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**Borderline Issues Between Direct Investment and Other Types of Investment:  
Responses to BOPCOM-02/35 *Exploring the Borderline Between Direct Investment and  
Other Types of Investment: The U.S. Treatment***

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**BORDERLINE ISSUES BETWEEN DIRECT INVESTMENT AND OTHER TYPES OF INVESTMENT:  
RESPONSES TO BOPCOM-02/35 *EXPLORING THE BORDERLINE BETWEEN DIRECT  
INVESTMENT AND OTHER TYPES OF INVESTMENT: THE U.S. TREATMENT***

**I. INTRODUCTION**

1. At its meeting in October 2002, the IMF Committee on Balance of Payments Statistics discussed the paper *Exploring the Borderline Between Direct Investment and Other Types of Investment: The U.S. Treatment* (BOPCOM-02/35) that was presented by the participant from the United States. The paper identified a number of cases where the borderline between direct investment and portfolio and other types of investment might be unclear, and identified the treatment in the U.S. statistics. Further, the U.S. periodically publishes a supplemental, ownership-based presentation of the current account. This presentation was developed in response to interest in understanding the increasing role and importance of multinational corporations, in particular the growing tendency of these companies to use locally established affiliates to deliver goods and services to international markets.
2. The Committee agreed that this was a useful document and some members undertook to provide written comments.
3. The issues raised and the responses by members of the Committee are given in this paper. Section II provides responses regarding the eight borderline issues identified in the paper, section III provides responses regarding the U.S. supplemental balance of payments current account statement based on an ownership, rather than a residence, basis; section IV identifies other issues raised in the country responses; and section V provides a summary of the responses and asks some questions of the Committee.
4. In addition, BOPCOM-03/46A (tabled) describes more fully the situation in Japan with respect to financial transactions associated with permanent debt with financial affiliates.
5. Country comments are indicated by the country name in square brackets at the beginning of a paragraph.

## II. BORDERLINE ISSUES BETWEEN DIRECT INVESTMENT AND OTHER TYPES OF INVESTMENT

### A. General comments

6. [Chile] In general, I feel that the paper correctly applies the principles of *BPM5* to borderline situations which are not explicitly dealt with in the *Manual*, balancing practical and conceptual aspects. *BPM6* should include examples of the recommended treatment for borderline cases such as those presented in this paper, which require more specific guidance than before. Little room should be left for subjective assessment, in order to promote international consistency. However, it is important to explain the rationale and general principles behind the recommendations, as it is difficult for any manual to anticipate and cover all the cases which countries may face.
7. [France] In preamble we consider that any correction to the FDI account in the balance of payments which would result in a decrease of the net flows of assets or liabilities must be studied carefully. We would recommend caution on this point. However we strongly support any type of decision which would make more consistent the different national practices in order to facilitate the international comparisons.
8. [Hong Kong SAR] We are generally in support of the U.S. treatment on various borderline cases discussed in the paper. For the eight borderline issues discussed in the paper, we consider that all of them are of equal importance and hence similar priority should be accorded in formulating internationally consistent treatments.
9. [Saudi Arabia] The set of guidelines provided in the paper regarding what constitutes a direct investment enterprise or affiliate, is in general satisfactory and practicable.
10. [United Kingdom] We were impressed by this paper and its descriptions of the U.S. treatment of particular types of direct investment. It really does encourage balance of payments compilers to think about the data they are collecting, and whether they are reflecting economic reality and providing analytically useful statistics on direct investment. It also highlights the need to clarify the type of guidance on direct investment that should be included in *BPM6*. The *Manual* could try to cover as many specific arrangements as possible, with precise guidance on the treatment in each particular case. This is likely to be less effective in the longer term as new arrangements become evident and the treatment is uncertain. It may be better to keep the guidance in *BPM6* simple and inclusive, so that all countries are likely to have sufficient data to apply it reasonably consistently and symmetrically. A blanket

"ten percent indicator" (or maybe 50 percent, to keep FDI and FATS consistent) may still be the most practical guidance.

