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FDI Statistical Units: Local Enterprise Groups and Enterprises

Prepared by the Statistics Department
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I. INTRODUCTION

The three types of affiliates that are included in statistics on foreign direct investment (FDI) – i.e., direct investor, direct investment enterprise, and fellow enterprise – are described in two fundamentally different ways by different economies. Some economies use the concept of an enterprise in describing these units, and others use the concept of local enterprise groups (LEGs). Under the sixth edition of the IMF's *Balance of Payments and International Investment Position Manual* (*BPM6*), either enterprises or LEGs may be used as the statistical unit for compiling and presenting direct investment statistics (*BPM6* para. 4.56, and *Coordinated Direct Investment Survey Guide*). Currently, neither is preferred over the other.

An enterprise is an institutional unit engaged in production (*BPM6* para 4.23). A LEG includes the enterprise at the top of an ownership chain within an economy and, following down that enterprise's ownership chain, includes all enterprises below it in its same economy (*BPM6* para 4.55). The use of these two different types of statistical units has important consequences on headline statistics for FDI, including on the levels of inward and of outward FDI under the directional principle. Data that are presented at aggregate levels on the Asset/Liability basis are unaffected by the choice of statistical unit.

The main purpose of this paper is to briefly note how differences in the statistical unit for FDI may result in asymmetries and differences in headline statistics on FDI. It also notes how work is being carried forward to promote improved consistency in statistics on inward and outward FDI.

II. DIRECT INVESTMENT, FELLOWS, AND THE DIRECTIONAL PRINCIPLE

As noted, the choice of statistical unit (enterprise or LEG) will have an impact on the totals shown for inward and outward FDI under the Directional Principle, because the statistical unit decision affects what enterprises are regarded as fellows by a given economy, and positions between fellows are classified in inward and outward FDI in *BPM6* according to the residence of the ultimate controlling parent (UCP)[1]. The choice of statistical unit does not affect highly aggregate data on a straight Asset/Liability basis, but will affect the totals shown for the several sub-categories (i.e., direct investor in direct investment enterprises; direct investment enterprises in direct investor (reverse investment); and between fellow enterprises).

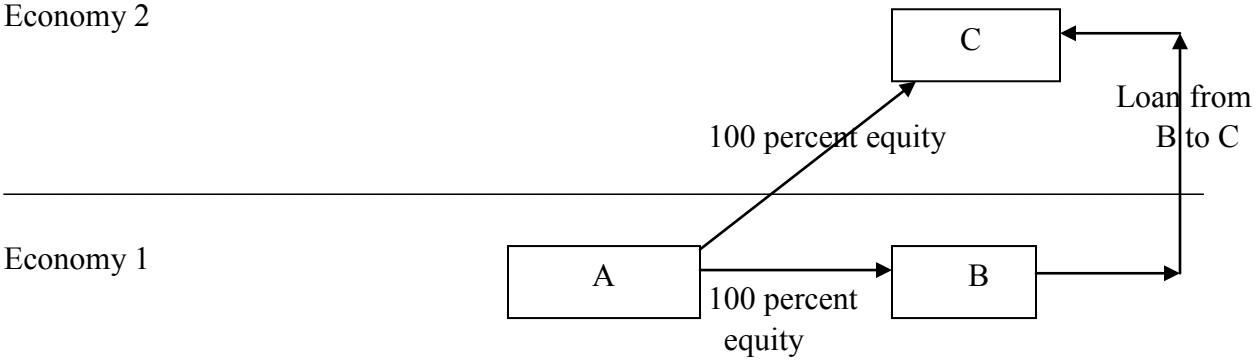
[1] The treatment of fellow enterprises in *BPM6* is consistent with the treatment in the fourth edition of the *OECD Benchmark Definition of Foreign Direct Investment* (*BD4*). However, *BPM6* allows positions between fellow enterprises to be recorded consistent with the treatment in the earlier editions of these manuals (i.e., on a gross asset/liability basis) in the case where economies are not able to implement the preferred basis of presentation.

BPM6 describes the impact of the new treatment of fellows as follows:

> *"The treatment of fellow enterprises under the directional principle is:*
>
> - *In principle, all assets and liabilities between fellow enterprises are shown in direct investment abroad when the ultimate controlling parent is a resident [of the fellow's economy] ...*
>
> - *In principle, all assets and liabilities between fellow enterprises are shown in direct investment in the reporting economy when the ultimate controlling parent is a nonresident [of the fellow's economy]." (BPM6*, para. 6.43)

The following examples illustrate the treatment of direct investment between fellows.

