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Update on the Benchmark Definition of Foreign Direct Investment and Work of the OECD Working Group on International Investment Statistics

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Working Group on International Investment Statistics

UPDATE ON BENCHMARK DEFINITION OF FOREIGN DIRECT INVESTMENT AND WORK OF OECD WORKING GROUP ON INTERNATIONAL INVESTMENT STATISTICS

REPORT BY THE OECD

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This note was prepared by WGIIS Secretariat for 4-7 November 2008 meeting of the IMF Committee on Balance of Payments Statistics.

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UPDATE ON BENCHMARK DEFINITION OF FOREIGN DIRECT INVESTMENT AND WORK OF OECD WORKING GROUP ON INTERNATIONAL INVESTMENT STATISTICS: REPORT BY OECD[1]

1. INTRODUCTION

1. OECD Working Group on International Investment Statistics (WGIIS) held two meetings in 2008, in March and October. As accustomed, these meetings are held in the same week as the parent committee, the Investment Committee and its other subsidiary bodies. The present note was prepared for the attention of the IMF Committee on Balance of Payments Statistics (BOPCOM) to inform delegates of major developments in the work of WGIIS since October 2007.

2. The document reports on the following items:

(i) OECD Benchmark Definition of Foreign Direct Investment, 4th edition (BMD4): From approval to implementation

(ii) Research agenda: Priority items

(iii) Annexes including extracts from various documents.

2. BENCHMARK DEFINITION OF FDI (4TH EDITION): FROM APPROVAL TO IMPLEMENTATION

2.1 BMD4 approval

3. Following its October 2007 meeting, WGIIS was asked to provide comments and/or agree with the draft BMD4 by mid-January 2008. WGIIS Bureau assumed the responsibility of overseeing that a revised version incorporates the amendments proposed by delegations. In addition to editorial changes, the amendments related mainly to: (i) clarifying the treatment of SPEs in various presentations of FDI statistics; (ii) adding a box on the treatment of fellow enterprises in chapter 2; (iii) clarifying the treatment of transfer pricing in Chapter 5; (iv) adding a box on sign convention in Annex 2; (v) improving the description of Framework for Direct Investment Relationship; (vi) improving the questions on mergers and acquisitions type transactions in Annex 9; (vii) improving the description of ultimate investing country in Annex 10; (viii) and including a glossary. A revised draft BMD4taking on board these corrections was circulated at end-February 2008.

4. WGIIS Chair, accompanied by other Bureau members (vice-chairs) and the Secretariat, presented on 26 March the revised draft BMD4 to the Investment Committee which accepted the draft unanimously and without reservation. On the other hand, OECD Statistics Committee was asked to provide by written procedure its opinion by the same date.

[1] This note was prepared by the Secretariat of WGIIS (OECD Directorate for Financial and Enterprise Affairs- Investment Division). It is not intended as a summary record of WGIIS meetings and draws on various documents prepared for the working group.

5. Following the approval by both committees, the final version of BMD4 was submitted to the OECD Council in April. This final draft of BMD4 [C(2008)76] was adopted by the Council on 22 May unanimously and without any reservation when it was also deristricted for dissemination to the public at large. The text of the Council recommendation accompanying BMD4 is included in Annex 1.

6. Electronic versions in official languages of the Organisation, English and French, can be accessed at the OECD web site[2]. Printed versions will soon be available. The Secretariat is currently looking into possible translation into other languages.

2.2 Revision of the Survey of Implementation of Methodological Standards for Direct Investment (SIMSDI)[3]

7. In March 2008 WGIIS reviewed a preliminary revised version of SIMSDI as a first attempt to bring its content into line with BMD4. Most important presentational changes related to the reduction of numerous text boxes for additional comments or future plans as well as repetitions of the same question for inward and outward investment which were added to the 2003 version. Delegates endorsed these amendments which clearly reduced the reporting burden without reducing the quality of the information.

8. While BMD4 is one of the instruments of the OECD, SIMDI is the assessment tool to measure the compliance of countries with these standards. In this respect, WGIIS agreed that the revision of the SIMSDI questionnaire should be finalised in June 2008 with a view to allowing its usage to assess the position of candidate countries vis-à-vis BMD4. The revision was conducted in consultation with WGIIS Bureau for the final approval by WGIIS by written procedure.

9. OECD Member countries will be requested to fill in the revised SIMSDI when they report data for the first time according to BMD4 in 2010. In the meantime, the Secretariat will develop an electronic database with a more robust structure than the previous database designed for 2003 version. New SIMSDI responses will be available at the OECD web site and will serve as metadata for FDI statistics to be disseminated in 2010 and thereafter.

2.3 Implementation of BMD4

10. OECD Council recommends that member countries implement the BMD4 in 2010 for the reference year 2009. This recommendation follows closely the time table agreed by WGIIS.

11. OECD report submitted to BOPCOM meeting of October 2007 enumerates other initiatives related to implementation of BMD4 [BOPCOM-07/04].

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2 See also:
English:http://webdomino1.oecd.org/horizontal/oecdacts.nsf/subject?OpenView&Start=1&Count=1000&Expand=17.2#17.2

French:http://webdomino1.oecd.org/horizontal/oecdacts.nsf/subjectfre?OpenView&Start=1&Count=1000&Expand=17.2#17.2

3 SIMSDI is an OECD exercise while IMF officially withdrew from SIMSDI in 2006 due to resource implications.

3. RESEARCH AGENDA- PRIORITY ITEMS

12. WGIIS reviewed the research agenda included in Annex 13 of BMD4 and identified priorities as follows:

(i) Items complementing Benchmark Definition, 4th edition:

- Extended directional principle
- Issues concerning access to voting power:

(ii) Treatment of multi-territory enterprises:

(iii) Capital in transit

(iv) Globalisation also including:

13. WGIIS agreed that the work on the research agenda items be organised, in most cases, as small electronic discussion groups [EDG] to facilitate the exchange of views and the preparation of reports for the consideration of WGIIS.

3.1 Items complementing Benchmark Definition, 4th edition

Extended directional principle

14. BMD4 recommends that standard and supplemental FDI statistics by partner and by industry classification be compiled according to the directional principle. In addition to reverse investments of direct investment enterprises in their direct investors, the definition of directional principle was extended to include transactions/positions between fellow enterprises.

15. Fellow enterprises are identified on the basis of their relationship by being directly or indirectly influenced by the same enterprise in the ownership chain, as defined by the Framework of Direct Investment Relationship (FDIR). The direction of the influence, and in consequence the direction of the transaction/position, is determined according to the residency of the ultimate controlling parent (UCP) of each entity qualifying as fellow enterprise.

16. UCP is defined as the controlling entity above which there is no other controlling entity according to FDIR. The specific residency of the UCP is not required. It is sufficient for the compiler to know if the UCP is a resident or non-resident and record transactions/positions between these fellow enterprises as outward or inward, as appropriate.

17. If the UCP of the resident fellow enterprise is also resident, its assets and liabilities *vis-à-vis* non resident fellow enterprises are classified as *outward* FDI (the resident UCP is considered to exert control or influence on non resident fellow enterprise through the resident fellow enterprise). In contrast, if the UCP of the resident fellow enterprise is non-resident, its assets and liabilities *vis-à-vis* non resident fellow enterprises are classified as *inward* FDI (the non-resident UCP is considered to exert control or influence on resident fellow enterprise through the non-resident fellow enterprise).

18. The report on *extended directional principle* includes two parts, in line with its mandate:

(i) Refining the examples to identify the direction of investments between enterprises (following the residency of the UCP);

(ii) Conducting numerical studies to verify the existence or not of negative figures as a result of directional principle (the case of French direct investment statistics before and after applying BMD4 recommendations).

19. The mandate of this EDG did not call for any recommendations but was intended to provide clarifications. Only one report was requested for WGIIS review in October 2008. Extracts of the report on main outcomes of the study are included in Annex 2.

20. Notwithstanding the completion of the work of this EDG in 2008, WGIIS welcomes other country studies similar to the one conducted by France, if and when countries are in a position to provide the statistics and their assessment. Such exchange of information will be included in the regular Tour d'Horizon items.

21. In addition, WGIIS recalled that special attention will be devoted to the interpretation of the data resulting from the directional principal as a part of the communication strategy included in the work programme.

Issues relating to access to voting power

22. Ownership of at least 10% of the voting power of a company is necessary to qualify as FDI. According to BMD4, the acquisition of the voting power is understood as being obtained through the purchase of voting shares. However, there is increasing incidence of their acquisition of voting power obtained through derivative instruments. This can enable the investor to have voting influence amounting to 10% or more of the voting power while at the same time actually owning less than 10% of the voting shares. The possible impact of this phenomenon on the compilation and interpretation of FDI statistics needs to be explored and understood, and some practical recommendations are required to enable compilers to address the issue.

23. The research item related to voting power covers acquisition of voting power by means other than direct ownership of voting equity. The executive summary of the interim report presented by the discussion group in October 2008 is included in Annex 3. The final report will be submitted to WGIIS for its March 2009 meeting.

Treatment of multi-territory enterprises

24. BMD4 recommends that in the case of multi-territory enterprises a parent and branch(es) be identified separately if possible and using the principles for identification of branches. If a distinct identification of the parent and branches is not feasible because the operation is so seamless that separate accounts could not be developed, then multi-territory enterprises should be treated as separate enterprises in each of the economies in which they are present with their external assets and liabilities prorated across these economies. No specific guidance is given in BMD4 on how this allocation should be made e.g. whether one of the economies would be identified as the 'parent economy' with the other created entities considered to be 'branches' of this parent entity, or whether other approaches may be useful. Whatever treatment is advanced, further guidance is required on whether any equity positions should be recorded between the created entities, and whether any income flows should be imputed between the entities. As an extension and where relevant, if a decision is made to attribute another economy as the 'parent economy, guidance is also required on how the change in the equity positions (particularly for the economies of the former and new parent, where the changes will not net to zero) should be recorded.

25. There research items related to multi-territory enterprises and the changing identification of the parent is articulated as follows:

(i) Developing methods to identify a parent entity in a multi-territory enterprise, and imputing the consequential equity positions and income flows; and

(ii) Establishing the processes for recording the changes in the identification of the parent entity in a multi-territory enterprise

26. The executive summary of the interim report presented by the discussion group in October 2008 is included in Annex 4. The final report will be submitted to WGIIS for its March 2009 meeting.

3.2 Capital in transit

27. Capital in transit relates to funds that are channelled through an entity acting as an intermediary for cross-border investments of multinational enterprises. The entity that is channelling the funds could be either a Special Purpose Entity (SPE) or an operational subsidiary acting on behalf of a parent.