11. [United Kingdom (ctd)] If a country has particular concerns about the treatment in their balance of payments accounts they can present extra detailed breakdowns of the balance of payments components, for example as memorandum items, footnotes, satellite accounts. This would allow their users to interpret the balance of payments data more effectively. Many countries will not have the sort of detailed information about their potential direct investment population (inward and outward) to enable them to apply specific treatments in certain circumstances. In fact memorandum items in the partner country balance of payments might be very useful for them too. Confidentiality or disclosure might be a problem.

## **B. Mutual funds**

12. Investment in mutual funds in the U.S. by nonresidents, regardless of the level of investment, is always treated as *portfolio investment*, not as *direct investment*. Similarly, investment by a U.S. resident mutual fund is usually regarded as *portfolio investment*. *BPM5* is not clear on the treatment of mutual funds.
13. [Chile] In both cases I agree with the U.S. treatment: not considering them as direct investment, regardless of the percentage held by an individual investor. This, mainly on the conceptual grounds that are set out in the paper. For similar reasons, we have adopted this criteria in Chile's BOP and IIP.
14. [France] We do not encounter the same problems as the BEA for recording FDI transactions involving mutual funds. Although very rare, these transactions (direct investment *in* or *by* a mutual fund) are usually correctly reported and recorded as direct investment. There is therefore no reason for excluding them from French FDI statistics in a systematic way.
15. [Japan] *BPM5* does not define what a mutual fund is and only touches about its treatment in paragraph 388. Therefore, the treatment of mutual funds might differ across countries. For example, the IMF's paper, "Mutual Funds and Fund of Funds: Portfolio Investment or Direct Investment? (BOPCOM-01/22)" shows two classifications of these funds and the issue has been discussed at some international conferences. Thus, firstly, it should be necessary to define what is a mutual fund and clarify its characteristics or natures. We also propose to define and clarify not only mutual funds but also other collective investment vehicles such as trusts and investment trusts. Such technical words are used in *BPM5* without special explanations. As domestic laws concerning these collective investment schemes differ across countries, it is necessary to define general conceptual criteria for promoting international consistency of treatment.

16. [Japan (ctd)] We think that collective investment schemes, including mutual funds<sup>1</sup>, should be recognized as Portfolio Investment rather than Direct Investment, regardless of the percentage of ownership, or investment types. It is because those collective investment schemes are temporary investment vehicles or pass-through entities. They are used by investors being interested in gaining short-term investment incomes or capital gains (an asset management) rather than benefits occurring from a long-term managerial control. Referring to paragraph 330 and 361 of *BPM5*, these are characteristics of Portfolio Investment.
17. [Japan (ctd)] The above treatment is expected to be included in the next edition of BPM, which is under preparation. However, further discussions are necessary. Concerning issues include:

How should we treat distressed funds and REIT (real estate investment trust)? In Japan, investment by distressed funds, such as a capital participation by a distressed fund managed by U.S. Ripplewood into Shinsei Bank in Japan, is intended to control an enterprise, and investment by REIT is to manage real estate indirectly. Their controlling or managing attitude in a long-term relationship are characteristics of Direct Investment. Although they are forms of collective investment schemes, they might be classified as Direct Investment based on the percentage of ownership.
18. [Saudi Arabia] It would be advisable to avoid recommending case-by-case treatment. In general, cross-border investment made in a mutual fund or by mutual fund is temporary and no managerial control is exercised by the investors. Therefore, this investment does not qualify to be classified as direct investment, and as such should not be included in direct investment.
19. [South Africa] We agree with the treatment of mutual funds by the United States. Investments in and from mutual funds are mainly undertaken to obtain dividends and capital gains and not to have an effective voice or controlling interest in organizations.
20. [United Kingdom] We agree that it is unlikely that a mutual fund would consider itself to be a Direct Investor in a foreign company, and equally unlikely that cross-border investment in a mutual fund would be for purposes of management or control. It could happen, but the costs to reporters and compilers of identifying the particular cases would be prohibitive. On balance we're inclined to support the general rule that a mutual fund cannot be a DI or DIE. At least that should result in reasonably symmetrical reporting.

