DIRECT INVESTMENT TECHNICAL EXPERT GROUP (DITEG)

OUTCOME PAPER (DITEG) # 7 AND # 8

FEBRUARY 9, 2005

1. **Topic:** Reverse investment and directional principle

2. **Issues:** See DITEG Issue Paper # 7 and # 8 by the United States (November 2004), which, in turn, references IMF issue paper #7 and #8 (dated May 2004 and discussed at the June 2004 DITEG meeting).

3. **Recommendations:**

(i) In regard to the standard components of the international investment position, a significant majority of the group (13 of 16) agreed that direct investment positions representing claims on foreign residents should be presented gross under assets, and that direct investment liabilities representing claims on residents of the reporting economy should be presented gross under liabilities. This is a change from the existing international standards, which nets claims on affiliated enterprises against liabilities to affiliated enterprises in the direct investment functional categories.

(ii) The same majority agreed that flows on assets should be presented separately from flows on liabilities, rather than netting flows on reverse direct investment interests in the direct investment functional categories.

(iii) In the case where a direct investment enterprise holds an equity interest of less than 10 percent in the direct investor, the experts had split views regarding whether this holding should be recorded in direct investment (as under existing standards) or recorded as portfolio investment (resulting in a change to existing standards). As further elaboration:

a. DITEG agreed that the categories pertaining to equity finance claims on direct investors, and to equity finance liabilities to direct investment enterprises, would be very narrowly defined. Although this is the present standard, some members were concerned about confidentiality and about their country's inability to show data for these rows;

b. DITEG had questions regarding whether reinvested earnings should be recorded on this investment, should the existing standards be retained. Under existing standards, reinvested earnings should be recorded on the reverse equity investment; the Annotated Outline asked whether this treatment should be retained, and members generally felt that it should not.

(iv) Most who spoke felt that, even were equity in a reverse investment relationship to be treated as portfolio investment, other capital should remain in direct investment. However, in a situation where an SPE, acting as a conduit for the raising of funds external to the group, and having a reverse investment with its direct investor, the treatment of nonequity transactions between the SPE and the direct investor (or the rest of the group) was not considered in this discussion. See Outcome paper #11 (Affiliated nonfinancial enterprises and financial SPEs).

(v)There was little discussion of income flows at the December 2004 DITEG meeting. At the June 2004 DITEG meeting, it was proposed that income flows be reported gross under receipts and payments if direct investment positions are reported gross under assets and liabilities, and no one spoke against this proposal at the June or December 2004 DITEG meetings. It was noted in December that this treatment would eliminate instances of negative interest income flows in direct investment in the case where SPE's act as conduits for the raising of debt for direct investors.

4. **Rejected Alternatives:**

(i) The group rejected the existing international standards, which call for the netting of reverse equity and reverse debt investment in the direct investment functional categories.

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

(i) Do the Committee and the WIIS agree that direct investment positions and flows should be presented on a gross basis, under assets, liabilities, receipts, and payments, as appropriate, rather than including reverse investment flows and positions on a net basis in direct investment?

(ii) Do the Committee and the WIIS feel that reverse equity investment of less than 10 percent should be included in direct investment (as under existing standards), or – on either conceptual or practical grounds -- should such holdings be included in portfolio investment?

(iii) Do the Committee and the WIIS have a view as to whether debt transactions and positions between a direct investment entity with less than 10 percent in its direct investor and the direct investor (or other members of the group) should be recorded as direct investment (excepting, for separate consideration, those instances where an SPE acts as a conduit for external financing for the group as a whole) or as other investment?