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Comparison of Official and EDO/IPA FDI Accounting Methods

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IMF/OECD FDI Accounting Methods

Sources used include:

- **OECD Benchmark Definition of Foreign Direct Investment, 4th Edition, 2008**
- **OECD Survey of Implementation of Methodological Standards for Direct Investment, May 2008**
- **IMF Balance of Payments and International Investment Position Manual, 6th Edition BPM6, 2009**
- **IMF Balance of Payments and International Investment Position Compilation Guide , 2014**
- **IMF, Foreign Direct Investment, Trends, Data Availability, Concepts, and Recording Practices, 2004**
- **IMF, Foreign Direct Investment Statistics, How Countries Measure FDI, 2003**

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OECE/IMF Definition of FDI

- The OECD *Benchmark Definition of Foreign Direct Investment* sets the world standard for official direct investment statistics.
- Direct investment is a category of cross-border investment made by a resident in one economy (the *direct investor)* with the objective of establishing a lasting interest in an enterprise (the *direct investment enterprise)* that is resident in an economy other than that of the direct investor.
- The motivation of the direct investor is a strategic long-term relationship with the direct investment enterprise to ensure a significant degree of influence by the direct investor in the management of the direct investment enterprise.
- The "lasting interest" is evidenced when the direct investor owns at least 10% of the voting power of the direct investment enterprise.
- FDI statistics include direct investment positions (equity and debt), direct investment income flows (distributed earnings, reinvested earnings, interest income) and direct investment financial flows (equity and debt).

Components of FDI

- The internationally accepted definition of FDI is provided in the IMF's Balance of Payments Manual.
- Under this definition FDI has three components:
    1. Equity investment.
    2. Reinvested earnings.
    3. Short- and long-term inter-company loans between parent firms and foreign affiliates.
- The components of direct investment capital transactions are recorded on a directional basis (i.e., resident direct investment abroad and nonresident direct investment in the recording economy).
- The *FDI net inflow* records the net flow of nonresident direct investment in the recording economy, while the *FDI net outflows* records the net flow of resident direct investment abroad.
- Direct investment statistics are also disaggregated by major industry sectors based on the International Standard Industrial Classification (ISIC).

Types of FDI

- FDI statistics encompass mainly four types of operations that qualify as FDI:
  1. Purchase/sale of existing equity in the form of mergers and acquisitions (M&A).
  2. Greenfield investments.
  3. Extension of capital (additional new investments).
  4. *F*inancial restructuring.
- While M&A transactions imply the purchase or sale of existing equity, greenfield investments refer to altogether new investments (ex *nihilo* investments). Extension of capital relates to additional new investments as an expansion of an established business; conceptually and in terms of economic impact, it is similar to greenfield investments. Financial restructuring refers to investment for debt repayment or loss reduction
- At the present time, the *Benchmark Definition* recommends that supplemental series be produced only for FDI equity flows for M&A type activity.
- Further research is planned for Greenfield investments, extension of capital and financial restructuring, all of which are also part of FDI. Similar analysis of FDI positions would not be meaningful as such data relate indistinguishably to the stock of all types of investment accumulated over time.

National and International Data Availability and Sources

- In most countries national statistical offices, central banks or ministries collect the balance of payment statistics which contains records of resident direct investment abroad and nonresident direct investment in the recording economy.
- The World Bank publishes FDI data based on balance of payment data reported by the International Monetary Fund (IMF), supplemented by staff estimates using data reported by the United Nations Conference on Trade and Development (UNCTAD) and official national sources.
- UNCTAD publishes data on foreign direct investment flows and stocks in its annual *World Investment Report.*
  - *Note that UNCTAD publishes in the World Investment Report greenfield FDI data from fDi Markets (fDi Intelligence, Financial Times Ltd), which is based on a similar methodology to that discussed in the section "IPA FDI Accounting Methods".*
- Because of the multiplicity of sources and differences in definitions and reporting methods, there may be more than one estimate of foreign direct investment for a country, and data may not be comparable across countries .

