

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

DIRECT INVESTMENT TECHNICAL EXPERT GROUP (DITEG)

ISSUES PAPER (DITEG) # 12

COUNTRY IDENTIFICATION

**(ULTIMATE BENEFICIAL OWNER/ULTIMATE DESTINATION AND
IMMEDIATE HOST/INVESTING COUNTRY)**

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I. Current international standards for the statistical treatment of the issue

1. The *BPM5* treats regional allocation principles in §§481-498. *BPM5* discusses the distinction between the *transaction principle* and the *debtor/creditor principle*. In both cases reference is made to the *immediate host/investing country* of the transactor or debtor/creditor, respectively. Financial flows may be geographically allocated either on the basis of the *transaction principle* or on the basis of the *debtor/creditor principle* (§482). International investment position data are to be allocated on the basis of the *debtor/creditor principle* (§484).
2. The OECD *Benchmark Definition of Foreign Direct Investment (Benchmark Definition)* also recommends that direct investment flows, income and stocks be allocated to the country of the *immediate host/investing country* (§§46-47).
3. The *Benchmark Definition*, however, suggests that the stocks of direct investment net assets be also compiled in respect of the ultimate host or controlling country (§45).

II. Concerns/shortcomings of the current treatment

4. The *Benchmark Definition* does not give definitions of the ultimate host or controlling country.
5. A less important concern is that the reference to “net assets” is not completely clear about the components of FDI stocks to be compiled in respect of the ultimate host or controlling country.
6. There is a widespread interest among users in knowing more than the immediate host/investing country. Investors frequently use entities located in offshore centres or SPEs to

channel FDI funds, while users are also interested in knowing about the ultimate country of control or destination. Data available in some EU Member States for inward stocks compiled in respect to the ultimate controlling country, when compared to data according to the immediate investing country, show that the impact of the reallocation may be substantial¹.

III. Possible alternative treatments

7. In practical applications, the reclassification of inward stocks by *ultimate controlling country* is more developed than the reclassification of outward stocks by *ultimate host country* (see also point 10 below). The rest of this paper therefore considers mainly the case of inward FDI stocks. After a preliminary distinction on the concept of control, a definition for the *ultimate controlling country* is proposed and the case of *other capital* stocks is discussed.

8. Given the interest of users in this subject, it is proposed that, for inward stocks at least, the ‘suggestion’ given in §45 of the *Benchmark Definition* be strengthened and transformed into a ‘recommendation’.

9. However, supplementary definitions seem needed to overcome the concerns mentioned above regarding the definition of *ultimate controlling country* and the identification of the components of FDI stocks to be reallocated.

10. The case of outward stocks by *ultimate host country* is treated more concisely and in less detail. Information on outward FDI stocks by ultimate host country is until now collected, according to table 12 in IMF-OECD (2003, p.79), only by Denmark, Estonia and Luxembourg². A tentative definition for the ultimate host country is proposed in §15. If a general definition is agreed, more analysis would be needed, at least for the case of multiple *ultimate host countries*. A discussion of the *other capital* component is similarly not provided here for outward stocks.

Inward stocks by ultimate controlling country

11. Considering the case of inward stocks, it should be preliminarily observed that the concept of control³ may in general be interpreted as referring to the direct investment

¹ See chapter 7 of the report of the Eurostat/ECB Task Force on FDI (Eurostat/ECB, 2004). Data for inward FDI stocks according to the ultimate controlling country were provided by Austria, Denmark and Germany.

² According to the same source, however, Estonia and Luxembourg do not disseminate data by ultimate host country.

³ In the *Benchmark Definition* control is not explicitly defined. However, it can be said that the definition of subsidiary in §14 of the *Benchmark Definition* gives a definition of control in the sense that A is controlled (directly or indirectly) by B if A is a subsidiary (or a branch) of B. §14 makes reference to the majority ownership criterion and to other forms of control.

enterprise as a whole, or to any given position of inward FDI held by an immediate direct investor⁴ (there can be more than one immediate direct investor for the same direct investment enterprise, or the enterprise may be nationally controlled). The second interpretation is equivalent to referring control to the immediate direct investor itself.

The two concepts obviously give different results in cases such as: i) there is more than one foreign owner above 10% in a direct investment enterprise, one of which controls the enterprise; ii) there is one or more foreign owners below 50% and the direct investment enterprise is controlled by a resident entity.

In statistics such as those on ‘operating data of foreign affiliates’ (also called FATS), the concept of control is actually referred to the enterprise as a whole.

It seems however that the second interpretation (namely, to refer control to the immediate direct investor) is the correct one in the context of the FDI methodology. Paragraph 43 of the *Benchmark Definition* refers to the stock of net assets *due to the immediate investing country*, reanalysed by country of ultimate control.