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<sup>1</sup> Mutual funds were categorized into public, professional, and private in IMF's paper, *Mutual Funds and Fund of Funds: Portfolio Investment or Direct Investment?* (BOPCOM-01/22)

### C. Trusts

21. The treatment of trusts in the U.S. varies, depending on the type and characteristics of the trust. Trustees are always considered to be independent managers of the trust assets and operations; in no cases are they regarded as owners of the trust assets. Whether or not the trust itself can be a direct investor depends on the nature of the trust and its investments. Rules are in place to determine whether trusts meet the criteria for a direct investment relationship. Trusts are not discussed in *BPM5*.<sup>2</sup>
22. [Chile] I agree that they should be associated to the beneficiaries and not the trustees. We have no experience with them, so cannot provide practical examples.
23. [United Kingdom] This is a relatively weak area in our FDI statistics. We are in the process of tightening up the guidance given on our FDI forms. In theory we follow the same treatment of Trusts as the US - they can be DIs or DIEs. In practice I don't think we always know enough about the circumstances of a trust to ensure the correct treatment. For example we probably would not know if a corporation had set up a trust to convert non-marketable assets into debt securities which it could sell to investors at home or abroad, or the particular reversionary interest of the creator in a trust. So we are not too sure that the guidance is always followed.

### D. Positions between affiliated banks and between affiliated financial intermediaries

24. The U.S. has found the *BPM5* recommendation with respect to *permanent debt* (that the only loan transactions and positions between affiliated banks and between affiliated financial intermediaries recorded as direct investment, other capital be those related to permanent debt) to be very difficult to apply and strongly urged that this recommendation be reconsidered in the updating of *BPM5*.
25. [Chile] Because of the practical difficulty in separating “permanent” and other debt, as well as the other more conceptual reasons stated in the paper (fungibility of funds), it would be better not to classify any debt as direct investment. This coincides with what we have been doing in Chile’s BOP and IIP.

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<sup>2</sup> Nor do the *System of National Accounts 1993* and other macroeconomic statistics manuals discuss trusts adequately. BOPCOM-01/12, *The Legal Structure, Economic Function, and Statistical Treatment of Trusts*, concluded that trusts perform a wide range of economic functions and there is no one straightforward recommendation for their statistical treatment. It also concluded that the legal residence of the trust was that of the trustee, thus making the legal trustee a suitable point for data collection. Finally, it concluded that further work was needed in this area.

26. [France] We do not have in practice difficulties to apply the guidance provided in *BPM5*. It depends on the way these positions are broken down in the financial institutions balance-sheets, and thus on the instructions given by the prudential regulators. In the case of France the banks balance-sheets (so called BAFI documents) are clear enough to distinguish between the cases stressed in *BPM5*. Therefore we would not follow the U.S. recommendation and we would in counterpart make the proposal to undertake a research in order to have a better definition of a permanent debt, which is in France deemed as equivalent to equity capital.
27. [Hong Kong SAR] We concur with the view that it is practically difficult to identify permanently invested capital debt positions between affiliated depository institutions and other financial intermediaries. In the case of Hong Kong, permanently invested capital debt positions between affiliated depository institutions and other financial intermediaries are mainly classified under other investment, rather than direct investment.
28. [Japan] To harmonize the international treatment, it is necessary to discuss whether or not it is rational to continue to record only capital transactions associated with equity investment and permanent debt with financial affiliates under Direct Investment.
29. [Japan (ctd)] We note that most part of initial equity investment provided for a financial affiliate is usually used for some permanent purpose, such as purchasing fixed assets. However, once founded, as Mr. Kozlow says in his paper, almost all of the funds (whether from debt, equity, reinvested earnings or other sources) that a financial affiliate receives are used in its banking-business or an asset management. These transactions could be regarded as Portfolio Investment or Other Investment in nature based on paragraph 372 of *BPM5*. So, reexamining what is Direct Investment among intercompany transactions between financial affiliates and excluding capital transactions associated with permanent debt (or equity investment and permanent debt) might be necessary to show the business realities of Direct Investment. In this context, as well as permanent debt, equity investment other than initial one should be excluded from Direct Investment.
30. [Japan (ctd)] Although the paper shows some extra reasons for excluding permanent debt with financial affiliates from Direct Investment, we could show some other viewpoints for them. For example:
  - i. It was noted that U.S. Government agencies are interested in monitoring the worldwide transactions of debts, regardless of whether certain debt is deemed to permanent. It is highly required to provide useful statistics for users, but it might be possible to provide breakdown data as supplemental information, without changing the definition of Direct Investment for this case.