Definition of FDI Accounts

- Direct investment statistics embody three distinct statistical accounts: *i)* investment positions, *ii)* financial transactions, and *iii)* associated income flows between enterprises which are related through a direct investment relationship:
  1. *Direct investment positions* (stocks of investment); provide information on the total stock of investment made abroad and received from abroad. FDI position data allow a structural analysis of investments in the host economy or industry sector, and investment by the investing (home) country or industry sector. Due to the accumulation of earlier investments over time, in general, stock data allow the dissemination of more detailed estimates as they are less likely to be susceptible to statistical confidentiality constraints.
  2. *Direct investment financial transactions* show the net inward and outward investments in any given reference period (yearly, quarterly or monthly). FDI inward flows provide a useful indicator in relation to the attractiveness of economies but such interpretations require additional information on which to base sound conclusions.
  3. *Direct investment income* provides information on the earnings of direct investors and of the direct investment enterprises.

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Data collection methods

- The sources used by compilers have an impact on their ability to implement the international recommendations for the compilation of FDI statistics.
- There are three major data sources:
  1. Enterprise surveys.
  2. International transactions reporting systems (ITRS).
  3. “Administrative” data from exchange control or investment control authorities.
- Other data sources include:
  - Financial Statements.
  - Monitoring the media and bilateral sources.

How to compile FDI data?
1. Enterprise Surveys

- Statistical questionnaires often constitute the core source of information and are used to obtain information on direct investment from businesses involved in direct investment activities. To close gaps in the collection of company data, usually economies will develop surveys on companies' external financial assets and liabilities.
- A frame (register) of enterprises is needed to incorporate and maintain the list of those included in the FDI survey(s). It has to be designed specifically to include the necessary information for FDI requirements.
- It is considered that a survey-based system is better able to collect the data for the balance of payments and international investment position as transactions become increasingly complex, while in some more "basic" circumstances the ITRS is still effectively used.
- In many economies, a statistics act or formal legal arrangements exist under which the central bank or statistical agency has the authority to collect information or conduct a survey.
- It is preferable to have legal authority as soon as possible. Good legal authority needs to state that reporting of statistical information is mandatory, especially for large companies.

How to compile FDI data?
2. ITRS

- The international transactions reporting system (ITRS)1 is part of the broader institutional data collection framework of many economies.
- It differs from economy to economy, drawing from economies' legal framework, accounting systems, and foreign exchange regulations; however, virtually all such systems have certain features in common.
- Most ITRS (formerly known as foreign exchange record systems) evolved as by-products of foreign exchange control systems. However, as foreign exchange restrictions were eased or lifted, many systems were extended be- yond their original purpose of measuring foreign ex- change transactions.
- As a general rule, an ITRS is a data collection system that obtains data from banks and companies at the level of individual transactions.
- The most comprehensive "traditional" ITRS measures:
    1. Cash transactions with nonresidents that pass through domestic banks.
    2. Cash transactions that pass through enterprise accounts with banks abroad.
    3. Transactions on intercompany accounts with nonresident companies.
    4. Positions.
    5. Noncash transactions.
- Statistics are compiled from forms submitted to/by domestic banks and from forms submitted by companies.

How to compile FDI data?
3. Administrative data

- Data gathered from Governments' bodies are often useful to complete the data collected by the questionnaires.
- Local investment review agencies can also provide a good source of financial data to complement mailing lists of companies.
- Catalogues showing corporate structures of companies (e.g. Who Owns Whom) can also constitute reliable indexes to adequately populate enterprises likely to be involved in FDI.
- Many economies have foreign investment boards or similar institutions that promote, place conditions on, or monitor various forms of foreign investment. To make certain types of investments or to expand existing investments, investors may be required to submit application forms to the investment board, which may be required to give approval of the investment before it can proceed, which may also assist investors in establishing companies and may ensure that investments comply with government guidelines.
- These statistics are generally not directly usable for balance of payments compilation purposes as they relate to intended investments rather than actual investments and reporters sometimes record the expected value of the investment, including total financing and not just the external investment.

