

**Eighteenth Meeting of the
IMF Committee on Balance of Payments Statistics
Washington, D.C., June 27–July 1, 2005**

Shipping

I. DIRECT INVESTMENT TECHNICAL EXPERT GROUP (DITEG)
II. OUTCOME PAPER (DITEG) # 21B

April 8, 2005

- 1. Topic: Various Special Cases: Shipping**
- 2. Issues: See DITEG Issue Paper # 21 (B) by Greece (Statistics Department, Bank of Greece –November 2004)**
- 3. Recommendations:**
 - (i) DITEG agreed on the complexity of the statistical treatment of shipping activities while it recognized the need for clarification on different aspects such as residency, nature of shipping companies' activities, etc. The group accepted that the existing manuals should be clarified about the treatment of shipping companies and recommended that this further clarification should be included to distinguishing between FDI and services.
 - (ii) DITEG stressed the importance of following the principles of the existing system, which would involve clear identification of units involved in shipping activities which are namely the owner and the operator of the ship: it should make clear that the flag of convenience is not relevant:
 - (a) *The owner holds an asset (the ship).*
 - (b) *The operator is effectively involved in shipping activities such as fishing, transporting, etc.*
 - (c) *The flag of convenience is for the legal registration of the ship. The flag is not considered in determining the residency of the owner or operator of the ship.*
 - (d) If the owner and the operator are the same entity, then they comprise a single institutional unit.
 - (e) If the owner and the operator are not the same entity, then they comprise separate institutional units. The owner will typically receive a fee from the operator, reflecting the payment (rent) for the use of the vessel; in this case, the owner is a lessor, and is not a provider of transportation services. The operator of the vessel provides transportation services; it receives revenues for transporting passengers and/or freight, pays wages to crew members (who may be residents of a different economy than the operator), and incurs other transportation-related expenses including port expenditures.
 - (iii) DITEG indicated that the treatment of management offices and business promotion and ticket sales offices would depend upon individual circumstances; in some circumstances, they would qualify for treatment as direct investment enterprises and,

in other circumstances, they would not. In this latter case, some members of DITEG believed that transactions related to these offices should be recorded as international services transactions.

- (iv) DITEG agreed that the starting point of the statistical treatment of shipping is the basic asset/liability principle. Following from that principle, transactions related to branches should meet the criteria to be included under FDI. Distinction should be made between the branches which engage in real economic activities and have income statements, etc. and units that are set up to increase sales of the institutional units that established them but that have no sales of their own, such as ticket sales offices and business promotion offices.
- (v) It was pointed out that determining the residency of shipping companies is often a difficult issue. As noted, the residence of the owner and of the operator are determined independently from the country where the ship is registered (from the country of the flag of convenience), and different types of leasing arrangement may exist that can make it difficult to determine whether the ship is being leased or effectively sold to the institution that operates it.
- (vi) DITEG noted that issues related to complex leasing arrangements and their solutions could be extended to other types of mobile equipment, such as aircraft. DITEG could not fully articulate its recommendations, pending clarification of the criteria for differentiating between financial and operational leases that are still under review in other groups.

4. Rejected Alternatives:

None.

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 WIIS agree that recording transactions/positions under FDI related to shipping companies requires further clarifications in the manuals?*
- (ii) *Do the Committee and WIIS agree with the description of institutional units above (under 3- ii)?*
- (iii) *Do the Committee and WIIS agree with the principles indicated under 3 (iv)?*

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

DIRECT INVESTMENT TECHNICAL EXPERT GROUP (DITEG)

ISSUES PAPER (DITEG) #21 B

SHIPPING COMPANIES' FDI RELATIONSHIPS

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The views expressed are those of the author and do not necessarily represent the views of the Bank of Greece

1. CURRENT INTERNATIONAL GUIDELINES FOR THE STATISTICAL TREATMENT OF SHIPPING COMPANIES' ACTIVITIES

The international activities of shipping companies are recorded in the balance of payments mainly under the transport services. However the usual practice for such companies to establish 'branches' or 'operating offices' to a number of countries as well as to be registered for flying flags of convenience for their vessels makes difficult to determine the residency (i.e. the country) to whom and to which country the activities of the shipping company would be allocated to. Furthermore, such a worldwide establishment of branches/offices raises the question of how these should be treated. A clear-cut answer has not yet been provided by the Balance of Payments Manual, 5th edition, (BPM5) or the Benchmark definition of FDI, 3rd edition, (BD3).

In chapter IV (Resident unit of an economy) under the section of "Units operating mobile equipment" paragraph § 81 points out to the problem of residency that **"For ships flying flag of convenience, it is often difficult to determine the residence of the operating enterprise. There are may be complex arrangements involving ownership, mode of operation and chartering of such ships. In addition, the country of registry differs, in most instances, from the operator's (or owner's) country of residence. Nevertheless, in principle, the shipping activity is attributed to the country of residence of the operating enterprise."**

With regard to the FDI issue, BPM5 (Chapter XVIII-direct investment) devotes a section to "Other Special Cases of Direct Investment Enterprises" (§378 to §383) in which there is no any special reference to FDI in shipping companies and its treatment. However again in chapter IV (Resident unit of an economy) there is a short remark that **"If an enterprise establishes, for tax or other consideration, a branch (direct investment) in another country to manage the operation, the operation is attributed to the resident (branch) operating in that country."**(§81).