- ii. Although it was noted that most permanent debt reported to BEA was misclassified, capital transactions associated with permanent debt with financial affiliates can not be ignored in Japan. For example, some banks are collecting funds to boost its capital-adequacy ration (BIS ratio) with permanent debt in Direct Investment relationship.
- 31. [Japan (ctd)] Furthermore, in the case of including capital transactions associated with equity investment and permanent debt under Direct Investment, it might be better to exchange some experiences about how we should define “permanent” and assure the accuracy of reports submitted by direct investors.<sup>3</sup>
- 32. [Saudi Arabia] It will be preferable to exclude all such debt from direct investment. This is so because money is fungible and it is usually impossible for a bank to directly link the sources of funds to its use of those funds, a pre-requisite specified in *BPM5*.
- 33. [South Africa] Although it is difficult to determine whether loans are provided on a permanent basis between these institutions, we feel that it is important that this distinction should be maintained in the Manual. Capital is in many cases provided on a permanent basis between these institutions which is similar in many ways to other forms of direct investment.
- 34. [United Kingdom] We disagree with the U.S. proposal to exclude from FDI all debt between affiliated banks and other affiliated financial intermediaries. U.K. affiliated banks have little difficulty in separating out permanent debt and equity investment from other deposits. We do not advise our reporting banks that there should be a link between such capital transactions and specific "long-term" assets. Perhaps the wording of *BPM5* Paragraph 372 could be amended so that it does not imply this connection. The figures are not insignificant and are related to issues of stability, financial management and long-term interest - all part of the direct investment relationship. U.K. banks have not queried the split, but we have not investigated the figures reported by the counter-party financial intermediary.

**E. Positions between financial intermediaries and affiliated enterprises not principally engaged in financial intermediation**

- 35. For the most part, the U.S. practice is to treat these as direct investment (as recommended in *BPM5*). However, debt transactions and positions between

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<sup>3</sup> BOPCOM-03/46A describes the situation in Japan with regard to financial transactions associated with permanent debt with financial affiliates.



nonfinancial parent companies in the U.S. and their financial affiliates in the Netherlands Antilles are recorded as if the two parties are not affiliated; in particular the debt owed to the affiliates is classified as either portfolio or other investment.

36. [Chile] Regarding the exception to the *BPM5* treatment which is set out in paragraphs 35 to 37 of the paper, it is possible that the suggested treatment create geographical inconsistencies. In the example, this could occur if the European countries whose residents are holders of the bonds, attribute them to the Netherlands Antilles, instead of the U.S. Would they have sufficient information to enable a consistent geographical attribution (classifying them as issued by U.S. residents, so as to be consistent with the U.S. treatment)? What about a possible BOP of the country where the affiliate is located (in this case, the Netherlands Antilles)?
37. [Chile (ctd)] Another inconsistency could arise if the U.S. classifies the borrowing as loans, and the holders of the bonds as portfolio investment holdings. However, if the US classifies the liabilities as bonds, considering the essence of the transaction, there would be consistency in functional classifications.
38. [Chile (ctd)] Another concern is that if the purpose of the Netherlands Antilles affiliates is only, or primarily, to serve as conduits between US corporations and unaffiliated foreign lenders, then it is as if their operations were carried out on behalf of the US corporations, and the case is similar to that of offices that provide trade promotion services and others. In that case, is it correct to record any direct investment at all (when the affiliates are established)?
39. [France] Though understanding that this case could have a significant impact on the FDI account, we would not be in favour of the U.S. proposal, knowing that such operations are less important in France than in the U.S., and that their knowledge seems rather difficult in practice. To deduct the debt positions from FDI as proposed by the BEA is reducing; it seems to us that a clearer definition of the debt to exclude, and more importantly of the cases where such treatment would be applicable, is needed before going along with this proposal.
40. [Saudi Arabia] We would prefer not to recommend exceptional treatment for certain cases. The case like the one cited by the author is sensitive to changes in regulations and tax treaties. Allowing different treatment just because of a change in tax treaties is likely to make the already-agreed guidelines rather weak and pave the way of infiltration of subjectivity and whims in determining the nature of the said financial transaction.
41. [United Kingdom] We can understand the concern, but applying a unilateral exception to international guidance may not be the most appropriate solution. The paper implies that position and transaction data with these financial affiliates are available. We think it would more useful to apply *BPM5* and breakdown the totals

to show the Netherlands Antilles figures in an "of which" row, or put them into explanatory footnotes or memorandum items.