How to compile FDI data?
Financial Statements of companies

- Financial statement of companies can provide useful information in estimating such international investment position items as direct investment, portfolio investment, and other investment (loans, trade credit and advances, currency and deposits, and other accounts receivable/payable).
- The key to determining the usefulness of this data source is the level of consolidation of the financial statements—whether they are consolidated or unconsolidated.
- The source of the financial statements— publicly available or accessible to the compiler through official channels—largely determines the level of consolidation available.
- The most useful financial statements for deriving direct investment are the books of the direct investment enterprise (DIENT). When the DIENT is in the reporting economy, the process of estimating direct investment from financial statements is straightforward. When the DIENT is not in the reporting economy, using financial statements to estimate direct investment is more complex. In this case, if the only set of financial statements available is the consolidated statement of the resident direct investor, the balance sheet may not provide enough information to calculate direct investment asset positions.
- The compiler may have access to the data sources through official channels, and these sources may provide the unconsolidated financial statements of the resident direct investor. If this is the case, the asset side of the balance sheet may provide information on the *investment in foreign affiliates* (equity) and *loans to foreign affiliates* (debt instruments). The liability side may provide information on *loans from a foreign affiliate10* (debt instruments).

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How to compile FDI data?
Financial Statements of companies

- The source can also provide information on resident DIENTs such as *investment of direct/portfolio investors in equity, loans from the direct investors* (on liability side), and *loans to direct investors* (assets side).
- Generally, publicly available sources exist for publicly traded companies in an annual report, available in print format or on the Internet. Annual reports contain balance sheet items that can be used to estimate direct investment in a company. Financial statements that are publicly available are usually consolidated (i.e. no intercompany transactions).
- Internal sources available within official agencies may also contain financial statement information.
- Some compiling agencies collect—for their national financial statistics—the financial statement information for foreign-owned companies. Depending on the rules for data sharing that govern the compiling agency, it may be possible for the compiler to access information on the shareholders' equity of the foreign- owned company from this source.
- Although financial statements may provide an early source for estimating direct investment and other international investment position items, clearly the compiler needs to develop a more complete source, such as enterprise surveys.
- Once a survey system is in place, the compiler is encouraged to request copies of the financial statements of the DIENT from the reporters. These statements can be used to verify figures reported on the survey or to ascertain other information, such as realized or unrealized capital gains and losses and write-offs.

How to compile FDI data? *Monitoring Media & Bilateral Sources*

Media sources

- Monitoring financial information from the business community as published in the financial press is often very important both to highlight the occurrence of and to better assess important FDI transactions. Human resources (i.e. financial analysts) need to be devoted to review systematically the financial press. On occasion, it can be necessary to estimate an FDI transaction without making contact with the company because of official release constraints.
- The financial and economic press provides an excellent timely source of information for identifying large transactions that could have international implications, particularly for new investments or mergers and acquisitions for direct investment. The financial press may provide information on the names of the resident and nonresident companies, the economy with which the transaction occurred, and the size of the transaction. If the resident company involved is already surveyed by a questionnaire, the information could be validated against that questionnaire, and if necessary the company could be contacted to discuss the transaction.
- For some economies, this timely data source can account for a significant amount of the preliminary estimates of direct investment. However, caution should be exercised, because information in the press on the timing and size of in- vestment is often inaccurate.

Bilateral sources

- Reconciliation of data between partner countries can be conducted to validate and try to harmonize one another's statistics. This exercise can be done on a regular basis.