28. FDI statistics compiled according to the *Benchmark Definition 3rd edition* include capital in transit while transactions/positions are reported for the immediate counterparty disregarding the types of entity. Data including capital in transit demonstrate three major analytical problems: (i) multiple counting of the same capital flows in FDI transactions/positions at the global level; (ii) overstatement of the impact of FDI for the country hosting the intermediary (SPE or operational subsidiary); (iii) distortion of origin and destination of FDI statistics.

29. One of the quality parameters for FDI statistics is their ability to reflect "genuine" FDI. In other words, FDI statistics should provide the correct information on the origin and destination of funds in accordance with the concept of a long-term relationship between the investor and the investee that underpins the motivation of foreign direct investment.

30. Capital in transit was discussed a number of times and from different angles. There are recognised difficulties for segregating such transactions which justifies this research agenda item. In view of methodological and other technical difficulties, BMD4 limited its recommendations to funds passing through SPEs. Instead of taking the transaction approach, the focus was rather put on the type of entity. In other words, the entity that the reporting country would identify as an SPE set up for the purpose of passing the funds. Some examples of SPEs were provided in addition to some general criteria to help compilers identify such entities.

31. WGIIS recommended that the discussion group should focus on;

(i) Identifying all the issues related to capital in transit and preparing a priority list;

(ii) Exploring methods to expand the segregation of resident Special Purpose Entities (SPEs) to the transactions/positions, qualifying as "capital in transit", of all resident entities;

(iii) Exploring possible ways of improving data collection/data estimate methods for looking through non-resident entities, i.e. allocating them to the genuine origin and destination;

(iv) Exploring the use of business registers for additional data information;

(v) Reviewing the criteria of SPEs, if new instruments are put in place by MNEs for their financing structures and keeping in contact with other bodies working on SPEs and their description.

(vi) Exploring synergies with the research work on ultimate investing/host country attribution.

32. The outcome of the work was planned as two interim reports in October 2008 and March 2009 followed by a final report to WGIIS in October 2009 for publication of the results. WGIIS considered a document on Luxembourg's experience for looking through SPEs [corresponding to the first part of point (ii)]. WGIIS postponed the discussion of the EDG report which was circulated belatedly.

33. Regarding the follow-up of the work of this discussion group, WGIIS Bureau is currently considering that it may be useful to review the direction of this work in the light of recent financial developments.

3.3 Globalisation

34. Foreign direct investment statistics and the statistics on the Activities of multinational enterprises (AMNE) are closely related. They both deal with foreign direct investors and foreign direct investment enterprises. Ideally, the two data sets are complementary. While FDI data provides a financial measurement of cross-border investments, AMNEs data will provide its economic measurement based on a number of standard variables. However, in practice, the two data sets have significant inconsistencies in between their methodologies which may distort a correlated analysis of financial and economic measurements.

35. Reconciling the two sets of data is necessary in view of the key role of FDI in globalisation. However, starting from this very general statement not much has been accomplished to date for such a harmonisation. For most of the other research agenda items, at least the bulk of the work and its main direction are determined. With regard to globalisation, all remains to be reviewed and identified before any discussion can be organised and developed

36. Scope of the exercise relates to statistical and analytical reconciliation between FDI statistics and statistics on the activities of MNE. Initially, the coverage of the exercise relate to:

(i) Problem of population

(ii) Harmonisation of the definition of industrial activity: enterprise level or group level

(iii) Cross-border assets/liabilities versus total assets/liabilities

(iv) Definition of direct investment enterprise (including entities such as eg mobile equipment)

(v) Geographical allocation

(vi) Economic definition of FDI stocks

(vii) Hybrid system to identify direct investment relationship;

(viii) Further examining FDI by type with particular emphasis on M&As: divestments resulting from buy-backs; greenfield investment; extension of capital; financial restructuring;

(ix) Explore possible synergies with on-going work on business registers in their development of multinational registers.

37. The nature of this research agenda item is different than the others while it covers a broad range of issues for the reconciliation and interpretation of the two data sets. In this respect, the work is conducted in joint sessions of experts on FDI and AMNE statistics. This network of experts held their

second session on 8 October (see Annex 5 for the agenda). These discussions will continue in 2009 and possibly in 2010.

ANNEX 1
RECOMMENDATION OF THE COUNCIL
ON THE OECD BENCHMARK DEFINITION OF FOREIGN DIRECT INVESTMENT[4]

(Adopted by the Council at its 1175th session on 22 May 2008)

THE COUNCIL,

Having regard to Article 5 b) of the Convention on the Organisation for Economic Co-operation and Development of 14th December 1960;

Having regard to the Resolution of the Council of C(2004)3 and CORR1 on the Terms of Reference of the Investment Committee;

Having regard to the Recommendation of the Council of 27-28 July 1995 concerning the Third Edition of the Benchmark Definition of Foreign Direct Investment [C(95)112(Final)];

Considering that improvements have been achieved in the comparability of data collected on foreign direct investment since the first publication of the OECD Benchmark Definition of Foreign Direct Investment in 1983 but that however divergences still exist between the methodologies used by some Member countries and the methodology of the Benchmark;

Recognising the desirability of ensuring that the methodology of the Benchmark continues to reflect the reality of foreign direct investment transactions in a globalizing world economy;

On the proposal of the Investment Committee;

I. RECOMMENDS that Member countries continue to take steps to bring their statistical methodology into line with the OECD Benchmark Definition of Foreign Direct Investment and to consider 2010 as a target year for its full implementation, thereby providing a comparable and reliable basis for users of foreign direct investment statistics.

II. INSTRUCTS the Investment Committee, through its Working Group on International Investment Statistics, (i) to continue co-ordinating within OECD the collection of information on international direct investment and multinational enterprises; (ii) to collect and publish at regular intervals stock and flow data on inward and outward foreign direct investment; (iii) to prepare accompanying methodological notes in light of the results of the Survey of Implementation of Methodological Standards for Direct Investment; documenting areas where the methodology used by Member countries differs from the OECD Benchmark Definition; (iv) to take steps for the harmonization and integration of FDI statistics and the statistics on the activities of multinational enterprises to respond to the needs of the analysis of the global economy; and (v) to keep abreast of new developments impacting statistical methodologies, including issues indicated in annex 13 of the OECD Benchmark Definition.

III. DECIDES to repeal the Recommendation of the Council C(95)112(FINAL) referred to above.

4 Reference: C(2008)76

ANNEX 2: EXTENDED DIRECTIONAL PRINCIPLE- EXTRACTS FROM THE REPORT TO WGIIS[5]

2.2 Applying the extended directional principle (ExDP) using FDIR

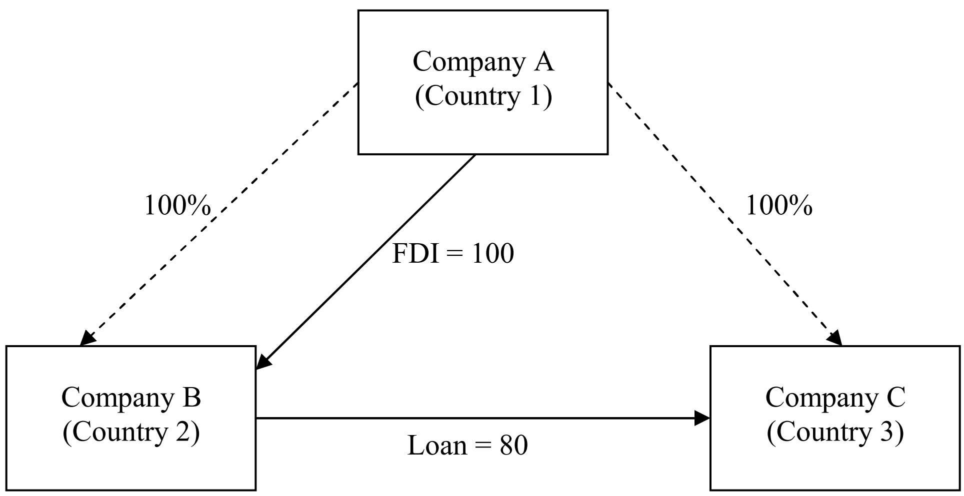
38. The complexity of intra-group financial relations is at the origin of increasing difficulty to understand and interpret FDI statistics. The existence of intermediary financing entities, financing or treasury centre companies may blur the economic analysis of FDI statistics compiled on a strict asset/liability basis. In a simple and ideal world, an increase of assets could be interpreted as an outward investment and an increase of liabilities as an inward investment (and, conversely, a reduction of assets or liabilities would respectively correspond to an outward or inward disinvestment). However, multinational enterprises (MNEs) have accomplished such a high degree of financial integration between their different components that this identification between assets and outward FDI (or between liabilities and inward FDI) is no longer possible. This is one of the reasons why the directional principle has been introduced (in the BMD3) and is extended in the BMD4.

39. To illustrate the impact of the application of the *extended directional principle*, this part of the document will be devoted to practical cases relating to transactions/positions between fellow enterprises which compilers are confronted with every day. Moreover, differences resulting from the application of the *asset/liability principle* or the *extended directional principle* will be highlighted.

2.2.1 Capital in transit

40. Capital in transit consists of the "transfer of funds via structures put in place to facilitate the financing and transfer of direct investment". Fellow enterprises are also part of such structures. Typically, the case of capital in transit involving fellow enterprises is the following: a company A in country 1 fully owns two subsidiaries: B in country 2 and C in country 3. A lends \$100 to B which lends \$80 to C (see Chart 1).

Chart 1. Capital in transit



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5 For the full report see DAF/INV/STAT/(2008)6.

41. According to *asset/liability principle*, country 2 will record $80 in FDI assets and $100 in FDI liabilities.

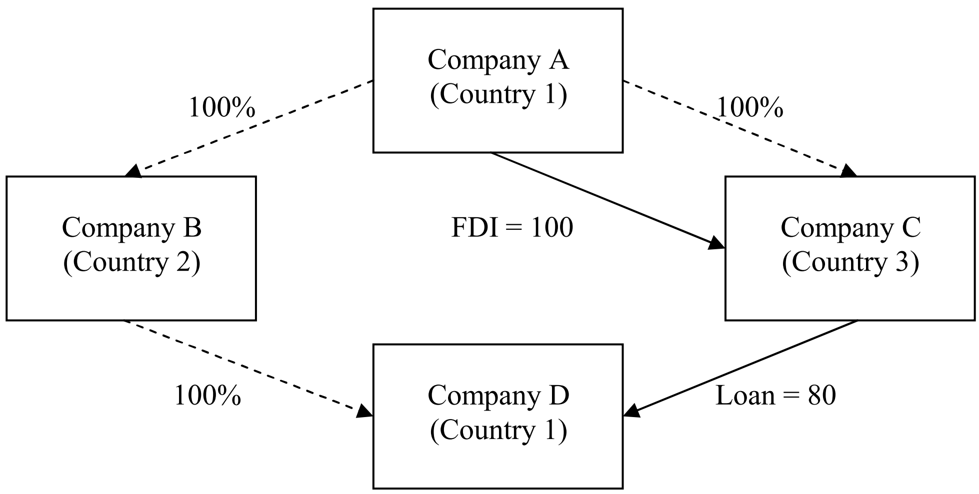
42. According to the *extended directional principle*, the compiler in country 2 has to determine if the UCP of B is resident in country 2 or not. In this case, the UCP of B is A, which is resident in the country 1. So, country 2 will record $100 as (positive) inward FDI (investment) and $80 as (negative) inward FDI (disinvestment). The total inward FDI in country 2 will be positive (investment) and equal to $20.