Several arguments in favour of the second interpretation can be given. First, FDI statistics measure lasting interest, which obviously does not necessarily imply control on the enterprise. Secondly, in ‘operating data’, variables such as turnover or employment are allocated 100% to the controlling country. FDI positions refer instead to the capital stock of the direct investment enterprise only in proportion to the share held by the immediate direct investor. Thirdly, if control was referred to the direct investment enterprise, for all resident associate companies the “ultimate controlling country” would be the compiling country. Finally, for subsidiaries, there would be the additional question of how to allocate minority shares (above 10%) held by a direct investor other than the one controlling the subsidiary.

On the other hand, the main argument in favour of the first interpretation seems to refer to the fact that for compilers it would be easier to obtain information on the ultimate controlling country of the enterprise than on that of the immediate direct investor. Collecting data for the ultimate controlling country of the immediate direct investor (when this is not the same as for the direct investment enterprise) may be difficult and may result in statistics of lower quality.

To sum up this part, main intermediate conclusions are:

i) in the framework of the present FDI methodology, for determining the ultimate controlling country of inward FDI stocks, control is to be referred to the immediate direct investor, not to the resident direct investment enterprise;

⁴ The qualification “immediate” may be redundant, but is kept in the rest of this paper for clarity to indicate the first non resident entity directly holding an inward FDI position. The immediate investing country is the country of residency of the immediate direct investor. Incidentally, while checking the definition of direct investor in chapter XVIII of *BPM5*, it was noticed that §359 refers to the direct investor as a “resident entity”, which is not the case for inward FDI.

ii) point i) implies that for a given resident direct investment enterprise there may be more than one ultimate controlling entity and, if they reside in different countries, more than one *ultimate controlling country*.

12. Having clarified these points, the following definition of *ultimate controlling country* is proposed:

The ultimate controlling country is the country of residency of the first person (proceeding up the chain beginning with and including the immediate direct investor) that controls the immediate direct investor and is not controlled by another person.

13. Regarding the identification of components of FDI stocks to be re-allocated according to the *ultimate country of control* criterion, two points seem to deserve consideration by the DITEG:

i) the meaning of “net assets” needs clarification.

It may be preferable to speak of net liabilities for inward stocks and net assets for outward stocks. ‘Net’ in both cases seems to refer to the case of reverse investment below 10%.

ii) should the reallocation concern only the *equity capital and reinvested earnings* component or also the *other capital* component of FDI liabilities?

During the discussion at the EU Task force on FDI (Eurostat/ECB, 2004) it emerged that the interpretation of the methodology differs among compilers. Some compilers consider also the other capital component and some do not.

It seems however to be no difficulty in including also the *other capital* component if (as proposed above) the reallocation by country of ultimate control is referred to the immediate direct investor. Stocks of *other capital* can be reallocated applying the same principles as for the *equity capital and reinvested earnings* component.

Outward stocks by ultimate host country

14. Regarding outward stocks, the problem of defining the *ultimate host country* may be considered in a symmetric way with respect to the case of inward stocks by *ultimate controlling country*. That is to say, net assets invested in the immediate direct investment enterprise are reallocated to the country where the immediate direct investment enterprise ultimately holds FDI stocks.

15. The following definition of “ultimate host country” is proposed:

The ultimate host country is the country of residency of the first affiliate (proceeding down the chain beginning with and including the immediate direct investment enterprise) that is

controlled by the immediate direct investment enterprise and does not control any other affiliate.

16. Clearly, the immediate direct investment enterprise may hold different chains of control ending up in different *ultimate host countries*. A criterion for breaking down net assets (invested in the immediate direct investment enterprise) among the different destinations is not proposed at this stage. Given the potential complexity of the reallocation, one possible option could be to recommend a reallocation by *ultimate host country* only for cases in which the immediate direct investment enterprise is a holding company and/or an SPE.

IV. Points for discussion

1. *Do DITEG members agree that the Benchmark Definition should recommend allocation of FDI inward stocks by ultimate controlling country?*
2. *Do DITEG members agree with the definition of ultimate controlling country proposed in §12?*
3. *Do DITEG members agree that the reallocation by ultimate controlling country should refer to both equity capital and reinvested earning and other capital inward stocks?*
4. *Do DITEG members agree that the reallocation by ultimate controlling country should refer to net liabilities, i.e. liabilities to the immediate direct investor minus assets below 10% possibly held by the direct investment enterprise in the capital of the immediate direct investor?*
5. *Do DITEG members agree with the definition of ultimate host country proposed in §15?*
6. *Do DITEG members agree that §359 of BPM5 needs redrafting in the part where it says that the direct investor is a resident entity (see footnote 3)?*

References

Balance of Payments Manual, fifth edition (*BPM5*), IMF, 1993.

Benchmark Definition of Foreign Direct Investment (Benchmark Definition), third edition, OECD, 1996

Foreign Direct Investment Task Force Report, Eurostat and ECB, March 2004. Available also as a PDF file on the ECB website at

<http://www.ecb.int/pub/pdf/foreigndirectinvestment200403en.pdf>

IMF-OECD (2003), *Foreign Direct Investment Statistics – How countries measure FDI*.