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Issues in compilation of official FDI statistics

- In compiling and presenting FDI statistics, compilers in many countries may encounter the possibility of confidential data occurring in the results to be disseminated. Such information generally does not directly identify the entity, *e.g.* the name and address of an enterprise, to which the data relate.
- In many countries, national statistical legislation prohibits the direct or indirect disclosure of information relating to a particular individual or entity.
- Many international organizations also operate statistical confidentiality regimes to ensure that confidential statistical information is not disseminated.
- These FDI statistics include all the funds that pass through SPEs as well as capital transiting through operating subsidiaries of MNEs on behalf of the parent companies. In consequence, while the data presented using the asset/liability principle provide an overall aggregate measure of FDI, they do not provide an appropriate basis for an analysis by partner country and/or by industry, as these data do not reflect the direction of influence or control. For example, the IMF found that FDI into France from the US was understated by around 50% and FDI from Netherlands to UK overstated by over $200 billion. Likewise, around 30% of FDI from China is "round-tripping" through Hong Kong (see www.wavteq.com/countryreports)
- Governments have been recommended to provide inward FDI position according to the ultimate investing country (UIC).

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EDO/IPA FDI Accounting Methods

Sources used include:

- Columbia FDI Perspectives, “A New Foreign Direct Investment Accounting Methodology for Economic Development Organizations” by Dr Henry Loewendahl, 2015 (No. 165, Jan. 18, 2016)
- Columbia University/UN, “A Handbook for Investment Promotion”, lead author Henry Loewendahl, 2010
- UNCTAD, “Framework for Investment Promotion”, by Henry Loewendahl, TNCs 2003
- WAVTEQ, Survey of IPA Foreign Direct Investment Accounting Methods, 2014
- WAVTEQ, Survey of IPA FDI Target Setting Practices for Invest Canada Bureau, 2010

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Economic Development Organizations Investment promotion agencies

- EDOs/IPAs are established in almost every country and most major regions and cities of the world to attract FDI to their location and maximize the benefits for the host location.
- The objective is to attract FDI to promote economic development in their location.
- The activities of EDOs/IPAs can be classified into four main areas:
  1. **Investment Facilitation:** helping foreign investment implement their projects.
  2. **Investment Promotion:** promoting the location to potential investors.
  3. **Investor Development:** providing "aftercare" services to existing investors to encourage them to stay and expand in the location and contribute more to the local economy.
  4. **Policy Advocacy:** developing policy initiatives and influencing policy to improve the attractiveness of the location for foreign investors.
- The activities of EDOs/IPAs are therefore very much focused on engaging with individual investors to encourage and assist them to invest in their location and supporting them with their operations so they expand and embed into the local economy.
- Amongst developed economies, very few EDOs/IPAs have a focus on capital investment: their focus is on attracting FDI projects and jobs in strategic sectors.
- Developing country EDOs/IPAs have a stronger focus on capital investment (as well as job creation) to provide often much needed foreign exchange to the country.

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Definition of FDI used by EDOs/IPAs

1. Type of FDI

- All EDOs/IPAs have a key focus on Greenfield FDI (GFDI) both new foreign investors and expansion of existing foreign investors.
- Less than 20% of IPAs focus on M&A and less than 10% other equity investment.

FDI data from EDOs/IPAs cannot be compared to official FDI statistics, which include all types of FDI and do not segment to the level of GFDI (except for the BEA in US, which started this for its 2014 FDI dataset).

- EDOs/IPAs have a core focus on only one type of FDI. The reason is explained by the OECD:

"Direct investment will have, all other aspects being equal, a different impact, in particular, on the "host" economy depending on the type of FDI. It is generally considered that cross-border investments in the form of M&As will not involve significant changes in the performance of economic variables such as production, employment, turnover, etc., unless the acquired enterprise is subject to significant restructuring. On the other hand, new investments, greenfield investments and extension of capital, are likely to add new dimensions to the economic performance of the host economy and to the earnings of the direct investor"

2. Equity share

- As EDOs/IPAs focus on Greenfield FDI, over half of EDOs/IPAs define FDI as when the foreign companies has over 50% ownership of the operation. This is a similar definition to that used by the OECD and IMF in their recommendations on collecting statistics on multinational enterprises (MNEs).