43. The loan of $80 between B and C is not considered as an outward FDI for country 2 because it does not represent an increase of the control or influence exerted by company B in country 2 on Company C in country 3. On the contrary, it may be analysed as an inward disinvestment since B has been obliged by its UCP to send a significant part of the funds it has received from company A to its fellow enterprise C. The UCP has not injected $180 in its foreign subsidiaries: it has only injected $100, $20 in country 2 and $80 in country 3.[6] In other words, the FDI statistics according to the *extended directional principle* represents the amount of funds injected by the UCP in its overseas subsidiaries.

2.2.2 Round tripping

44. Round-tripping refers to the "channelling abroad by direct investors of local funds and the subsequent return of these funds to the local economy in the form of direct investment". To illustrate, a company A in country 1 fully owns two companies: a company B in country 2 and a company C in country 3. On the other hand, company B fully owns a company D in country 1. A sends $100 to C which lends $80 to D (see Chart 2).

Chart 2. Round tripping



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6 The application of the extended directional principle changes the existing symmetry between inward and outward FDI. In the BMD3, every inward transaction in one country was related to an outward transaction in the counterpart country. In the BMD4, it may happen that the two involved countries both record the same transaction/position in outward (or in inward) FDI. In the 'capital in transit' example, the loan between B and C will be recorded as an inward investment for country 3 and as an inward disinvestment for country 2. At a global level however, the total inward FDI always equals the total outward FDI.

45. According to the *asset/liability principle*, country 1 will record $100 in FDI assets and 80 in FDI liabilities.

46. According to the *extended directional principle*, the compiler in country 1 has to determine if the UCP of D is resident or not. In this case, the UCP of D is A, which is resident in the country 1. So, the country 1 will record $100 as (positive) outward FDI (investment) and $80 as (negative) outward FDI (disinvestment). The total outward FDI in the country 1 will be positive (investment) and equal to $20.

47. The loan between C and D is not considered as an inward FDI for country 1 because it does not represent an increase of the control or influence exerted by country 3 in country 1. On the contrary, it may be analysed as an outward disinvestment since C has been obliged by its UCP to send back a significant part of the money it has received towards the residence country of the UCP. The UCP has only injected $20 in its foreign subsidiaries.

2.2.3 Existence of holding companies and treasury centre companies

48. The existence of holding companies and treasury centre companies is a very common phenomenon that may blur the analytical relevance of FDI statistics based on a strict *asset/liability principle*.

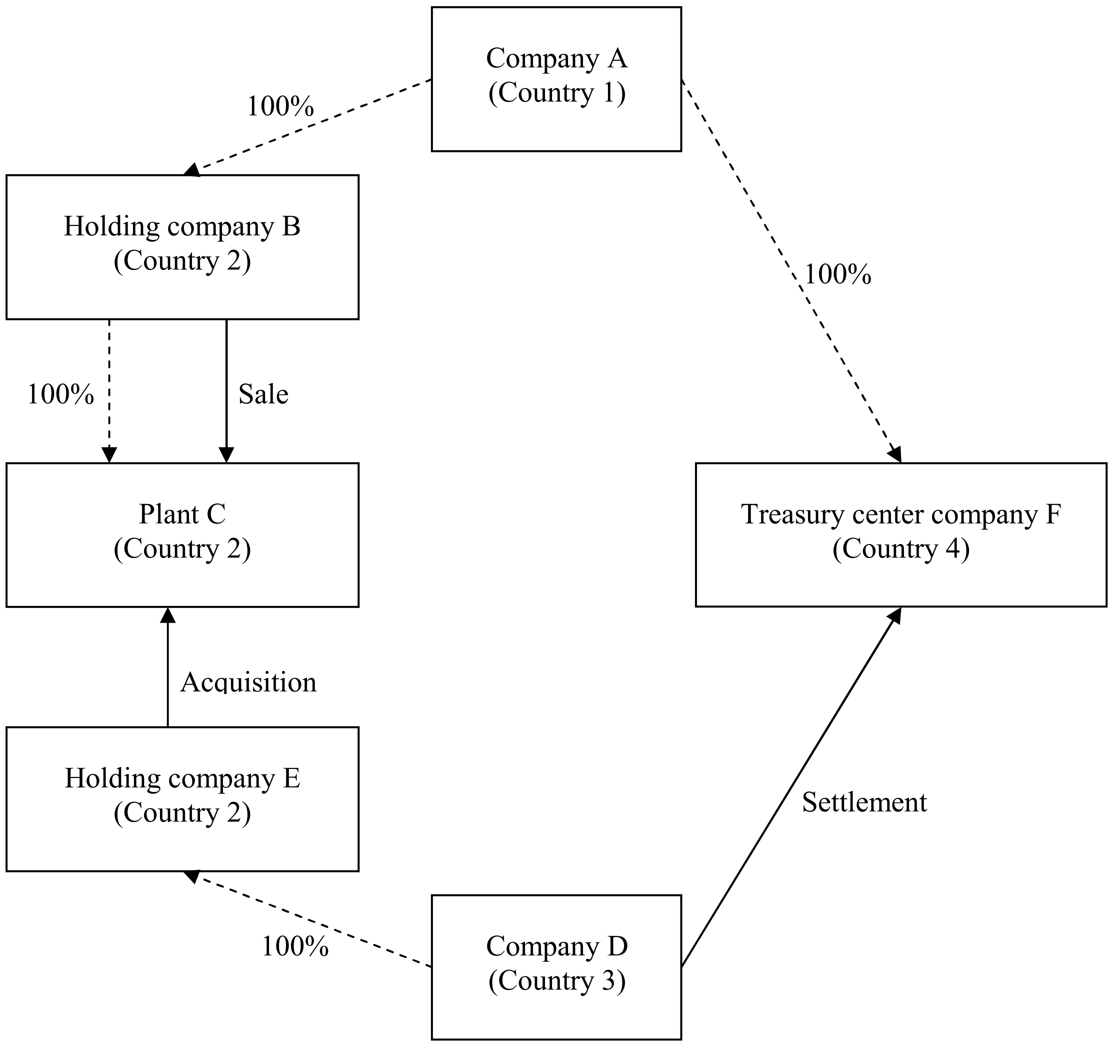
49. To illustrate, a company A (in country 1) fully owns a holding company B in country 2 that fully owns a plant C (in country 2). Company A decides to sell the plant C to another company D, resident in country 3. The price is $100. In order to acquire this plant, company D decides to use an existing holding company E, resident in the country 2. In other words, the holding company B (the genuine former owner) sells the plant C to the holding company E (the genuine new owner). However, the payment of this acquisition is realized by the company D and the funds are received by the treasury centre company F (resident in the country 4) of the companies A and B (see Chart 3).

50. According to the *asset/liability principle*, country 2 will record $100 in FDI assets (claims of the holding company B on the treasury centre company F) and $100 in FDI liabilities (debt of the holding company E *vis-à-vis* its 'mother' company D).

51. According to the *extended directional principle*, the compiler in country 2 has to determine if the UCP of B is resident or not. In this case, the UCP of D is A, which is resident in the country 1. So, country 2 will record $100 as (negative) inward FDI (disinvestment) for the claims of the holding company B on the treasury centre company F. The debt of the holding company E *vis-à-vis* its 'mother' company D is recorded as a (positive) inward FDI (investment).

52. Claims between B and F are not considered as an outward FDI for the country 2 because it does not represent an increase of the control or influence exerted by the country 2 in the country 4. On the contrary, it may (and, clearly in this case, it should) be analysed as an inward disinvestment since B has not been authorized to receive from F the funds from the sale of its own asset. From the point of view of the country 2, an inward investment has been balanced by an inward disinvestment.

Chart 3. Existence of holding companies and treasury centre companies



2.3 Interpreting FDI under the directional principle

53. As explained above, inward and outward FDI clearly have a different meaning as compared with assets and liabilities.

54. FDI liabilities of a country show the total direct investment by non-residents (including non-resident enterprises belonging to a resident MNE) into that country, without any consideration of the position of these non-residents within the involved multi-national groups, and without excluding any capital in transit as shown in section 2.2.1 above. They are however net of any disinvestment from the country by these non-residents.

55. Under BMD4, FDI inward investment reflects the net[7] investment by non-resident direct investors in resident direct investment enterprises, plus the net investment by non-resident enterprises into

7 i.e. net of disinvestment

resident fellow entities having a non-resident ultimate controlling parent (i.e. belonging to foreign groups).[8] In other words, inward FDI is the investment realized by non-resident entities that exert a control or an influence in resident enterprises (non-resident direct investors in resident direct investment enterprises[9] wherever the UCP is, and non-resident fellow enterprises in resident fellow enterprises on behalf of a non-resident UCP).

56. In line with Section 2.2, a further interpretation, possibly more useful to data analysts and policy makers, of inward FDI is that it shows FDI liabilities, excluding (a large part of) capital in transit and round-tripping involving resident non-SPEs.

57. Similar interpretations may of course be given regarding assets and outward FDI.

2.4 Borderline cases

58. The application of the extended directional principle could raise difficulties in some cases. This part, more conceptual than the previous one, is devoted to identifying these special cases. The following examples may not be experienced in practice and, therefore, should be subject to scrutiny by compilers in the future as case studies, should they ever occur. Of course, some new additional 'borderline' cases could also emerge in the future with the development of globalization and financial integration. Hence, we cannot pretend that these examples are fully exhaustive.

2.4.1 Negative values and risk of "deflation" of FDI

59. To illustrate, we can consider a very similar case to the capital in transit example presented above. If we suppose now (see Chart 4) that the loan between B and C is \$120 (instead of \$80), country 2 will record 100 as (positive) inward FDI (investment) and 120 as (negative) inward FDI (disinvestment). The total inward FDI in country 2 will be negative (disinvestment) and equal to \$-20. In that case, it is necessary to clarify the interpretation of these negative figures:

- Conceptually, an inward negative position means that the reporting company has send more funds to affiliated companies than it has received from them. However, that does not mean that the company exerts a control or influence on its affiliates: so, we cannot analyse this case as an outward investment.[10] Moreover, it may be argued that the conceptual agreement to record the loan between B and C as an inward disinvestment in order to reflect the direction of control or influence should be independent of the amount of the loan: in other words, the direction of FDI between fellow enterprises is not defined by the sign of net positions/transactions between them but by the residency of the UCP.