42. [United Kingdom (ctd)] It may be that consideration can be given for including specific guidance on these sorts of arrangements in BPM6. The judgment would have to weigh up the economic relevance and costs of being able to identify and implement the specific guidance. The problem is that there are always likely to be new arrangements springing up and any manual cannot cover them all. Unilateral treatment outside the current manual may well mean the treatment changes relatively frequently, as recognized in Footnote 4. If a country does have a specific issue like this it would be helpful to check what is recorded in the balance of payments of the counterpart country.

#### **F. Shell<sup>4</sup> companies**

43. If the shell company has operations in only one jurisdiction, the U.S. "looks through" the shell company to the physical location (not in line with *BPM5*). If the shell company has physical presence in more than one economy, the U.S. practice is not to "look through."
44. [Chile] The treatment followed by the U.S. seems appropriate.
45. [South Africa] In principle we agree with the U.S. proposal, but we think that the application of this proposal is difficult to apply in practice and could lead to large discrepancies between countries' statistics.
46. [United Kingdom] There are risks of asymmetrical reporting caused by unilateral treatment outside the guidance, and the costs to compilers and reporters in trying to collect detailed information about each particular case would be high. It might be better to keep to the Manual and show the detailed estimates in a breakdown or a footnote.

#### **G. Offices abroad that provide services**

47. Included in this category are offices that provide trade promotion or public relations-type services; manufacturers' sales offices; state tourism and business promotion offices; news bureaus; and stations, ticket offices, and terminal or port

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<sup>4</sup> A business that is formally registered, incorporated, or otherwise legally organized in a foreign country, but that does not conduct any operations in that country.

facilities of an airline or ship operator. These are not treated as direct investment enterprises in the United States' statistics<sup>5</sup>, with two exceptions. First, in the case where a promotion or sales office produces revenue for its own account from goods or services that it provides to unaffiliated foreign persons, it is considered to be a foreign affiliate and is subject to U.S. reporting requirements. Second, where stations, ticket offices, and terminal or port facilities of an airline or ship operator provide services to unaffiliated persons rather than, or in addition to, the airline or ship operator that owns them, they are considered to be affiliates.

48. [Chile] I think that the U.S. treatment is appropriate, and applies a principle similar to the one for agents set out in paragraph 83 of *BPM5*: “ Transactions of agents should be attributed to the economies of principals on whose behalf the transactions are undertaken, and not to the economies of agents representing or acting on behalf of principals”.
49. [United Kingdom] Many of the types of offices described in the paper would probably be included on our register of companies for the FDI inquiry, especially if they employ people who pay income tax. Ticket sales of, say, a foreign airline company are included in Transportation Services and not counted in the FDI statistics. The U.S. treatment does make good sense. This is an area where *BPM6* can be more specific to give reporters and compilers more precise guidance.

## H. Corporate inversions<sup>6</sup>

50. The U.S. shows foreign direct investment in the U.S. by the other economy, and U.S. portfolio investment in the other economy, in line with *BPM5* recommendations. Some users have questioned whether this gives rise to meaningful statistics, and consideration is being given to alternative statistical treatments.
51. [Chile] The ten percent principle is a general convention used to define direct investment relationships. A one-by-one analysis of whether there is an influence in management to determine whether there is a direct investment relationship would incorporate subjective criteria and could lead to inconsistent results. This general rule should also apply to corporate inversions.

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<sup>5</sup> In line with *BPM5*, which recommends that transactions of agents for nonresident entities should be attributed to the economies on whose behalf the transactions are undertaken.

<sup>6</sup> In a number of cases, a U.S. corporation has created a new corporation in Bermuda or another low-tax economy, and the resulting corporation has exchanged stock in itself for the outstanding shares of stock in the U.S. corporation that created it.

