

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

DIRECT INVESTMENT TECHNICAL EXPERT GROUP (DITEG)

ISSUES PAPER (DITEG) #20

DEFINITION OF FOREIGN DIRECT INVESTMENT (FDI) TERMS

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One objective of the current round of revisions to the fifth edition of the IMF's *Balance of Payments Manual (BPM5)* and the third edition of the OECD's *Benchmark Definition of Foreign Direct Investment (BD3)* is to maintain and strengthen the harmonization of definitions used. While the process to date has witnessed the desire of the various parties to maintain harmonization, the drafting of the revisions to *BPM5* and *BD3* will be undertaken by separate drafting teams, each working under tight deadlines. It will be impossible to have the drafting teams consult with one another on every word. It is therefore important that a process be put in place to identify "key concepts and variables" for which explicit consultation will be required and to establish a process to ensure that the drafting teams and the decision bodies involved can efficiently consult on these key definitions that should be constant across the manuals.

This note addresses some principles and processes that could form the basis for ensuring the harmonization of definitions for FDI.¹

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

Not applicable.

II. Concerns/shortcomings of the current treatment

It has been noted that even when there is general agreement on the definition of the concepts and variables, various manuals and documentation may contain a variety of wordings that can lead to differences in interpretation. There is also a desire to have definitions that are consistent with other statistical manuals such as the SNA93.

There are several glossaries in and out of manuals that provide definitions of many of the terms under consideration. There are differences in the wording of definitions across manuals that need to be resolved. The conflicts may arise due to differences in emphasis in the various sources.

III. Possible alternative treatments

Common definitions in glossaries

The proposition would be to have exactly the same wording for the basic definitions of "key concepts and variables". Any effort to harmonize definitions should assure the use of basic terms in a consistent manner. For example, the definition of resident units is fundamental to all aspects of the balance of payments and FDI as well as the SNA. There should be a common definition of these terms that can be used in any other definition without ambiguity.

This suggests there will be a hierarchy of terms such that more complex terms will depend on the previously established common definitions of simpler terms. For example, in defining the term

¹ This issue has been identified as a DITEG issue but it is also important to other domains in the revision process including the revision of the SNA. Consideration should be given to expanding the scope of this issue to other parts of the process.

direct investment enterprise the use of the word “enterprise” should be fully consistent with the general definition of enterprise in SNA93 and other manuals.

A place to start

The IMF and OECD developed a glossary of FDI terms in preparing the report on the 2001 Survey on the Implementation of Methodological Standards for Direct Investment (SIMSDI) that is published on the IMF and OECD websites². This could provide a starting point for the creation of a FDI glossary that could be included as part of both the next version of the balance of payments manual and of the next version of the *Benchmark Definition*³.

A working group could be established with country members from both drafting teams. It is proposed that this working group would work via e-mail given the already busy schedules of the participants. An e-mail process also has the advantage that a written process allows time for reflection on the subtle differences that come from alternative wording proposals.

The first step would be to identify the key concepts and variables that should have common definitions. As part of this process, it would be useful to identify basic definitions where there is already widespread agreement that would be useful in defining FDI terms e.g. non-resident.

Once a list of terms is defined for common definitions, it would be posted on the relevant IMF, OECD, and DITEG websites and a call for written submissions would be put forward. It is proposed that any suggested definition follow a simple basic format that would provide an explanation of the authors’ rationale for how the proposed definition change improves the existing definition, with explicit reference to other key terms and the glossaries of other principal manuals. (See Annex I.)

Principles to Follow

- * Care should be taken not to define a general term to fit the context but to use the general term to develop the definition of the specific definition. (See Annex II for examples.)
- * A term should not be defined inside the definition of another term.
- * The hierarchy of definitions should be reviewed. Is there a logical flow between one term in the glossary and the use of that term to define other terms – e.g. enterprise, direct investment enterprise? (A practical test would be to substitute the definition of a term into its location in another definition. Does the definition still make sense?)
- * The exclusions, as well as the inclusions, implied by the definitions proposed should be considered. Do sub-classes completely exhaust the general class? Are there cases where it is not clear where to assign a particular transaction or position?

² *Foreign Direct Investment Statistics: How Countries Measure FDI, 2001*. (See reference list for access details.)