FDI data from EDOs/IPAs cannot be compared with official FDI data which is based on 10% voting interest

3. Definition of capital investment

- EDOs/IPAs include **the total capital investment of the FDI project** not the amount of capital that will cross borders as a direct investment transaction. The focus on total capital investment shows the contribution of the foreign investor to fixed capital formation in the location and its therefore its likely GDP impact.

FDI data from EDOs/IPAs cannot be compared with official FDI data which is based on capital crossing borders as FDI not the total capital investment of the foreign investor

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What counts as an FDI success for an EDO/IPA?

- EDOs/IPAs are investment facilitation and promotional organizations. Most measure a "success" as when a company **announces** their investment in the country, often through a press release.
- There is a very strong reason for doing this, which is because of the time it takes from the announcement of an FDI project to when the project is opened and the investment is realized.
- For capital intensive operations, it typically takes 1-2 years (or longer) from announcement to opening. During this period, the EDO/IPA supports the company implement their project.
- If the EDO/IPA had to wait 2 years before they can count the project as a success their FDI statistics would be several years out of date and they maybe closed down for not attracting any FDI!!
- As a result, over 90% of EDOs/IPAs count "Announcements" in their FDI successes and FDI results. Less than 10% of EDOs/IPAs include only "Opened" projects in their results.

The FDI data from EDOs/IPAs cannot be compared with official FDI data as EDOs/IPAs include announced FDI while the official data only includes actual, realized cross-border transactions.

- Because of the importance of announced investments (and ensuring that these operations are indeed realized), EDOs/IPAs utilize metrics to qualify that announced investment will happen and follow-up with investors to ensure the operation opens. www.fdiaccounting.com developed by WAVTEQ is a tool to facilitate this.
- While EDOs/IPAs included announced FDI in their FDI statistics, over 90% qualify that announced projects actually happen, which ensures their FDI statistics are robust over time.

How to EDOs/IPAs measure their FDI performance?

FDI targets

- EDOs/IPAs primarily measure their performance by the number of announced and opened FDI projects they attract in a given year and often the direct job creation, safeguarded jobs, and capital investment of these projects. Many have clear annual targets around these metrics.

Over 90% of EDOs/IPAs surveyed measure job creation, which is not a metric in the official FDI statistics

Quality of investment

- Many EDOs/IPAs also have additional targets around the quality of investment being attracted.
- In the US and some European EDOs/IPAs, the salary level of the operation is benchmarked against average salary levels in the economy or industry to measure FDI upgrading of the economy.
- Many EDOs/IPAs also attach specific weight to R&D and strategic projects.
- The FDI Accounting system developed by WAVTEQ measures both the technology-level of projects (based on OECD, EU and BEA definitions) and strategic projects. See www.fdiaccounting.com

EDO/IPA involvement and return on investment

- The more sophisticated EDOs/IPAs have developed metrics to measure their involvement in winning a project. Two-thirds of EDOs/IPAs surveyed measure their involvement. The FDI Accounting system developed by WAVTEQ includes an international standard for measuring involvement.
- EDOs/IPAs are increasing measuring their return on investment. FDI Accounting calculates the capital investment multiplier of EDOs/IPAs and the cost per project and per job created.

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Data fields captured by EDOs/IPAs

EDOs/IPAs typically capture the following fields when tracking FDI. These fields are all included in the FDI Accounting system developed by WAVTEQ:

Company information

1. Parent and investing company name.
2. Ultimate headquarters of the parent company *(which provides more accurate origin country statistics than the official FDI statistics).*
3. Origin country, state and city of the company *(which allows for deeper analysis than official statistics, which do not include subnational data for the origin of foreign investors).*
4. The turnover/revenues of the company (which facilitates strategic company analysis).
5. The URL of the company (to enable further research).
6. Contact person in the company (to facilitate account management).