- However, views are divided about the interpretation of negative figures and users could prefer to say that the UCP in country A has invested 20 in country C, and 0 in country B. So compilers

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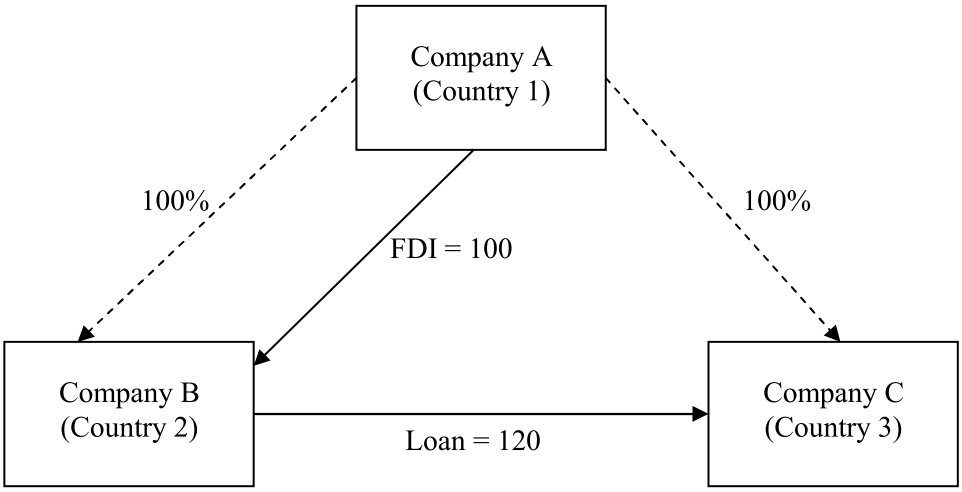
8 This would be net of investment by resident enterprises into non-resident fellow enterprises belonging to foreign groups.

9 When there is a direct FDI relationship between a direct investor and direct investments enterprises, the definition of the direction of control or influence is based on the type of entities involved (the control or influence always go from the direct investor to the direct investment enterprise) and not on the residency of the UCP.

10 However, the attention should be drawn to the fact that a decrease in FDI assets in economy B by a foreign group to obtain cash is, in economic terms, not exactly the same as borrowing funds in country B to invest abroad. This difference could be especially important for the assessment of the attractiveness of a country for foreign companies.

could record, in case of such negative values, an increase in outward investment of 20 (in country B), rather than a decrease in inward investment. However, this approach would imply to monitor, at least once a year, the positive or negative position of each resident entity involved in loans with fellow enterprises,[11] so this solution is regarded as impractical.

Chart 4. Capital in transit: case of larger investment abroad



- In practice, an inward FDI position will be negative only if the reporting company borrows funds from (non-affiliated) banks or in financial markets. If these amounts are important, a substantial share (or almost all) of the assets and liabilities of the enterprise may be raised in another economy, and therefore represent investment in and from other countries. For this reason, in practice, a number of cases of negative values may be related to resident SPEs, which would anyway be presented separately within the standard FDI tables to be reported to the OECD. As a consequence, the number of significant cases of negative values may be expected to be limited, in most countries.

- In addition, compilers could identify, within FDI stocks and yearly transactions whether significant negative positions may be found at the level of individual companies, or, preferably, by group of resident entities having the same UCP.[12] Compilers could disseminate this supplementary information, which could be taken into account by analysts e.g. in the context of analysing attractiveness of a country in terms of FDI, or the overall financing raised by a country in terms of FDI. This identification of negative inward and outward positions has been investigated in the French case: at the end of 2006, there was no negative position in both inward and outward FDI positions for all the entities belonging to a resident or a non-resident UCP.

[11] A negative annual transaction would be identified in cases the outgoing transaction is higher than the inward FDI position recorded for that entity [and other resident entities having the same UCP] at the beginning of the corresponding year.

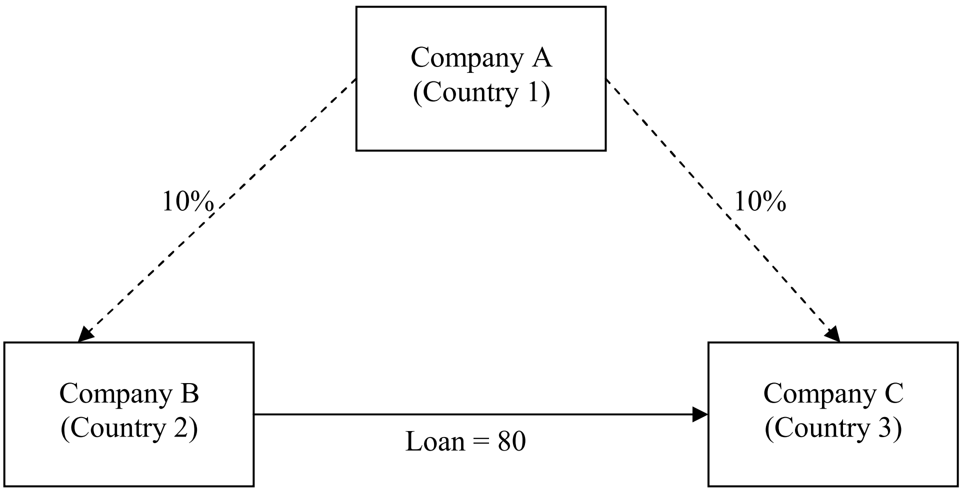
[12] Given that two entities of the same group may have offsetting positions or transactions.

2.4.2 Transactions between fellows that do not have the same ultimate controlling parent

60. In some cases, there may be FDI transactions/positions between two fellow enterprises that do not have the same UCP. What is the impact of the application of the extended directional principle in this case?

61. To illustrate, a company A (in a country 1) owns 10 per cent of company B (in the country 2) and 10 per cent of company C (in the country 3). We suppose that no other direct investor owns more than 10 per cent of the capital of B and C. In other words, B and C are resident in the same country as their own UCP. B lends $80 to C.

Chart 5a. Fellow enterprises with different UCPs



62. According to *asset/liability principle*, the countries 2 and 3 will record respectively $80 in FDI assets and $80 in FDI liabilities.

63. According to the *extended directional principle*, the compilers in both countries have to determine if the UCPs of B and C are resident or not. Since it is the case, the countries 2 and 3 will record respectively $80 as (positive) outward FDI (investment) and $80 as (negative) outward FDI (disinvestment).

64. The loan between B and C is not considered as an inward FDI for the country 3 because it does not represent an increase of the control or influence exerted by the country 2 in the country 3. In theory, it could be analysed as an outward disinvestment since C (that is resident in the same country of its UCP) has received funds from overseas affiliated companies.

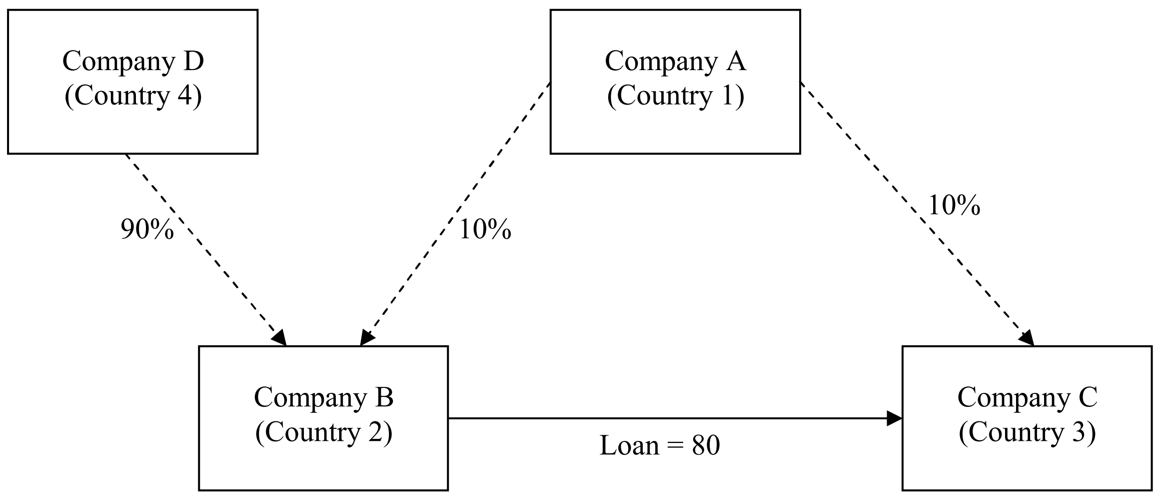
65. The analytical difficulty in this case consists in the fact that the UCP of C has not really invested before in the company B. From this point of view, it is difficult to pretend there may be a disinvestment since there was no (direct or indirect) investment before. The sole ownership link between B and C is established by A, which has no relationship with the UCPs of B and C.

66. However, it must be underlined that the practical relevance of this case should be verified very carefully (in France for example, not a single case like this might be identified). In practice, it could occur when investment funds or private equity funds owns just more than 10 per cent of important multinational

enterprises. But, it is difficult to understand why these non related MNEs could borrow money between themselves. In fact, this case is by definition a 'borderline' case and raises issues not so much on the directional principle but rather than on the definition of the direct investment itself.

67. An interesting variant of this case would be the existence of a non-resident UCP for the company B (see chart 5b). If we strictly apply the recommendations of the BMD4, the UCP of B is the company D; and since the company D is not resident in the residence country of B, the loan between B and C will be classified as a negative inward FDI for the company B.

Chart 5b. Fellow enterprises with different UCPs



38. However, views are divided on the interpretation of this case. The loan between B and C could be analysed as a negative inward FDI for B since B has devoted one part of its funds to finance C instead of investing them in its own business. Conversely, if we interpret the loan between B and C as a positive outward FDI for B, this would mean that this sole loan justifies that B exerts an influence in C.

39. In the same time, enterprise D is not in a direct investment relationship with enterprise C and it may be strange to consider that the loan between B and C is considered as inward for B (based on the influence of D), when it is made to an enterprise unrelated to D. A solution could be to consider that the identification of the UCP of an enterprise should be limited to only those investors that are in a direct investment relationship with <u>both</u> fellows. So, for the loan between B and C, the only enterprises in a direct investment relationship with both B and C are the enterprises A, B, and C. D should not be considered B's UCP for the purposes of this loan, and B would be B's UCP and C would be C's UCP. This gets practically very difficult, as it means that an enterprise could have different UCPs for positions with different enterprises. So, recognising the rarity with which situations like this would occur and the difficulties associated with implementation, the approach recommended by the BMD4 (identify the UCP independently for each fellow) could be allowed as a practical approximation.