There is more discussion and exploration of shipping companies' activities in the Balance of Payments Compilation Guide (BPCG) where paragraphs 442 – 450 deal with the "Treatment of the operations of mobile equipment". There, in §442 is stated clearly that **"the key to correct treatment of this (shipping) equipment lies in determining the residency of the operator of the equipment"** and § 449 considers a further complication that arise when **"the operating enterprise may be registered in two or more countries as a result of special legislation"**. The solution suggested is twofold. The first solution establishes an FDI relationship (not clearly stated in the text) since it

suggests **“the country where the head office of the enterprise is located could be considered the operator’s office and the other countries could be consider shareholders in the operation** while the second solution suggests that **“the earnings, expenses, assets and other activities of the operator could be split between the countries in proportion to shares held in the operating enterprise “** without recording an FDI relationship.

Finally in chapter XVI (Compiling BoP financial account and IIP) in BPCG there is a section covering the “Nonoperating Direct Investment Enterprise”(§ 705 – 707) where does everything but names Special Purpose Entities since for the first time brass plate companies are defined **“as those to register ownership of shipping vessels or to raise capital through the issuance of securities”(§ 705)** and goes on in § 706 to specify that such nonoperating companies **“may register in a country but for all practical purposes have no operational presence in that economy.That is the companies do not carry out production, have no employees and do not pay taxes... Brass plate companies may pay a fee to register in a host country and may share an office or directors with similar enterprises. However books or accounts may be maintained elsewhere and, thus, be invaluable to the host country compiler”**.

In BD3, in chapter VI “special entities” there is section 3 which is devoted to “shipping companies”. Within that section (§ 64 pp23) is reaffirmed the complexity of arrangements involved in shipping companies operations by repeating more or less § 81 and § 82 of the BPM5.

An interesting remark is made in Annex 3 where SPEs are covered. Specifically, when other types of SPEs are discussed it is mentioned that although it is not usual to associate SPEs with manufacturing or other operating activities **“some companies that appear to be merchandising, insurance or other financial or shipping companies are really SPEs. In these case the statistician has to determine the center of their economic activities. For instance, if a Canadian company incorporates a subsidiary shipping company in Singapore, flies a flag of convenience of another country and directs the activities from Belgium, to which country should Canadian direct investment abroad be attributed? “**

Finally in BD3 there is a reference about the followed practices by most countries where it is stated, **“ Many countries try to allocate ships involved in international trade to the country of residency of the owner regardless of the country under whose flag the ship is registered. Other countries allocate the ship to the country of the ship’s operator if different from that of the owner “(pp 23)**

2. CONCERNS/SHORTCOMING OF THE CURRENT TREATMENT

There seems to be no clear guidance about if ,when and what type of FDI relationships are established when shipping companies are involved.

From the treatment of this issue by BMP5 and BD3 , they are mainly concerned with the problem of determining the residency of the actual operator of the vessel so that to determine the country to which operations (shipping services) would be allocated to. There is no clear guidance about the treatment of the management offices (call them branches) established by the ship owner. Should such offices be considered as FDI? How then should we record freight receipts flows between owner and its office?

It is true that the ultimate beneficial in the cases of shipping companies' branches and management offices is the ship owner. Such 'branches' are merely intermediate offices for freight collection and manage the employment for ships. Given that the ship owner and its country of residency could be easily determined, a solution would be to generalize the practiced followed so far i.e. to allocate ships involved in international trade to the country of residency of the owner regardless of the branches and flag of convenience they are flying.

3. POINTS FOR DISCUSSION

- a. Given, as presented above, the complexity of shipping company's residency and the nature of shipping 'branches' activities, does DITEG consider that there might be no ground for direct investment in the operations of shipping companies?
- b. If not, does DITEG consider the shipping management offices as branches or as a special case of SPEs (brass plate)?
- c. If branches/offices are considered as direct investment enterprises (branch or SPE), how should the transactions between owner and branch/office be recorded when such flows involve direct transfer of freight receipts to the owner. Under FDI other capital or under services/transport? . In the former case shall we miss the receipts from transport services, which ultimately accrue to the owner?
- d. Should we keep following the current practice that is to allocate all shipping activities (freight, loans etc) to the country of the ship owner?
- e. Which one of the two solutions provided in the BPCG (§ 449) is considered the appropriate one in case where the operating enterprise (branch/office) is registered in two countries?

4. REFERENCES

- a. Balance of Payments Manual, fifth edition, 1993, IMF,

- b. OECD Benchmark definition of foreign direct investment. Third edition, 1996, OECD.