

**Fourteenth Meeting of the
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**Clarification of the Recommended Treatment of Selected
Foreign Direct Investment Transactions**

**Prepared by the Statistics Department
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CLARIFICATION OF THE RECOMMENDED TREATMENT OF SELECTED FOREIGN DIRECT INVESTMENT TRANSACTIONS

I. INTRODUCTION

1. The October 1999 meeting of the IMF's Balance of Payments Statistics Committee (BOPCOM) discussed the treatment of three types of foreign direct investment (FDI) transactions that have caused confusion among compilers, namely (i) transactions with affiliated financial intermediaries,¹ (ii) payments associated with the acquisition of a right to undertake a direct investment, and (iii) the shutdown of an FDI enterprise set up for natural resources exploration. (BOPCOM99/19).
2. In order to clarify the methodology set out in the fifth edition of the IMF's *Balance of Payments Manual (BPM5)*, the BOPCOM supported the Fund's recommendations set out below, but asked to be informed of the views of the OECD Working Party on Financial Statistics (WFS) and the ECB Working Group on Balance of Payments and External Reserves (WGBP&ER) prior to making a final decision on the recommendations.

Transactions with affiliated financial intermediaries:

- *The BPM5 definition of the scope of enterprises included under "banks and other financial intermediaries such as security dealers" should be clarified as being equivalent to the following SNA93 financial corporations sub-sectors: other depository corporations (other than the central bank); other financial intermediaries, except insurance corporations and pension funds; and financial auxiliaries. As a result, SPEs principally engaged in financial intermediation for a group of related enterprises would be encompassed in that definition.*

¹ Confusion has arisen because the *BPM5* text that limits FDI transactions "between affiliated banks (depository corporations) and affiliated financial intermediaries (e.g. security dealers)" to transactions involving equity and permanent debt (paragraph 372) could be interpreted as meaning only those transactions between affiliated banks and between affiliated financial intermediaries, and not transactions between affiliated banks and affiliated financial intermediaries. Furthermore, *BPM5* and the *Balance of Payments Textbook (BOP Textbook)* are not clear about what exactly is meant by financial intermediaries. Finally, the text in the *BOP Textbook* (paragraphs 542-544) that specifically excludes from the FDI data all non-equity/permanent debt transactions between a nonfinancial enterprise and an affiliated SPE with the sole purpose of financial intermediation, and specifically includes such transactions between a nonfinancial enterprise and an affiliated SPE with the primary purpose of financial intermediation has also caused concern because of the argument that there is essentially no economic difference between the two types of SPEs.

- *The implications of the above clarification are that financial (and investment income) transactions between two affiliated enterprises that are part of (1) other depository corporations (other than the central bank); (2) other financial intermediaries, except insurance corporations and pension funds; or (3) financial auxiliaries would be excluded from FDI except for transactions in the form of equity capital or permanent debt.*
- *Financial transactions between units that are not financial intermediaries and affiliated financial SPEs abroad should be recorded under FDI.²*

Payments associated with the acquisition of a right to undertake a direct investment

- *The contra-entry to the payment of a rent (bonus) by a non-resident investor to the government authorities should be recorded under direct investment when there is a clear intention to establish a direct investment enterprise (such as in the case of a contractual arrangement between the investor and the government).*
- *The contra-entry to the payment of a rent by a non-resident enterprise, when no direct investment enterprise is or will be established, should be recorded under “income; investment income; other investment” until a “rent” sub-component of income is included in the balance of payments manual. Rent would be paid by non-resident enterprises when they make payments to exploit movable natural resources such as in the case of tree cutting rights or fishing rights in a country’s territorial waters.*

The shutdown of an FDI enterprise set up for natural resources exploration

The transactions should be recorded in accordance with the approach set out in BPM5 and the Benchmark, which is to use the other adjustments heading of the IIP statement to show the reduction in assets, and to show no further entries in the balance of payments statistics.

² This recommendation overturns the practice recommended in the *BOP Textbook*, which excludes from the FDI data transactions between nonfinancial FDI enterprises and affiliated SPEs with the sole purpose of financial intermediation. The effect of the recommendation is that there will no longer be any difference in the treatment of SPEs that have the sole purpose of financial intermediation and SPEs that have the primary purpose of financial intermediation—both (i) transactions between nonfinancial FDI enterprises and affiliated SPEs with the sole purpose of financial intermediation, and (ii) transactions between nonfinancial FDI enterprises and affiliated SPEs with the primary purpose of financial intermediation are to be included in the FDI data.

II. Views of the OECD and ECB

3. The recommendations were discussed at the February 2000 meeting of the ECB WGBP&ER and the November 2000 meeting of the OECD WFS. Both groups concurred with the Fund recommendations for the treatment of payments associated with the acquisition of a right to undertake a direct investment and for the shutdown of an FDI enterprise set up for natural resources exploration

4. As indicated by the ECB representative at the BOPCOM meeting in October 2000, the ECB initially also concurred with the recommendations for the treatment of transactions with financial intermediaries. Subsequently, the ECB WGBP&ER re-visited the issue at its February 2001 meeting and a decision was deferred until the May 2001 meeting of the Working Group. That meeting concurred with the Fund recommendations. However, in view of concern expressed by several countries about the recommendation that would result in including in the FDI data transactions between nonfinancial FDI enterprises and affiliated financial SPEs, the WGBP&ER members suggested that the issue be re-examined at an appropriate time, such as the next revision of the *Balance of Payments Manual*.

5. The members of the OECD WFS deferred a decision on the recommendations for the treatment of transactions with financial intermediaries and asked that the issue be referred to the June 2001 OECD FDI workshop for a decision. As indicated in the OECD paper (BOPCOM01/20A), that group “supported the views expressed by the IMF on the transactions with affiliated financial intermediaries and indicated that national compilers will try to apply the recommendations despite some practical difficulties.” However, like the ECB, the OECD group had concerns about transactions between nonfinancial FDI enterprises and affiliated financial SPEs and, as indicated in BOPCOM01/20A, suggested that in the long-term it “would be useful, and even necessary, to review all aspects of financial institutions.”

6. *In light of the concurrence of the OECD WFS and the ECB WGBP&ER with the recommendations of the Fund for the treatment in FDI statistics of (i) transactions with affiliated financial intermediaries, (ii) payments associated with the acquisition of a right to undertake a direct investment, and (iii) the shutdown of an FDI enterprise set up for natural resources exploration, the members of the Committee are asked to:*

1. *Confirm their 1999 support for the recommendations set out in paragraph 2 above.*
2. *Approve the promulgation by the Fund of these clarifications to national compilers, recognising that the 1999 paper indicating the support of the Committee for the recommendations is already posted on the Committee’s webpage on the Fund’s external website.*

3. *Accept the suggestion of both the ECB and the OECD that the issue of the treatment of transactions with financial intermediaries be re-examined in the long-term, such as at the time of the next revision of the Balance of Payments Manual.*