3. FDI statistics according to the *extended directional principle* and their interpretation

3.1 Impact of the extended directional principle on the level of FDI statistics

3.1.1 Estimates on the application of the extended directional principle on FDI transaction data

40. The application of the *extended directional principle* has been estimated for the French FDI transaction data since 2000. The results are presented in the Table 1:

Table 1. French FDI transactions according to the BMD3 and the BMD4 since 2000

(in EUR billion)

	2000	2001	2002	2003	2004	2005	2006	2007
Outward FDI (according to the BMD3)	**192,6**	**97,0**	**53,6**	**47,1**	**45,7**	**92,5**	**96,7**	**164,1**
Outward FDI (according to the BMD4)	**180,0**	**67,8**	**33,7**	**19,4**	**24,1**	**56,7**	**54,2**	**87,7**
Equity capital	151,1	60,9	41,4	11,8	25,7	27,6	58,3	56,6
of which Mergers and acquisitions	116,0	41,2	14,8	5,3	6,4	24,9	45,4	51,7
Reinvested earnings	7,8	0,4	-9,6	1,7	10,5	21,7	24,6	27,2
Other capital (according to the BMD3)	33,7	35,6	21,7	33,6	9,5	43,2	13,9	80,4
Other capital (according to the BMD4)	21,1	6,5	1,9	5,9	-12,2	7,5	-28,7	4,0
Inward FDI (according to the BMD3)	**46,9**	**56,4**	**52,1**	**37,7**	**26,2**	**68,3**	**62,3**	**115,4**
Inward FDI (according to the BMD4)	**34,3**	**27,3**	**32,3**	**10,0**	**4,4**	**32,6**	**19,8**	**39,0**
Equity capital	29,9	23,1	36,0	15,1	4,2	18,4	21,8	21,7
of which Mergers and acquisitions	18,8	13,3	19,1	5,1	-5,7	5,7	3,1	5,0
Reinvested earnings	2,6	-2,8	-4,8	-1,9	4,8	14,2	9,6	17,6
Other capital (according to the BMD3)	14,5	36,2	20,9	24,5	17,2	35,7	30,9	76,2
Other capital (according to the BMD4)	1,8	7,0	1,1	-3,2	-4,6	0,0	-11,7	-0,3

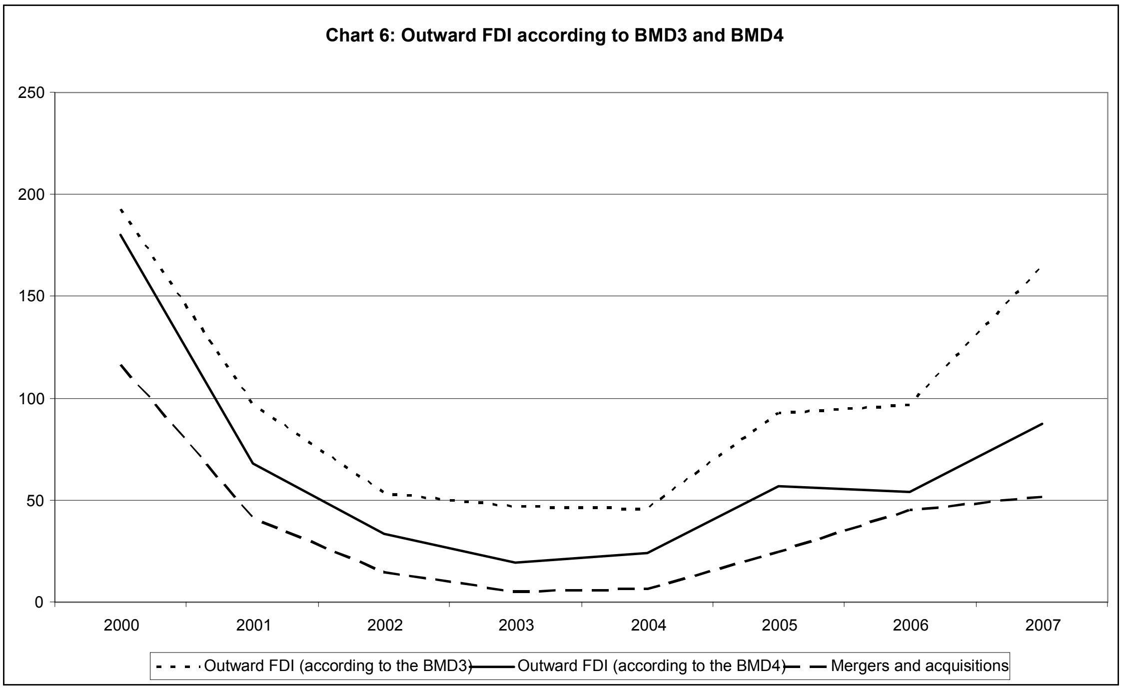
41. For the year 2007, the French outward FDI transaction was €164.1 billion under the BMD3 methodology and amounted to €87.7 billion under the extended directional principle, i.e. a difference of over €76 billion. Inward FDI was correspondingly affected, i.e. €115.4 billion (BMD3) compared to €39.0 billion (extended directional principle). The difference results from the fact that a significant part of French FDI assets *vis-à-vis* foreign fellow enterprises is owned by resident institutional units with a foreign ultimate controlling parent. Moreover, the ultimate controlling parents of some resident institutional units that have liabilities to non-resident fellow enterprises are resident in France.

3.1.2 Interpretation

42. The analysis based on FDI time series established according to the BMD4 is somewhat different from those based on FDI data according to the BMD3.

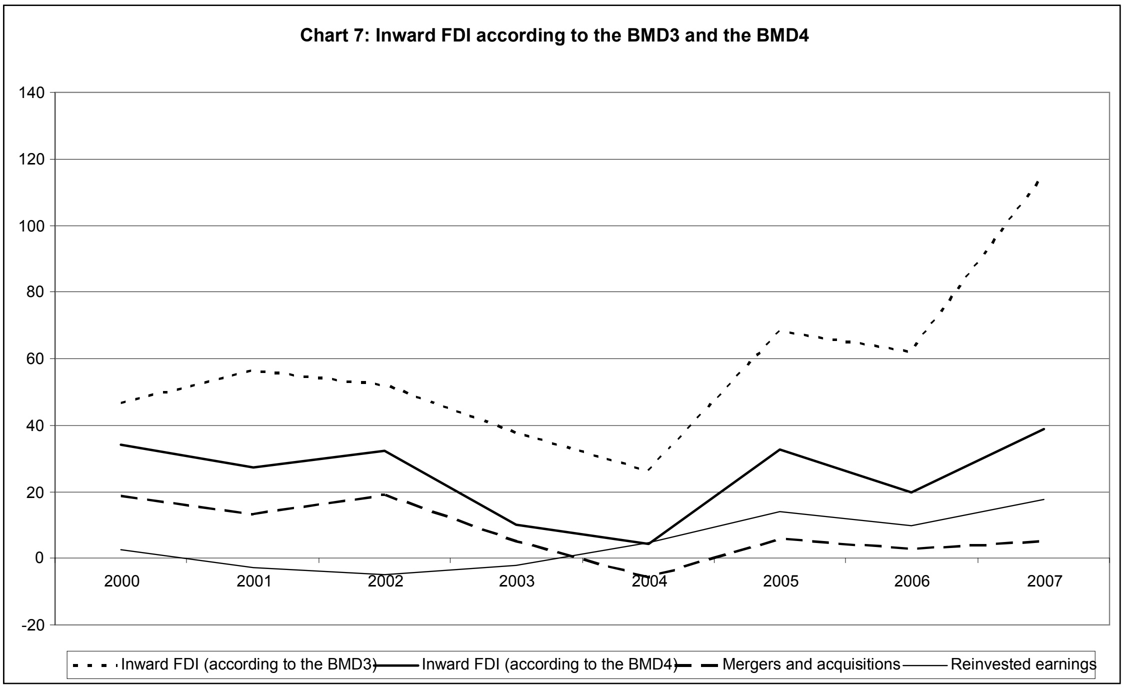
43. According to the BMD3 methodology, French outward FDI have strongly increased since 2004 (see Chart 6). They have almost reached the all-time high levels of the late nineties. During the same period, mergers and acquisitions have increased also, but not that much. The recent rise of French outward FDI is partially unexplained since it cannot be explained entirely by an increase in mergers and acquisitions (or another identified phenomenon).

44. The study of the evolution of the FDI data established according to the *extended directional principle* leads to somewhat different conclusions. First, even if the level of French outward FDI reached in 2007 is high, it is not as high as the level reached in 2000. In other words, the recent rise of French outward FDI is significant, but not as exceptional as the analysis of the data established according to the BMD3 could suggest. Moreover, this increase is very close to the evolution of the cross-border mergers and acquisitions data, which appears as the main explanation of the rise of FDI transactions.



45. A similar analysis may be conducted for inward FDI data (see Chart 7). According to the methodology recommended by the BMD3, French inward FDI would have reached an all-time high level in 2007 (€115.4 billion). This rise is particularly noticeable (and difficult to understand) since trends in mergers and acquisitions in France is rather to decline during the same period. Similarly to the French outward FDI, the recent rise of the French inward FDI would remain partially unexplained according to BMD3 data.

46. Once again, the study of the FDI data established according to the *extended directional principle* leads to slightly different conclusions. If there is clearly a recent rise in the French inward FDI data, it is not as important as the BMD3 methodology could suggest. In fact, the level reached in 2007 is very close to the one reached in 2000. In 2000, mergers and acquisitions in France were at the origin of the high levels of French inward FDI. In 2007, it is no longer the case. In fact, French inward FDI transactions reach high level thanks to reinvested earnings.



3.2 Impact of the extended directional principle on FDI position data

3.2.1 Estimates on the application of the extended directional principle in the French case

47. The application of the *extended directional principle* has been estimated for the French FDI position data for 2005 and 2006. The results are presented in the Table 2.

48. At the end of 2006, the French outward FDI position was €800.9 billion under the BMD3 methodology and amounted to €583.0 billion under the extended directional principle, i.e. a difference of almost €218 billion. Inward FDI was correspondingly affected, i.e. €585.8 billion (BMD3) compared to €367.9 billion (extended directional principle). The difference results from the fact that a significant part of French FDI assets *vis-à-vis* foreign fellow enterprises is owned by resident institutional units with a foreign ultimate controlling parent (€121.7 billion at the end of 2006). Moreover, the ultimate controlling parents of some resident institutional units that have liabilities to non-resident fellow enterprises are resident in France (€96.3 billion at the end of 2006).