Figure 1



Case 1 ***Impact of choosing enterprise versus LEG***

1. *Using the enterprise as the statistical unit in both economies.*

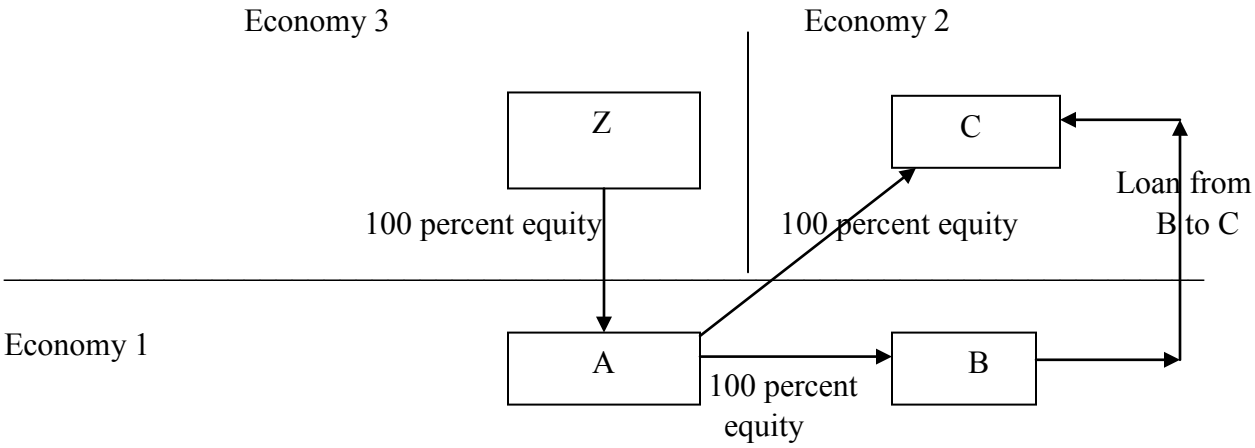
In this example (see Figure 1), A and B are residents of Economy 1, and C is a resident of Economy 2. A owns 100 of the equity in both B and C. B and C are fellows. B has lent funds to C.

In this example, the loan from B to C is recorded as outward direct investment by Economy 1 (and as inward direct investment by Economy 2), because the ultimate controlling parent of both fellows is A, who is a resident of Economy 1 (nonresident of Economy 2).

2. *Using the LEG as the statistical unit in both economies.*

If a LEG is the statistical unit in both economies, then A and B together (AB) comprise the direct investor in C, and the loan from AB to C is recorded as outward direct investment by Economy 1 (and as inward direct investment by Economy 2), because the classification of the loan should follow rules for classifying positions between direct investors and their direct investment enterprises (not the rules that apply to positions between fellows).

Figure 2



Case 2

Case 2 is similar to Case 1, except that enterprise Z has acquired 100 percent of the equity ownership of enterprise A.

1. *Using the enterprise as the statistical unit in both economies.*

In this example (see Figure 2), A and B are residents of Economy 1, C is a resident of Economy 2, and Z is a resident of Economy 3. Z owns 100 percent of the equity in A. As before, A owns 100 of the equity in both B and C; B and C are fellows; and B has lent funds to C.

In this example, the loan from B to C is recorded as negative inward (not as outward) direct investment by Economy 1, because the ultimate controlling parent of B is Z, who is a nonresident of Economy 1. The loan from B to C is recorded as positive inward direct investment by Economy 2 (as before), because the ultimate controlling parent of C is Z, who happens to be a nonresident of Economy 2.

2. *Using the LEG as the statistical unit in both economies.*

If a LEG is the statistical unit in both economies, then AB together comprise the direct investor in C, and the loan from AB to C is recorded as outward direct investment by Economy 1 (not as negative inward direct investment), because the classification of the loan should follow rules for classifying positions between direct investors and their direct investment enterprises (not the rules that apply to positions between fellows).

