of activities to be recommended

13. Reference could be made to "current ISIC sections", as a minimum requirement. Some sections can be excluded, because they are not relevant for FDI: section P (Activities of private households as employers and undifferentiated production activities of private households) and section Q (Extraterritorial organizations and bodies).

14. A supplementary, more specific, list of ISIC activities could be proposed for FDI statistics. For services, a possible reference is the classification ICFA (ISIC Categories for Foreign Affiliates) contained in the *Manual on statistics of international trade in services* (2002, p. 64).

Classification according to the activity of the direct investor or of the direct investment enterprise

15. It is suggested that, as a second priority (after the double classification recommended by paragraph 48 of the *Benchmark Definition)*, the methodology recommend to record the activity of the direct investment enterprise for both inward and outward FDI.

Classification of holding companies by activity

16. It is proposed that:

i) if a holding company owns no enterprise resident in the same country, the holding company is included in class 6599 (*Other financial intermediation n.e.c)*, in section J (Financial intermediation). This proposal is consistent with Outcome paper # 9 and 10 of BOPTEG;

ii) if a holding company owns enterprises resident in the same country, and a main activity of the resident group can be determined, the holding company is classed in the main activity of the group;

iii) if a holding company owns enterprises resident in the same country, and a main activity of the resident group cannot be determined, the holding company is included in class 7414 *(Business and management consultancy activities)*, in section K (Real estate, renting and business activities);

IV. Points for discussion

1. Do DITEG members agree that the Benchmark Definition should refer to the "industrial activity classification", rather than to the "industry sector classification"?

2. Do DITEG members agree that the Benchmark Definition should refer to "current ISIC sections" as a minimum requirement for the classification by industrial activity?

3. Do DITEG members agree that a supplementary classification by industrial activity specific for FDI statistics should be recommended in the Benchmark Definition?

4. Do DITEG members agree that, as a second priority, the Benchmark Definition should recommend to record the activity of the direct investment enterprise for both inward and outward FDI?

5. Do DITEG members agree with the classification by industrial activity proposed in point 16 for holding companies?

References

Balance of Payments Manual, fifth edition (*BPM5),* IMF, 1993.

Benchmark Definition of Foreign Direct Investment (Benchmark Definition), third edition, OECD, 1996

Manual on statistics of international trade in services, United Nations, European Commission, IMF, OECD, Unctad, WTO, 2002.