Table 2. French FDI positions according to the BMD3 and the BMD4 for 2005 and 2006

(in EUR billion)

	2005	2006
Outward FDI (according to the BMD3)	**736,2**	**800,9**
Outward FDI (according to the BMD4)	**556,0**	**583,0**
Equity (including reinvestment of earnings)	491,4	547,4
Other capital (according to the BMD3)	244,8	253,5
Other capital (according to the BMD4)	64,6	35,5
Resident direct investor in non-resident direct investment enterprises (assets)	41,1	41,7
Non-resident direct investment enterprises in resident direct investor (liabilities)	-3,0	-14,4
Fellow enterprises in other fellow enterprises when the ultimate controlling parent is resident	26,5	8,2
Assets	105,3	104,5
Liabilities	-78,8	-96,3
Inward FDI (according to the BMD3)	**532,4**	**585,8**
Inward FDI (according to the BMD4)	**352,1**	**367,9**
Equity (including reinvestment of earnings)	325,1	349,3
Other capital (according to the BMD3)	207,3	236,5
Other capital (according to the BMD4)	27,1	18,6
Non-resident direct investor in resident direct investment enterprises (liabilities)	34,9	39,6
Resident direct investment enterprises in non-resident direct investor (assets)	-0,8	-1,2
Fellow enterprises in other fellow enterprises when the ultimate controlling parent is non-resident	-7,0	-19,8
Liabilities	94,5	101,9
Assets	-101,5	-121,7

3.2.2 Breakdown by country and by economic activity

49. Table 3 shows the differences in the geographical breakdown of the French outward FDI position at the end of 2006 according to the methodologies recommended by the BMD3 (directional principle) and the BMD4 (extended directional principle).

50. Even if countries of first destination remain more or less the same (the most significant change is the swap for the fourth and the fifth position between Belgium and Germany), it is interesting to note that positions *vis-à-vis* some countries fall dramatically, and notably for Ireland (-60.6%), Luxembourg (-48.3%) and Belgium (-45.1%). Conversely, the outward FDI position is almost not affected for some destination countries like Morocco (-2.4%), Brazil (-2.6%) or China (-3.6%).

51. An important fall in the outward position means that French ultimate controlling parents repatriate significant amounts they have invested in the destination country. If not, there is no change in the outward position.

52. Only two countries have negative outward positions: Jersey (€-0.7 billion) and Bermuda (€-0.2 billion). The economic meaning of these negative figures is that French ultimate controlling parents have repatriate more funds from these countries than they have directly invested in. In other words, French ultimate controlling parents have used the affiliated enterprises resident in Jersey and Bermuda to raise funds on behalf of the group.

Table 3. French outward position data by first counterpart country

(in EUR billion)

According to the BMD3			According to the BMD4			
1	United States	142,3	1	United States	122,4	-14,0%
2	United Kingdom	124,5	2	United Kingdom	93,0	-25,3%
3	Netherlands	90,2	3	Netherlands	56,0	-37,9%
4	Belgium	74,8	4	Germany	45,6	-36,8%
5	Germany	72,3	5	Belgium	41,0	-45,1%
6	Switzerland	37,6	6	Switzerland	26,8	-28,6%
7	Italy	33,7	7	Italy	22,2	-34,1%
8	Spain	30,6	8	Spain	21,5	-29,8%
9	Ireland	18,9	9	Japan	14,9	-6,4%
10	Luxembourg	17,1	10	Canada	13,7	-5,0%
11	Japan	15,9	11	Brazil	9,9	-2,6%
12	Canada	14,4	12	Luxembourg	8,8	-48,3%
13	Brazil	10,2	13	Poland	7,5	-11,0%
14	Poland	8,4	14	Ireland	7,4	-60,6%
15	Norway	6,2	15	Morocco	5,7	-2,4%
16	Sweden	6,0	16	Norway	4,7	-24,0%
17	Morocco	5,8	17	Sweden	4,5	-25,4%
18	Denmark	5,4	18	Australia	4,3	-16,5%
19	Australia	5,1	19	Denmark	4,2	-20,9%
20	Portugal	4,7	20	China	4,0	-3,6%
	Other countries	77,1		Other countries	64,8	-16,5%
	Total	**800,9**		**Total**	**583,0**	**-27,2%**

53. Table 4 shows the differences in the geographical breakdown of the French inward FDI position at the end of 2006 according to the methodologies recommended by the BMD3 (directional principle) and the BMD4 (extended directional principle).

54. Once again, it is interesting to note that positions *vis-à-vis* some countries fall dramatically: it is the case in particular of Ireland (-77.6%), Jersey (-61.1%) and Belgium (-51.9%). This means that a significant part of the liabilities of resident institutional units *vis-à-vis* these countries concerns fellow enterprises controlled by a French ultimate controlling parent.

55. Only one country has negative inward positions: Poland (€-0.2 billion). The economic meaning of this negative figure is that resident fellow enterprises controlled by a foreign ultimate controlling parent have greater assets on Polish fellow enterprises than they have liabilities. In other words, the resident fellows belonging to foreign MNEs have invested more in Polish fellows than they have received investment from Poland.

56. It may be surprising to see that the inward position *vis-à-vis* Luxembourg is relatively less affected. There is only a fall of 14.8 per cent and Luxembourg appears as the third investor in France at the end of 2006 (instead of the fourth position in the ranking based upon the BMD3 methodology). This only means that a great part of the liabilities of resident institutional units *vis-à-vis* Luxembourg concerns fellow subsidiaries controlled by a foreign ultimate controlling parent. But this ultimate controlling parent is not necessarily resident in Luxembourg. We have to note once again that the purpose of the extended directional principle is not to provide a more meaningful breakdown by country but to indicate the genuine

direction of FDI. If compilers want improve the geographical allocation, they have to use "looking through non-resident SPEs" technique or to reallocate positions to the Ultimate investing country (see Annex 10 of the BMD4).

Table 4. French inward position data by first counterpart country

(in EUR billion)

According to the BMD3			According to the BMD4			
1	United Kingdom	92,7	1	United Kingdom	61,2	-33,9%
2	Netherlands	87,4	2	Netherlands	53,2	-39,1%
3	United States	65,6	3	Luxembourg	47,3	-14,8%
4	Belgium	65,1	4	United States	45,7	-30,3%
5	Germany	63,8	5	Germany	37,2	-41,7%
6	Luxembourg	55,6	6	Belgium	31,3	-51,9%
7	Switzerland	33,3	7	Switzerland	22,6	-32,2%
8	Italy	24,2	8	Spain	14,9	-37,9%
9	Spain	24,1	9	Italy	12,7	-47,5%
10	Ireland	14,7	10	Japan	6,4	-13,6%
11	Japan	7,4	11	Canada	4,4	-14,2%
12	Sweden	5,1	12	Sweden	3,6	-29,8%
13	Canada	5,1	13	Ireland	3,3	-77,6%
14	Denmark	4,4	14	Denmark	3,3	-25,6%
15	Portugal	2,7	15	Finland	2,1	-24,0%
16	Finland	2,7	16	Portugal	2,0	-26,0%
17	Austria	2,5	17	Lebanon	1,6	-3,2%
18	Bermuda	2,1	18	Austria	1,5	-39,1%
19	Jersey	2,1	19	Hong Kong	0,9	-29,0%
20	Norway	2,0	20	Jersey	0,8	-61,1%
	Other countries	23,2		Other countries	11,7	-49,5%
	Total	**585,8**		**Total**	**367,9**	**-37,2%**

57. At the present time, France does not yet have the ability to present a breakdown of position data by ultimate investing country. However, we may approximate this breakdown by providing a breakdown by residence country of the ultimate controlling parent. This breakdown is presented in the Table 5. The United Kingdom remains the first investor in France (British ultimate controlling parents control more than 20 per cent of the total inward FDI positions in France), just before the United States. French ultimate controlling parents appear in the third position and are followed by Germany, Switzerland and Belgium. Luxembourg is only at the seventh position of this new ranking. In this case, there is no negative inward position *vis-à-vis* anyone of the residence countries of ultimate controlling parents.

Table 5. French inward position data by ultimate controlling parent

			(in EUR billion)
	According to the BMD4		
1	United Kingdom	74,0	20,1%
2	United States	71,2	19,3%
3	France	45,5	12,4%
4	Germany	40,7	11,1%
5	Switzerland	23,0	6,2%
6	Belgium	20,2	5,5%
7	Luxembourg	16,6	4,5%
8	Italy	15,8	4,3%
9	Netherlands	14,1	3,8%
10	Spain	8,6	2,3%
11	Japan	7,5	2,1%
12	Sweden	3,5	0,9%
13	Portugal	2,4	0,7%
14	Finland	2,3	0,6%
15	Ireland	2,3	0,6%
16	Canada	1,5	0,4%
17	Lebanon	1,4	0,4%
18	Denmark	1,3	0,4%
19	Australia	1,1	0,3%
20	India	1,0	0,3%
	Other countries	14,0	3,8%
	Total	**367,9**	**100,0%**

58. The compilation of the immediate counterpart country and of the residence country of the ultimate controlling parent may help to map the circulation of funds between affiliated companies. Table 6 indicates the immediate origin and destination of $ 100 FDI invested by a foreign ultimate controlling parent. The first counterpart countries are in line and the residence countries of the ultimate controlling parents in column. A positive figure indicates a FDI coming in France, and a negative one, a FDI going out of France.

59. The last line of the table (labelled 'Total'), indicates the amount of FDI that remains in France: since the FDI invested is equal to $100 by construction of the table, the 'Total' line cannot include a figure greater than $100. When the total is significantly inferior to $100, it indicates that a part of the investment coming in France is reinvested in another country.

60. The first diagonal of the table (with figures in bold characters) indicates the investment made by a foreign ultimate controlling parent directly coming from its residence country. One can note that inward FDI does not generally come directly from the residence country of the ultimate controlling parent. Only two countries (Denmark and Spain) are characterized by ultimate controlling parents that send directly more than 95 per cent of their FDI in France.

61. When an US ultimate controlling parent invests $100 in France, only $48 are coming directly from the United States: 18 per cent are coming from Luxembourg, 16 per cent from the Netherlands, 4 per cent from Ireland, another 4 per cent from Spain and 3 per cent from United Kingdom. French subsidiaries of the US ultimate controlling parents are sending 1 per cent of the funds they have received to their affiliated enterprises in Belgium. At the end, 99 per cent of the amount invested by US ultimate controlling parents as FDI remain in France.