52. [France] Being faced to such a case in our reporting system we would be theoretically in favour of a separate identification, but the confidentiality rule would prevent us from doing so. Thus we consider that this case does not require a specific treatment.
53. [Saudi Arabia] First, the investments arising from corporate inversions are not common phenomena. Second, in such cases, the foreign investment (owning) company does not influence management of the affiliate (i.e. management control is absent) - a prerequisite for a financial transaction to be classified as direct investment. Therefore, it will be preferable not to include such transactions as direct investment.
54. [South Africa] We agree with the views expressed by the United States.
55. [United Kingdom] We have a similar issue here with companies setting up intermediate holding companies in the Netherlands (not Antilles). We do the same as the U.S. - follow *BPM5*. They would be included under our normal data collection process on the FDI inquiry. We have had some queries from users about the impact on the FDI figures. If the issue becomes more significant we would give more explanation, but with the current inquiry it is unlikely we would have sufficient data to give separate estimates.

### **I. Derivatives**

56. The U.S. concurs with the recommended treatment: that financial derivatives should be excluded from direct investment and classified instead to the separate functional category.
57. [Chile] I agree with the U.S. treatment.

### **III. SUPPLEMENTAL BALANCE OF PAYMENTS CURRENT ACCOUNT STATEMENT BASED ON AN OWNERSHIP, RATHER THAN A RESIDENCE, BASIS**

58. The U.S. periodically publishes a supplemental, ownership-based presentation of the current account. This presentation was developed in response to interest in understanding the increasing role and importance of multinational corporations, in particular the growing tendency of these companies to use locally established affiliates to deliver goods and services to international markets. Receipts and payments between telecommunications companies for basic telecommunications services and reinsurance transactions are always classified as unaffiliated services.

59. [Chile] The growing interest in statistics based on ownership (such as for GATS), makes it advisable for BPM6 to consider recommending, as a supplemental item, a split between related-party and unrelated-party transactions, particularly in the case of services. This poses problems such as those singled out in the paper, where conventions may need to be established, in a similar fashion as those currently applied to other types of services. (For example, in the case of freight, where credits record freight associated to exports of goods by resident carriers, and debits, those of imports by nonresident carriers, regardless of whether the goods were sold on a f.o.b. or c.i.f. basis, and thus, of what the actual resident-nonresident transactions were. The rationale is that finally, it is the importers who pay the cost of freight, and that the convention provides uniform valuation of goods and equal and accurate net final results).
60. [Chile (ctd)] I agree with the treatment for telecommunications and reinsurance services, as these are cases in which the recording reflects the ultimate nature of the transactions.
61. [Chile (ctd)] Regarding trade data, it seems a natural extension of the ownership based approach, to recommend supplementary information on related-party goods trade data, although it may be difficult and costly to actually gather the data.
62. [France] We consider that disaggregating trade in goods and in services into trade between affiliated parties and trade between unaffiliated parties may provide useful information for understanding the operations of multinational companies (MNCs). However, we fear that providing this information as supplemental items in the balance of payments accounts will make balance of payments statistics less readable. Besides, information on the trade operations of MNCs is already provided by FATS statistics, although few countries currently compile them. A joint ECB-Eurostat task force on FATS is investigating the subject at the European level. We suggest to wait for its report before deciding to extend the scope of balance of payments statistics.
63. [Hong Kong SAR] On whether related-party goods and services trade statistics be presented as supplemental items in the balance of payments account, we are of the view that such statistics would be useful to major investor economies which have many overseas affiliates engaging in delivering a substantial amount of goods and services to the international market, but relatively less relevant for economies which do not have much involvement in this kind of activities. Given that compilation of such statistics would require compilers to make significant effort to enhance their statistical systems, it would seem more appropriate that such type of statistics, if considered worth compiling, are first developed by major economies only. Other economies would consider their individual circumstances and decide whether it is feasible for them to compile similar statistics.