Many other examples have been discussed in various fora (including at prior meetings of the Committee, Working Group on External Statistics, and the ECB/Eurostat Technical Expert Group on the Directional Principle). The examples could be made more complete by, for example, showing how results will differ depending upon whether all of the economies involved in a direct investment relationship use LEGs as their statistical unit, or they all use enterprises, or some use LEGs and others use enterprises, or whether the Ultimate Controlling Parent of fellow enterprises is unknown, etc. Some conclusions can be drawn from many of these examples:

- A given position between fellow enterprises (e.g., the position between fellow enterprises B and C in the above cases) may switch from inward to outward direct investment (and vice versa) when the ultimate controlling parent changes. Also, much less switching occurs in economies that use LEGs as their statistical unit than in economies that use enterprises as their statistical unit, because the switching occurs only in connection with positions between fellow enterprises, and there are far fewer fellow enterprises in economies that use LEGs as their statistical unit.

- In economies that use enterprises as their statistical unit, new inward investments can manifest itself as net *reductions* in both inward and outward direct investment positions, rather than an increase in inward position. In the examples given above, enterprise A in Economy 1 is acquired by enterprise Z in Economy 3. If Economy 1 uses the enterprise as its statistical unit, the position between enterprises B and C will switch from positive outward to negative inward direct investment. This switching could result in a reduction in *both* inward and outward direct investment recorded by Economy 1, depending upon the relative sizes of the positions between the enterprises involved. However, if Economy 1 uses the LEG as its statistical unit, then the position between enterprises B and C remains classified in outward direct investment, before and after the acquisition of enterprise A by enterprise Z.

III. ARE LEGS ACCEPTABLE AS THE STATISTICAL UNIT FOR FDI DATA COLLECTION?

STA has recently received questions from compilers, asking it to confirm that LEGs can be used as the statistical unit in compiling data on FDI. We confirm that, under *BPM6*, the *CDIS*

Guide, and other standards and manuals, we believe that LEGs may be used as statistical units. In particular:

BPM6 para 4.56:
"Local enterprise groups may be used for compiling and presenting direct investment statistics…"

CDIS Guide
The IMF's *Coordinated Direct Investment Survey Guide* contains definitions of LEGs (paragraphs 2.24 – 2.26) and provides illustrations of their treatment (pages 17 – 19 of the *CDIS Guide*). Further, the *CDIS Guide* contains model questionnaires that compilers may use or adapt for collecting data on direct investment, and these clearly allow the use of LEGs as the primary statistical unit for data collection.

OECD Handbook on Economic Globalisation Indicators:
Defines "outward investment" (page 230):
"From the point of view of a compiling country, the parent company of its affiliates abroad controlled by residents of this country is the consolidated enterprise (enterprise group) comprising the domestic firms which the preceding firm controls directly or indirectly in the compiling economy."

The *OECD Handbook* defines "statistical units" as follows (page 232):
"The statistical units correspond to the following three levels of production: *a*) the establishment; *b*) the enterprise; and *c*) the enterprise group."

OECD Benchmark Definition of Foreign Direct Investment, fourth edition (*BD4*), para. 118, defines direct investor as follows:

> *"A direct investor could be classified to any sector of the economy and could be any of the following:*
> *(i) an individual;*
>
> *(ii) a group of related individuals;*
>
> *(iii) an incorporated or unincorporated enterprise;*
>
> *(iv) a public or private enterprise;*
>
> ***(v) a group of related enterprises;***
>
> *(vi) a government;*
>
> *(vii) an estate, trust or other societal organisation; or*
>
> ***(viii) any combination thereof.****"* (boldface type added)

Based on the Committee discussions at its meetings in 2007 and 2008 and follow-on electronic discussions, STA has agreed to clarify the FDI statistical standards as it develops the *BPM6 Compilation Guide*. At this time, there are a large number of economies that use LEGs as their statistical unit for FDI data collection (including the United States, Canada,

United Kingdom, and Australia), and also a large number of economies that use enterprises as their statistical unit for FDI data collection (probably including a majority of economies in Europe). As noted, either is acceptable under *BPM6*. It nonetheless should be recognized that the current situation is not a good one, because of the impact of these different methods in connection with the recording of data between fellow enterprises. It is recognized that it could be burdensome for any economy to change from its current method of data compilation.

Questions for the Committee

> *Do Committee members have any views about the issues raised in this paper? What are Committee members' own practices in regard to the statistical unit and the use of the LEG or the enterprise?*
>
> *The IMF has agreed to take work on FDI forward during its drafting of the BPM6 Compilation Guide. Do Committee members have other suggestions for addressing any of the issues raised?*