Project information

1. Location of the project in the country, down to state, city, zone and site level *(which allows for deeper analysis than official statistics, which in most countries does not include subnational data)*
2. Industry, Sector and Subsector following an SIC system.
3. Over 60% of EDOs/IPAs record the Business Activity of the project, which often drives location determinants and economic impact *(official statistics do not define the business activity as separate from the sector).*
4. Description of the investment project.
5. Total capital investment and job creation (and jobs safeguarded for many EDOs/IPAs) announced by the investor typically over either the lifetime of the project or over a 3 year period
6. Type of investment project (new vs. expansion) and status (announced vs. opened)

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Comparison of Official and EDP/ IPA FDI Accounting Methods

"Most EDOs and IPAs track and measure FDI based on the activities of multinational enterprises in their local economy not on the official OECD/IMF definition of cross-border FDI flows. There is limited comparison that can be made between the FDI results of an EDO or IPA and official FDI statistics; they measure different metrics for different purposes"

Henry Loewendahl, CEO, WAVTEQ Limited

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Accounting rule	IPA Methods	IMF/OECD Method
Investor equity	Two-thirds surveyed define FDI as more than 50% foreign equity. This is because the key focus is on GFDI not equity FDI	FDI is 10% or more foreign equity
Measure of capital investment	All EDOs/IPAs surveyed record the total capital investment of the FDI project or JV project (typically over a 3 year period and often including payroll costs) regardless of the amount funded overseas as FDI	Only funds that have crossed borders as FDI
Timing of investment	Only 5% of EDOs/IPA surveyed only include investments that are Operational; 95% include Announced projects, which have not yet been realized	Only actual FDI flows are included
Type of investment	All EDOs/IPAs surveyed include GFDI and 90% include re-investments and joint ventures (when it leads to a Greenfield project). Only 10% include M&A and less than 5% other types of equity investment	All types of FDI with no breakdown available (except US)
Industry classification	Two-thirds of EDOs/IPAs surveyed use their own sector definitions so they can include sectors and business activities not included in ISIC codes	ISIC codes
Source of investment	Almost all EDOs/IPAs surveyed include the ultimate parent headquarters of the company as the source country making the investment	The country where the FDI funds comes from
Location of investment	Over 90% of EDOs/IPAs surveyed record the sub-national location of the investment (State and City level)	Country level only in most countries
Job creation	Over 90% of EDOs/IPAs surveyed include the direct job creation announced by the investor (typically over a 3 year period). Some also include safeguarded jobs	Does not record job creation
Qualification (of announcements)	Over 90% of EDOs/IPAs surveyed qualify that planned investment are going to take place. The most common criteria are corporate press release (80% of respondents) followed by full project information provided by the investor (nearly two-thirds of respondents). Other commonly used criteria include provision of a local mailing address, a company registration number, a written declaration from the company, registration of the company, commencement of recruitment or signing a lease. They do not require all criteria to be fulfilled to include a project as an FDI success	Only actual FDI flows are included
Validation (of investments)	70% of EDOs/IPAs surveyed validate that investments have been realized. Methods include: contacts with companies and monitoring press reports, post project evaluation, independent surveys and information from the government to validate that the company is paying taxes	Only actual FDI flows are included
Involvement in securing the investment	Over half of EDOs/IPAs surveyed record only investments that they have been involved in winning as FDI successes. Metrics used to measure the level of involvement include whether or not they had a meeting with investor through to direct validation from the investor that they influenced the decision to invest	No measure of the involvement of the host country in securing the investment – all FDI is included
Quality of investment	Over half of EDOs/IPAs surveyed evaluate the strategic importance or benefits of investment projects in their accounting method, with the most important metrics including R&D & HQ operations and average salary levels	No measure of the quality of FDI

Columbia FDI Perspectives No. 165, January 18, 2016

A new foreign direct investment accounting methodology for economic development organizations, covering:

1. Company information
2. Project details and status
3. Location and sector information
4. Investment and employment
5. Qualification that announced investments will happen
6. Evidence of EDO involvement in securing the investment
7. Quality of investment
8. Return on investment

http://us6.campaign-archive.com/?u=ab15cc1d53&id=f24e5715cd

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