64. [Saudi Arabia] Usefulness of any improvement in the data collection and presentation can not be denied as long as it is in conformity with the agreed guidelines and is feasible. From the feasibility point of view, it looks rather straightforward to split the trade transaction in goods between related-party and unrelated-party, though it is difficult for services trade especially those related to telecommunication and reinsurance. The difficulty arises due to the fact that in most of the cases such services are provided jointly by a related-party and unrelated party. And there arises a borderline case. It would be better if, to start with, only merchandise trade is taken up for splitting and related-party goods trade data is presented as a supplemental item.
65. [South Africa] We again agree with the United States that such information would be very useful for analytical purposes, but are of the opinion that serious practical problems will be encountered in collecting such statistics. Regarding telecommunications and reinsurance services, we agree with the recommendations made by the United States.
66. [United Kingdom] This type of analysis would be welcomed by our users, but the reporting burden would be high (more instructions on the inquiry forms, visits to companies to explain what we want). We would hope that we can move towards it as we develop FATS for the U.K. If there is time, it would be useful to consider including some suggestions for analysis and presentation in BPM6. The increase in toll processing (mentioned above) will impact of this analysis. Research and Development services between affiliated companies are also becoming a big issue here. The U.S. treatment for Telecommunications Services and Reinsurance Services between affiliates looks sensible, once the framework and the statistics for it are in place.

#### **IV. OTHER COMMENTS ON DIRECT INVESTMENT AND BORDERLINE ISSUES:**

67. [Japan] The classification to direct investment is based on the criterion of percentage of ownership or actual control criterion<sup>7</sup>
- a. Is it rational to continue to apply a criterion based on the percentage of ownership, such as the ten percent criterion, and treat some transactions as exceptions to Direct Investment?

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<sup>7</sup> BPM5 discusses the notions of *lasting interest*, *significant degree of influence*, and *effective voice in management* as describing the direct investment relationship; however it recommends the exclusive use of the ten percent criterion and does not recommend exceptions based on the selective application of these notions.

- b. Is it rational to abolish criterion based on the percentage of ownership and apply an actual control criterion, i.e., classify a certain transaction as Direct Investment or Portfolio Investment according to the actual control situation, regardless of the percentage of ownership?

68. [Japan (ctd)] Merits and demerits of the criterion based on the percentage of ownership and actual control criterion are as follows:

	Merits	Demerits
Criterion based on the percentage of ownership with exceptions	<ul style="list-style-type: none"> <li>• It is useful for the bilateral comparison and cross-country analysis.</li> <li>• Reporting burden is relatively low.</li> <li>• It is not so burdensome for compilers because further investigations or interpretations are not necessary.</li> <li>• It is simple and understandable for users of the statistics.</li> <li>• It is likely to be easier to implement in practice because statisticians only have to define some exceptions.</li> </ul>	<ul style="list-style-type: none"> <li>• It might be possible that transactions, which are actually not Direct Investment, are included in Direct Investment figures.</li> </ul>
Actual control criterion	<ul style="list-style-type: none"> <li>• It is precise because transactions, which are actually Direct Investment, are included in Direct Investment figures.</li> </ul>	<ul style="list-style-type: none"> <li>• It is difficult to harmonize variations of statistical treatments, which differ from country to country.</li> <li>• Reporting cost is relatively high.</li> <li>• It is relatively burdensome for compilers because further investigations or interpretations are necessary.</li> <li>• It is necessary for statisticians to define what is actual Direct Investment. Furthermore, interpretations are necessary for each transaction, which do not fit in the taxonomy of Direct Investment transactions.</li> </ul>

69. [Japan (ctd)] Bilateral comparison and cross-country analysis are believed to be requirements for balance of payments. As stated above, if an actual control criterion were extensively applied, it would be necessary to redefine what is Direct Investment. It would be necessary to (i) define a comprehensive taxonomy of Direct Investment transactions based on the actual circumstances and update it promptly and (ii) apply the taxonomy across countries at the same time. Naturally, it may prove to be impractical at this moment. In other words, it might be more pragmatic to keep applying the criterion based on the percentage of ownership and define exceptions promptly based on specific developments than a comprehensive

reexamination. Furthermore, in case of keeping the criterion based on the percentage of ownership, it would necessary to discuss on the appropriateness of the ten percent level, because it might be necessary to consider the harmonization with International Accounting Standards.

70. [United Kingdom] We have two types of direct investment in our statistics that cause us problems.
71. [United Kingdom (ctd)] We have some parent companies that are major direct investors abroad, and which are jointly owned themselves. For example the parent company has dual residence in that it is incorporated in U.K. and another country and it allocates all its transactions, assets and liabilities in a fixed proportion between those two countries. The theory just about works, but it is difficult to ensure consistent, symmetrical reporting across time and in both countries.
72. [United Kingdom (ctd)] Another issue we are having problems with is toll processing within a group of companies. Typically a parent company sends materials to a foreign affiliate for a specific process which are then returned. The affiliate does not buy or sell the goods but records a service. The problem here is about the statistics collected within the FDI relationship rather than whether or not the relationship is FDI.

