I. DIRECT INVESTMENT TECHNICAL EXPERT GROUP (DITEG)
II. OUTCOME PAPER (DITEG) # 27

April 8, 2005

1. Topic: Principles for classification by industry (according to direct investor or direct investment enterprise).

2. Issues: See DITEG Issue Paper # 27 by Eurostat (December 2004).

3. Recommendations:

(i) From the terminological point of view, DITEG was of the opinion that the methodology should refer to a "classification by industrial activity" rather than to an "industry sector classification". The latter expression, contained in the present methodology, may give rise to confusion with the classification by institutional sector.

(ii) DITEG agreed that the methodology should refer to the categories of the United Nations International Standard Industrial Classification (ISIC). In particular, DITEG was of the opinion that the methodology should recommend, as a minimum requirement, a classification by industrial activity as reflected in ISIC *sections* in force at the time of the data compilation.

(iii) Based on analytical arguments, DITEG agreed to maintain the present recommendation of the methodology, namely that FDI statistics by industrial activity should refer, if possible, to the activity of the direct investment enterprise and to the activity of the direct investor, for both inward and outward statistics. The Group recommended that data be compiled at least according to the activity of the direct investment enterprise in both cases (inward and outward investment).

(iv) Concerning the specific problem of the classification of holding companies, the present FDI methodology in the *Benchmark Definition* recommends that holding companies be considered financial corporations, even though the investments that they hold may be in other industries[1]. Including all holding companies that are SPEs, regardless of the activities that the holding companies' subsidiaries may be involved in, in the financial sector had been rejected by DITEG at its December 2005 meeting[2]. More specifically,

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[1] See the OECD *Benchmark Definition* for FDI, 3rd edition, paragraph 117. This treatment may be compared with *1993 SNA*. Para. 4.100 which indicates that a holding company should be classified as financial "if the preponderant type of activity of the group of corporation as a whole is financial". The inference that could be drawn is that where the predominant activities of the group are non-financial, the holding company should be classified as non-financial. But note that the *SNA* refers here to the classification of the holding company corporation itself, exclusive of its subsidiary corporations, whereas the *BD* refers to the classification of the (consolidated) Direct Investment Enterprise, including subsidiary corporations.

[2] See Outcome paper #9, point 4 (ii), December 2004 DITEG meeting.

DITEG concluded at its December 2004 meeting that, in cases where the holding company owns other companies in its same economy, the "holding company is to be classified according to whichever industrial activity of its subsidiaries dominates in the resident economy. This may result in a holding company being classified as a financial corporation (when most of the group's activities in its same economy are in the financial sector), or as a non-financial corporation (when most of the group's activities in its same economy are in the non-financial sector). Some delegates confirmed this opinion during the March 2005 DITEG meeting, while other delegates were in favour of classifying all Direct Investment Enterprises that contain a holding company at the top of the organizational structure in its country of operation to Financial Intermediation. It was also noted that DITEG, at its December 2005 meeting, had recommended that the definition of "financial intermediation" needed to be modified to take account of the activities of holding companies as their activities may not meet the current definition of financial intermediation.

(v) DITEG also took note that the present discussion on the revision of ISIC, according to the provisional documents available at the time of DITEG meeting (mid-March 2005), may seem to go in the opposite direction as the conclusions of Outcome paper #9 (2). ISIC proposed revision seems to show a preference for classifying "holding companies" in Financial Intermediation irrespective of the activity of the subsidiaries controlled.

4. Rejected Alternatives:

DITEG rejected the proposal of creating in the new methodology a specific list of ISIC activities dedicated to FDI statistics.

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 the methodology should refer to a "classification by industrial activity" rather than to an "industry sector classification"? See 3(i) above

(ii) Do the Committee and the WIIS agree that the methodology should recommend, as minimum requirement, a classification by industrial activity as reflected in ISIC? See 3(ii) above.

(iii) Do the Committee and the WIIS agree that FDI statistics by industrial activity should refer, if possible, to the activity of the direct investment enterprise and to the activity of the direct investor, for both inward and outward statistics? See 3(iii)

(iv) In relation to the industrial classification of holding companies, what is the opinion of the Committee and the WIIS with respect to their classification in financial intermediation? That is, should a Direct Investment Enterprise be considered a holding company (and therefore a financial institution) when the corporation at the top of the organizational structure is a holding company, regardless of the activities of the enterprises that it owns in the same resident economy,), or should it be classified to the predominant activity of the rest of the group, resident in the same economy as the holding company? See 3(iv) above.