³ The glossaries in the two manuals will, of course, each have definitions that go beyond the common FDI terms covered in this note. While the balance of payments glossary will cover subjects beyond FDI, the *Benchmark Definition* glossary will have an extended list of FDI terms needed for the more detailed presentation demanded in the *Benchmark Definition*.

IV. Points for discussion

1. *Should glossaries of FDI terms be included in both the IMF's Balance of Payments Manual and the OECD's Benchmark Definition of Foreign Direct Investment?*
2. *Should the definitions of "key concepts and variables" be identical in the two manuals?*
3. *Should these glossaries use definitions from other manuals such as the SNA93, whenever possible?*
4. *Should a working group be established that includes country members of the drafting teams of both manuals?*
5. *Should the working group on common wording for these definitions function primarily by e-mail?*

References:

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Annex I

An example of a structure for proposing changes to definitions

I. Existing Definition(s)

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*).

II. Points considered in proposal for new definition

1. An incorporated or unincorporated enterprise – does the reference to two specific legal forms clarify or restrict the definition?
 - Economic units can take a wide variety of legal forms and it is important to ensure that we do not inappropriately restrict coverage of the concepts by reference to specific forms.
 - SNA93 has addressed this issue by defining “corporations (including quasi-corporations)” in a broad manner such that it is not a unit’s legal structure, but its economic goal, that determines its classification.
2. Enterprise – this term has a specific definition in SNA93. Is the usage consistent?
 - SNA93 defines “enterprise” as the portion of an institutional unit undertaking production.
 - It also notes that enterprises in the financial, non-financial and NPISH sectors are complete institutional units. Therefore the term “enterprise” and the term “institutional unit” for units in these sectors are synonymous.
3. Given the goal of foreign direct investment is it possible to identify specific types of economic units for which FDI would be defined?
 - Is it accepted that households and government units will never be foreign direct investment enterprises?
 - Is it clear that only non-profit units that are classified to the corporate sectors (financial or non-financial) would be potential foreign direct investment enterprises?
 - If the response is yes to both of these questions then, it follows that foreign direct investment enterprises would only be found in the financial and non-financial corporate sectors of an economy.

III. Proposed definition

Foreign direct investment enterprise is an *enterprise* (institutional unit) in the *financial* or *non-financial corporate sectors of the economy* in which a *non-resident* investor owns 10 per cent or more of the voting power of an incorporated enterprise or has the equivalent ownership in an enterprise operating under another legal structure.

- Words that are themselves well defined or are to be well defined as part of this process should be in italics to highlight the links between the definitions of key concepts and variables.

Annex II

Moving from the general to the specific – examples

Do not redefine a general term in a narrower way:

IMF/OECD Glossary

Quasi-corporations: are enterprises that produce goods and services in an economy other than their own, but do not establish separate legal corporations in the host country. Quasi-corporations that are in a direct investment relationship with the parent enterprise are deemed to exist if:.....(page 157, *Foreign Direct Investment Statistics: How Countries Measure FDI, 2001.*)

SNA Glossary

“Quasi-corporations are unincorporated enterprises that function as if they were corporations, A quasi-corporation may be:

Either an unincorporated enterprise owned by a resident institutional unit that is operated as if it were a separate corporation and whose de facto relationship to its owner is that of a corporation to its shareholders: such as enterprise must, of course, keep a complete set of accounts

Or an unincorporated enterprise owned by a nonresident institutional unit that is deemed to be a resident institutional unit because it engages in a significant amount of production in the economic territory over a long or indefinite period of time.”

(*SNA93*, Paragraph 4.49)

The first definition seems to eliminate the possibility of a quasi-corporation being a direct investor, which was not likely intended.

IMF/OECD Glossary

Market price: is the amount of money that willing buyers would pay to acquire a financial asset from a willing seller. The use of market price for valuation of assets and liabilities is one of the key principles of balance of payments compilation. (page 156, *Foreign Direct Investment Statistics: How Countries Measure FDI, 2001*)

SNA Glossary

Market prices for transactions are the actual price[s] agreed upon by the transactors. (*SNA93*, paragraph 2.68)

The first definition would seem to limit market price only to transactions in financial assets.