## V. SUMMARY AND QUESTIONS FOR THE COMMITTEE

73. Committee members welcomed the paper BOPCOM-02/35 and felt that the issues raised were important and identified areas where the revisions to *BPM5* should provide more detailed guidelines that would better support consistency in national practices. They noted the importance of clear general principles and generally felt that it was unwise for the manual to allow much room for subjectivity in the classification of transactions and positions. Responses also noted the possibility of individual countries presenting extra, more detailed breakdowns of balance of payments components where this would assist users to more effectively interpret balance of payments data. A number of members noted potential problems with confidentiality/disclosure problems.
74. For *mutual funds*, there was general but not complete consensus with the U.S. treatment. France did not see any reason for excluding investment in or by a mutual fund from direct investment. Members re-emphasized that there is a need to clearly define what is meant by the term “mutual fund”<sup>8</sup> and to further investigate other

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<sup>8</sup> This was previously raised in BOPCOM-01/22.



collective investment vehicles such as trusts and investment trusts (including real estate investment trusts). Japan also noted the need for further investigation of distressed funds.

75. For *trusts*, there was no disagreement with the U.S. position.
76. Regarding the U.S. recommendations with respect to *permanent debt positions between affiliated banks and affiliated financial intermediaries*, a number of members noted that the recommendations in *BPM5* were not implemented in their statistics, while others felt that the distinction was important and should be kept in the revised manual. In addition, a general view was expressed that a clearer definition of permanent debt was necessary. Further, Japan proposed an exchange of country experiences regarding the treatment of external debt.
77. Members did not agree with the U.S. practice on the specific exemption (in respect of nonfinancial parent companies in the U.S. and their financial affiliates in the Netherlands Antilles) to the *BPM5* recommendations with respect to *positions between financial intermediaries and affiliated enterprises not principally engaged in financial intermediation*. They felt that specific exemptions of this nature were not appropriate; rather the data could be identified separately within the direct investment component.
78. Regarding *shell companies*, there was no consensus. Several members noted that the U.S. treatment would lead to asymmetric reporting, and that additionally there would be practical implementation problems.
79. There was general agreement to the U.S. proposal relating to *offices that provide trade promotion or public relations-type services; manufacturers' sales offices; state tourism and business promotion offices; news bureaus; and stations, ticket offices, and terminal or port facilities of an airline or ship operator*. The revised manual should be more precise on this topic.
80. Regarding *corporate inversions*, one-by-one decisions would be subjective; most members felt that the U.S. treatment was appropriate. The United Kingdom noted that they had also received queries regarding the impact of this type of activity, but that they are unlikely to have sufficient data to provide separate estimates.
81. For *financial derivatives*, there was agreement that the existing treatment is appropriate.

**Question:** *Should the various borderline issues raised in this paper, and summarized in paragraphs 74--80, be forwarded to the proposed direct investment technical expert group (see BOPCOM-03/40 for information on the proposed technical expert groups)?*

**Question:** *Of these issues, which ones take priority for development work and incorporation in the revised manual for balance of payments and international investment position statistics? Are Committee members able to develop a priority ordering (that might be used to advise the proposed direct investment technical advisory group)?*

82. Members generally felt that it would be useful to consider including in the new manual recommendations for a supplemental, ownership-based presentation of the current account, and noted that this was closely tied to the development of FATS data.

**Question:** *Should recommendations for a supplemental ownership-based presentation be included in a balance of payments manual?*

83. Section IV of this paper reviews the criteria for determining when a direct investment relationship exists and asks whether the present ten percent criterion should remain.

**Question:** *Does the Committee agree that a review of the ten percent criterion is necessary, particularly in the light of the international accounting standards?*

84. Also in section IV, the United Kingdom describes two specific problems.

**Question:** *Does the Committee wish to comment on the situation described by the United Kingdom in paragraph 71? The situation in paragraph 72?*