Table 6. Origin and destination of a FDI amount of 100 invested by a foreign ultimate controlling parent in France at the end of 2006

	Residence country of the ultimate controlling parent																			
First counterpart country	Australia	Austria	Belgium	Canada	Denmark	Finland	Germany	Ireland	Italy	Japan	Luxembourg	Netherlands	Norway	Portugal	Spain	Sweden	Switzerland	United Kingdom	United States	Rest of the world
Australia	**17**	1	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Austria	0	**79**	0	0	0	0	1	0	0	0	0	0	0	0	0	-2	0	0	0	0
Belgium	2	1	**87**	-1	-2	0	4	1	4	7	14	-3	26	0	-1	18	7	0	-1	-1
Canada	0	0	0	**90**	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Denmark	0	0	0	2	**98**	0	0	0	0	0	0	0	0	0	0	0	0	0	2	0
Finland	0	0	0	0	0	**91**	0	0	0	0	0	0	0	0	0	-2	0	0	0	0
Germany	2	7	0	-23	-5	0	**82**	0	-1	2	4	7	1	0	-1	-4	2	0	1	-1
Ireland	0	0	0	0	0	0	1	**61**	0	0	0	-11	0	0	0	0	0	0	4	3
Italy	1	0	0	-2	0	0	0	0	**71**	5	0	1	0	0	0	1	-1	0	1	-1
Japan	0	0	0	0	0	0	0	0	0	**73**	0	0	0	0	0	0	0	0	0	0
Luxembourg	29	10	5	-1	1	0	2	0	10	0	**74**	2	0	0	0	-1	1	12	18	1
Netherlands	19	1	6	8	1	0	4	35	13	4	5	**89**	23	0	1	14	12	13	16	2
Norway	0	0	0	0	0	0	0	0	0	0	0	0	**44**	0	0	0	0	0	0	0
Portugal	0	0	0	0	0	0	0	0	0	-2	0	0	0	**77**	0	0	0	0	0	0
Spain	4	0	0	-3	0	0	0	0	1	7	0	-1	0	1	**98**	0	0	1	4	6
Sweden	0	0	0	0	0	0	1	0	0	-1	0	-1	6	0	0	**65**	0	1	0	0
Switzerland	0	-4	-1	-6	-1	0	1	-1	-1	-1	0	1	0	0	0	0	**78**	1	0	0
United Kingdom	14	-12	0	-2	0	8	4	2	0	1	1	-1	0	8	0	-3	-1	**71**	3	3
United States	11	0	1	-23	-1	0	0	0	0	0	-3	0	1	0	-4	0	0	2	**48**	-1
Rest of the world	-1	0	0	-3	-1	0	-1	0	0	-1	-1	0	-1	13	0	1	-1	0	1	**85**
Total	**99**	**83**	**99**	**35**	**90**	**99**	**99**	**99**	**97**	**96**	**94**	**83**	**99**	**100**	**93**	**88**	**97**	**100**	**99**	**96**

62. More than 95 per cent of the FDI entering into France remain in France for a majority of residence countries of ultimate controlling parents (Australia, Belgium, Finland, Germany, Ireland, Japan, Norway, Portugal, Switzerland, United Kingdom, and United States). There are exceptions however: the most remarkable one is Canada: only 35 per cent of the FDI coming from a Canadian ultimate controlling parent remains in France: 23 per cent goes to Germany and another 23 per cent goes to the United States.

63. Some specific countries appear as intermediary countries between France and the residence countries of the ultimate controlling parents. For example, 18 and 16 per cent of the FDI in France of US ultimate controlling parents are received respectively from Luxembourg and the Netherlands. A significant part of Swedish and Norwegian ultimate controlling parents are transiting by Belgium and Netherlands to invest in France. Australian ultimate controlling parents are sending more funds in France by the intermediary of Luxembourg (29 per cent) and Netherlands (19 per cent) than directly from the Australia (17 per cent).

64. France is rarely used as an intermediary country by foreign ultimate controlling parents. With the exception of the Canadian case mentioned earlier, it is to note that 12 per cent of the FDI of Austrian ultimate controlling parents in France are transferred to the United Kingdom. Similarly, 11 per cent of the FDI of Dutch ultimate controlling parents go to Ireland.

65. At last, Table 7 indicates the breakdown by economic activity of FDI position data at the end of 2006 according to the BMD3 and the BMD4.We may observe that the shares of financial intermediation and real estate, renting and business activities increase for the position data according to the BMD4, at the expense of manufacturing, trade and repairs, construction and electricity, gas and water.

Table 7. Breakdown by economic activity of FDI position data according to the BMD3 and the BMD4 at the end of 2006

(in EUR billion)

	French outward position data				French inward position data			
	According to the BMD3		According to the BMD4		According to the BMD3		According to the BMD4	
Agriculture anf fishing	0,1	0,0%	0,1	0,0%	0,5	0,1%	0,4	0,1%
Mining and quarrying	16,1	2,0%	15,9	2,7%	0,9	0,2%	0,7	0,2%
Manufacturing	121,8	15,2%	72,4	12,4%	91,3	15,6%	41,9	11,4%
Electricity, gas and water	13,7	1,7%	6,2	1,1%	8,1	1,4%	0,6	0,2%
Construction	3,5	0,4%	1,9	0,3%	2,0	0,3%	0,4	0,1%
Trade and repairs	41,4	5,2%	11,5	2,0%	42,7	7,3%	12,7	3,5%
Hotels and restaurants	4,2	0,5%	3,2	0,5%	1,7	0,3%	0,6	0,2%
Transports, storage and communication	31,3	3,9%	22,1	3,8%	12,7	2,2%	3,4	0,9%
Financial intermediation	169,5	21,2%	138,8	23,8%	92,7	15,8%	61,9	16,8%
Real estate, renting and business activities	391,0	48,8%	304,7	52,3%	307,2	52,4%	221,0	60,1%
Other services	3,1	0,4%	2,1	0,4%	2,3	0,4%	1,3	0,4%
Not allocated	5,1	0,6%	4,2	0,7%	23,9	4,1%	23,0	6,2%
Total	**800,9**	**100,0%**	**583,0**	**100,0%**	**585,8**	**100,0%**	**367,9**	**100,0%**

ANNEX 3: ISSUES CONCERNING ACCESS TO VOTING POWER - EXTRACTS FROM THE INTERIM REPORT TO WGIIS[13]

EXECUTIVE SUMMARY

I. The work of the EDG commenced following circulation of its mandate on 5 June 2008.

II. The mandate of the EDG required it to examine the impact on FDI statistical compilation of the phenomenon of an investor acquiring voting power by means other than or in addition to direct ownership of voting equity. The mandate states that as this is a growing phenomenon, "it is important for WGIIS to understand the type of operations put in place, the reasons and the impact on FDI statistics". This interim report attempts to describe what is involved under the different arrangements currently known to the EDG.

III. The report also considers some theoretical and practical implications of including significant access to voting power under such arrangements in FDI statistics and raises some issues for the WGIIS's consideration as well as requesting its opinion and overall guidance. The final report is due to be completed for the March 2009 meeting of the WGIIS.

IV. The EDG examined the acquisition of voting power via the following arrangements:

(i) *Nominee accounts* through which holdings of voting shares are registered to an intermediary at the request of and on behalf of their beneficial owner;

(ii) *Sell-/buy-back and repurchase (repo) agreements:* through which legal ownership of shares may be temporarily transferred from the original holder to a third party. There is generally no change in the beneficial ownership of the shares concerned but sometimes, depending on the agreement, voting rights may be transferred;

(iii) *Share lending:* through which, depending on the country involved and the conditions agreed in the contract, legal ownership may or may not be transferred to the borrower. Beneficial ownership is retained by the lender but voting rights may be transferred;

(iv) *Financial derivative contracts* which, only when exercised or settled result in the transfer of all ownership rights associated with voting shares from their original owner to the new owner. If not exercised or settled, no rights associated with the shares involved are transferred; and,

(v) *Financial derivative contracts* which, whether exercised or not, or prior to exercise or settlement, provide for the transfer of voting rights (but not of full ownership rights) associated with the shares involved from their registered holder to the holder of the derivative contract. In some cases, such contracts may be exercised or settled at a later date and all the rights associated with the shares are transferred to their new owner. In other cases, contracts may never be exercised or settled and the voting rights which were temporarily transferred revert to the registered owner of the shares.

[13] For the full report see DAF/INV/STAT/(2008)8.

V. Examples covering cases (ii) to (v) are described in the report. Cases (i), (ii) and (iii) and their statistical (including FDI) treatments are known and understood. In all three, the statistical recording for FDI (and other) purposes is based on the holder of the beneficial ownership of the shares involved.

VI. As regards cases (i), **nominee accounts**, compilers tend to seek information on the beneficial owners of securities held through such arrangements and therefore it is unlikely that any change in treatment is necessary. For cases (ii) and (iii) **sell-/buy-back**, **repurchase agreements** and **share lending**, the international standards require statistical recording on a beneficial ownership basis. This is the approach that is currently applied and, as such, would appear to meet the statistical standards. However, pending the final decisions of the WGIIS on the statistical treatment of other means of accessing voting power described immediately below, this treatment may need to be reviewed (see paragraph XVIII).

VII. Case (iv) is straightforward at one level in that the international standards require that **derivative** transactions be excluded from FDI statistics. However, the Group considered the situation where a foreign investor acquired ownership of voting equity in a resident enterprise which was marginally below the 10% FDI threshold because of formal approval requirements imposed by the resident authorities. At the same time, the investor arranged a derivative option contract to ensure at a later date ownership acquisition to a further significant amount of voting equity (to breach the 10% threshold) if and when investment approval was obtained from the authorities. The question arises as to whether, in the circumstances described, the initial voting equity ownership investment which was marginally below the FDI threshold should be ***classified*** as FDI. Taking the strict application of the 10% rule then, FDI would only occur at the point when (and if) the investor exercised the option contract and obtained ownership of sufficient voting equity to meet (or breach) the 10% barrier. Another view is that, given the investor's clear intention to have at some future time a significant influence on the enterprise, should the initial 'below-FDI threshold' investment, in the context of the evidence of the concurrent derivative transaction, be classified as FDI? This situation is described in more detail in the report.

VIII. There is evidence of an increasing incidence of case (v) type **derivative** contracts. Those of interest are generally Over-the-Counter (OTC) option contracts which can be settled *by delivery or by difference*. Those settled by difference are known as contracts for difference (CfDs) are very popular. Whatever type is used and depending on the motivation and the conditions agreed, the agreement is tailored to enable the holder of the contract to acquire (generally from initiation) access to voting power in an enterprise without at the same time owning the underlying voting shares covered by the contract. Depending on the specific agreement, the contract may never be exercised and the ownership of the shares in question remains with their registered owner while the holder of the contract retains the voting rights while the contract remains in force.

IX. Acquisition to voting power in case (v) situations poses serious and significant theoretical and practical questions for compilers. The critical issue concerns whether such access to significant amounts of voting power (without the respective share ownership) should be treated as FDI, i.e. does FDI and FDI statistical recording depend:

A. solely and strictly on ownership by the investor of at least 10% of an enterprise's voting equity,

or on

B. access by the investor to voting rights amounting to at least 10% of an enterprise's voting power where such voting rights are acquired by the investor either wholly or partly, through outright ownership of voting equity issued by the enterprise, or by acquiring voting rights by use of derivatives which do not confer outright ownership on the investor of the voting equity involved?

X. In looking at the sell-/buy-backs, repurchase and share lending agreements, where the borrower gaining access to voting power above 10%, the report shows the following:

- There will be discrepancies between beneficial ownership of equity and voting power
- Under the current BPM6 standards, the transaction/position would be registered as *Other Investment*
- According to the influence criterion (BD4 and BPM6) the relationship would be classified as FDI.

XI. The EDG felt that the issue should perhaps be further considered once the WGIIS had considered the other means of accessing voting power (see paragraph XVIII).

XII. In the case of voting power accessed by means of contracts settled by delivery or by difference, where the buyer of an OTC option (independently of the agreement about settlement) has access to voting power above 10% of the target company before the date of expiry of the contract, the report shows:

- There will be discrepancies between beneficial ownership of equity and voting power
- Under the current BPM6 standards, the transaction/position would be registered as *Financial Derivatives*
- According to the influence criterion (BD4 and BPM6) the relationship would be classified as FDI.

XIII. In the case of an investor purchasing marginally below 10% of a company and at the same time ensuring (at a future date) the ownership of a percentage above 10% by means of an OTC contract agreed to be settled by delivery of the underlying securities, the report shows:

- In the period between initiation an exercise:
    - There will be no discrepancy between ownership and voting power
    - The 9.9% investment would be recorded as Portfolio investment
    - The OTC contract would be recorded as Financial derivatives
    - There is a clear indication that the motivation of the investor is to acquire eventually sufficient equity so as to influence the management of the target company;
- At the date of expiry, when the option is exercised:
    - There will be no discrepancy between ownership and voting power

- A reclassification of the 9.9% position from Portfolio investment to Direct investment should be made

- A new transaction/position on FDI should be recorded.

XIV. However, opinion was divided in the EDG on the questions posed in paragraphs VII and IX.

XV. In examining the different types of scenarios (see the examples described in Section F of the report), the EDG was mindful of the BMD4 principles underpinning FDI and its strict recommendation to rigidly apply the 10% voting power criterion. The Group was also mindful of the important fact that in both the BMD4 and the BPM6, the 10% voting power criterion was clearly set in the context of ownership by the direct investor of that share of the target enterprise represented by the purchase of the voting equity it issued.

XVI. Concerning the classification to FDI of investment marginally below the 10% threshold but 'supplemented' by a derivative contract arrangement, opinion was divided in the EDG. One view was that the investment could not be classified to FDI until the 10% criterion was satisfied; the opposite view was that it should be classified as FDI given that the investor's longer-term intention was to have an FDI interest in the enterprise. The opinion of the WGIIS is therefore sought. An additional matter may also need consideration is: if the investment should be classified as FDI from the outset, a further issue arises as to what tolerance threshold should apply in relaxing the 10% rule for FDI, e.g. 9.9%, 9.5%, 9% or even lower, or can it be left to the discretion of the compiler to decide!

XVII. Concerning the broad issue of accessing significant amounts of voting power using derivative contracts, some members of the EDG were of the view that such access should be classified as FDI. The counter position was that FDI classification and recording should be made on the basis of the application of the strict 10% voting power criterion but only in the context of ownership by the investor of the voting securities issued by the target enterprise. The opinion of the WGIIS is again sought on this issue.

XVIII. Finally, depending on the views of the WGIIS concerning the treatment of other means of accessing voting power described above, there may be a need to have the current treatment reviewed for sell-/buy-back, repo and share lending arrangements in the context of FDI compilation given that voting power may be temporarily transferred from the original to the new holder of the shares using these contracts.

XIX. In order to make further progress on this broad topic, and with a view towards presenting the Final Report to the WGIIS at the March 2009 meeting, this report poses a series of questions (see Section H) to the WGIIS and seeks its opinions and guidance on a number of matters.

ANNEX 4: TREATMENT OF MULTI-TERRITORY ENTERPRISES - EXTRACTS FROM THE INTERIM REPORT TO WGIIS[14]

EXECUTIVE SUMMARY

I. The work of the EDG commenced following circulation of its mandate on 5 June 2008.

II. The mandate specifies that the research exercise address both the treatment of multi-territory enterprises and the impact of the changing identification of the parent in terms of:

(i) Developing methods to identify a parent entity in a multi-territory enterprise, and imputing the consequential equity positions and income flows; and

(ii) Establishing the processes for recording the changes in the identification of the parent entity in a multi-territory enterprise.

III. The EDG found that it could not at this stage reach conclusions on the recording of changes in the identification of the parent entity in a multi-territory enterprise structure until it had first reached some conclusions on the identification of such enterprises and how they might be treated in FDI statistical compilation. Consequently, this Interim Report focuses on:

(i) describing examples of cross-border economic activities of entities which might be considered, correctly or incorrectly, as multi-territory enterprises, and,

(ii) considering aspects of their structure and arrangements which could be important to compilers in determining their treatment.

IV. Following the WGIIS's consideration of this Report and with its approval, the EDG intends to address the issue of a change in the identity of the parent in a multi-territory enterprise structure and to present its findings in its final report to the WGIIS in March 2009.

V. The fundamental basis of the EDG's approach towards addressing the issue of what a multi-territory enterprise is hinged firstly on the concept of a *multi-territory enterprise* described in the BMD4 as follows:

> "***Multi-territory enterprises*** operate as a seamless operation over more than one economic territory. Such an enterprise, even though it has substantial activity in more than one economic territory, cannot be separated into a parent and branch(es) because it is run as a seamless operation and cannot supply separate accounts for each territory".

VI. The examination also relied crucially on the concept and definition of an institutional statistical unit and its residency (based on BMD4, Chapter 3 Section 2; and BPM6, Chapter 4, Section C and Section E) and, in addition, on the fundamental principles of FDI and the FDI Relationship as described in the BMD4.

[14] For the full report see DAF/INV/STAT/(2008)9.

VII. The notion of *seamlessness* was obviously important. Its practical consequences for a candidate multi-territory enterprise meant that the necessary information to allow determination of the existence of separate constituent entities (parent, branches, subsidiaries, etc) and their locations, as well as the relevant transactions and assets/liabilities would not be available. The BMD4 gives no specific guidance on how a multi-territory enterprise should be split into separate (notional) enterprises resident in the economies in which it operates i.e. how the assets and liabilities and associated income (or other) flows could be appropriately allocated by country, distinguishing a parent and its branches. The draft BPM6, however, did suggest that the authorities in different countries generally require separate entities or branches to be identified in each economic territory for tax, regulatory or other purposes.

VIII. A number of examples (based on real cases) of what might be thought of as multi-territory enterprises were examined. These related to: (i) a cross-border gas pipeline; (ii) a cross-border bridge; (iii) a space satellite installation; (iv) an international shipping line; and (v) an international airline hub arrangement. No case of a multi-territory enterprise was thought to exist in these examples. In order to progress the examination beyond the present findings, the EDG is anxious to know if the WGIIS is aware of any 'real' case of a multi-territory enterprise as defined.

IX. It was considered that the examples examined could apply to other similar scenarios. For example, the gas pipeline example could also apply to oil and water transportation across borders as well as to the delivery of electricity and to transmission of telecommunication signals via cable networks. Also, it was thought that there was a broad similarity between the company structures involved in space satellite installations, the operation of shipping lines and international airline hubs. In fact, the EDG was of the view that there was broad similarity of arrangements across all scenarios considered. In saying this, however, it was recognised that in some cases the operation of international shipping lines could potentially pose quite serious challenges for compilers. This is due to the fact that it is sometimes difficult for a compiler to identify the existence and residency of some of the entities involved in some of the company structures and registration arrangements used.

X. To assess these from the point of view of compiling FDI statistics, the EDG reckoned that the three main tasks facing compilers were: (i) determining the existence of an institutional unit (or units) resident in the national territory; (ii) deciding whether a direct investment relationship exists between this unit and other units resident and non-resident; and, (iii) collection, estimation and recording of the relevant FDI transactions and positions between resident and non-resident FDI related enterprises.

XI. The EDG reached the view that the concept of a multi-territory enterprise, while theoretically described in the different international standards, is not very clear in practical terms. It also concluded that the vast majority of cases, despite the apparent data and information difficulties at the outset, would resolve in a way to enable statistical treatment in the conventional manner. This means that, if a cross-border activity such as or similar to those described exists, it is likely that the relevant national authorities will want to have information on the activity and will probably want to collect tax of some kind from the entities involved. It was thought that compilers, following the necessary effort, would be generally able to obtain sufficient information to determine the existence or otherwise of the institutional units comprising the apparent cross-border structure and also to compile the statistical data required.

XII. Where a cross-border operation could be subdivided into a number of units resident in different economies but the parent and its residency was not easy to identify, the EDG suggest that the following criteria might be used:

- Does a legal entity exist and, if so, where is it registered?
- Can a head office or a principal operation be distinguished?
- Can any kind of hierarchical relationship e.g. mother-daughter between the different entities be observed?
- Where do the board of management meet or where is decision-making located?
- What is the country of residence of the chairman of the board (or the chief executive officer)?
- Where are accounts or key information about the operation prepared?
- Apart from the infrastructural facility, are there other physical structures or equipment that are linked to only one of the partner countries?

XIII. Finally, in order to progress the work further, the EDG requests the assistance and guidance of the WGIIS and poses a number of questions at the end of the report.

ANNEX 5: 2ND SESSION OF THE NETWORK OF STATISTICAL EXPERTS ON FOREIGN DIRECT INVESTMENT AND ACTIVITIES OF MULTINATIONAL ENTERPRISES

DRAFT ANNOTATED AGENDA

8 October 2008

JOINT SESSION OF THE WORKING GROUP ON INTERNATIONAL INVESTMENT STATISTICS AND THE WORKING PARTY ON GLOBALISATION OF INDUSTRY

1.	Opening statement Director, OECD, Financial and Enterprise Affairs	
2.	Adoption of the agenda	COM/DAF/DSTI/A(2008)1
3.	Scope and coverage of FDI and AMNE statistics	
3(a)	FDI and AMNE statistics: A comparative stocktaking of concepts and methods *Note by the Secretariat*	COM/DAF/DSTI(2008)1
3(b)	Population of FDI and AMNE statistics	
	Statistics on FDI and Foreign Affiliates – Definition of populations and impact on data analysis *Note by Eurostat*	COM/DAF/DSTI(2008)2
	"Similarities and differences between FDI and AMNE statistics – The German experience” *Note by Germany*	COM/DAF/DSTI(2008)3

	Population of FDI and AMNEs: Preliminary thoughts on the impact of revised methodological standards *Note by France*	COM/DAF/DSTI(2008)4
4.	Analysing FDI and AMNE statistics	
	Foreign Direct Investment Statistics: influence versus control *Note by Canada*	COM/DAF/DSTI(2008)5
5.	Revision of the OECD Handbook on Globalisation Indicators *Note by the Secretariat*	COM/DAF/DSTI(2008)6
6.	Conclusions and way forward	