



27-28 March 2008

GLOBAL FORUM VII

ON International Investment

IMPROVING ANALYSIS OF FOREIGN DIRECT INVESTMENT

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Session 2.5.: The revised Benchmark Definition (BMD): Adapting FDI data to the new realities of the global economy

This paper was submitted in response to a call for papers conducted by the organisers of the OECD Global Forum on International Investment. It is distributed as part of the official conference documentation and serves as background material for the relevant session in the programme. The views expressed in this paper do not necessarily represent those of the OECD or its member governments.

BENCHMARK DEFINITION OF FOREIGN DIRECT INVESTMENT

Improving Analysis of Foreign Direct Investment

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Introduction

1. The *Benchmark Definition of Foreign Direct Investment* sets the world standard for direct investment statistics. As such, it is a single point of reference for compilers and users of foreign direct investment (FDI) statistics, providing conceptual definitions and guidance on compilation methodologies.

2. The *Benchmark Definition* is fully compatible with the underlying concepts and definitions of the International Monetary Fund's (IMF) *Balance of Payments and International Investment Position Manual* (BPM) and follows the general economic concepts set out in the United Nations' *System of National Accounts*.

3. A revision process is now drawing to a close for both the *Benchmark Definition* and the IMF's BPM. The removal of legal and regulatory restrictions on cross-border business operations in recent years has led to a rapid increase in the statistical importance of understanding and measuring international business structures. At the same time, those structures have increased in complexity which has led to a reduction in the ability of the existing statistical systems to cater for them. The revision process has been a collaborative effort between the IMF and the OECD to better reflect the emerging business environment in the statistical standards.

4. This paper reviews the role of standards in assisting analysis of FDI statistics and describes the improvements to the *Benchmark Definition* through the revision process to improve analytical work on FDI and globalisation. Finally, the paper outlines the challenges that remain for FDI statisticians to further support their analytical users.

Supporting Analysis with Standards

5. The existence of an international standard provides immediate assistance to analysts comparing data from different compilers. The standard represents a benchmark against which analysts can assess the practices of compilers and identify national deviations from the standard that impact on data comparisons. The standard also provides an objective basis for measuring methodological differences that need to be taken into account in these comparisons.

6. The existence of an objective base against which to compare national practices and measure differences is particularly important in the field of FDI statistics. One characteristic of FDI is 'bilateral symmetry' – a relationship between two countries should be the same when measured by each of the two countries. Bilateral symmetry rarely holds, with large discrepancies being observed when a relationship is

separately measured by compilers in the respective countries. Understanding of the deviations from international standards by both compilers and the impact that this has on measurement can lead to the identification of the better measure of the relationship.

Improvements to the Benchmark Definition to Support Analysis

7. The key improvements to the *Benchmark Definition* to aid analysis of FDI and globalisation are:

- segregation of merger and acquisition transactions;
- separate identification of capital in transit in the host economy;
- identification of the ultimate control of investment positions; and
- strengthened linkage with statistics on the activities of multinational enterprises.

8. Within FDI statistics, mergers and acquisitions have a different impact on the host economy compared with most other forms of FDI. Mergers and acquisitions do not increase the overall level of capital within an economy and as a consequence, may not result in an increase in the level of production of the economy. For this reason, the *Benchmark Definition* has introduced guidance on segregating merger and acquisition transactions as a component of FDI.

9. Similarly, investment passing through special purpose entities (SPEs) may not have the same effect on the host economy as investment associated with other enterprises. This ‘capital in transit’ has the impact of grossing up both sides of an economy’s FDI positions (considered by many analysts as an overstatement of FDI). The *Benchmark Definition* resolves this issue by recommending reporting for SPEs separately from other investment flows and positions.

10. The *Benchmark Definition* also recognises analysts’ interest in understanding where the ultimate control of an FDI position resides. Previously, the standards only identified the immediate investor (which may be at the end of a long investment chain), while the new edition of the *Benchmark Definition* provides a methodology for attributing an investment to the economy that has ultimate control over the investment decision. This methodology also allows ‘round tripping’ to be identified in the host economy as the ultimate investor will be in the same economy as the host.

11. Finally, the *Benchmark Definition* provides information on the linkages between FDI statistics and the closely related field of globalisation statistics, strengthening the analytical power of both datasets. A fundamental aspect of FDI statistics is to identify which enterprises are in a relationship with each other. This edition of the *Benchmark Definition* refines the process used to identify FDI relationships. One aspect of the refined process is the harmonisation with the definition of multinational enterprises in globalisation statistics. The part of an FDI-related business structure that is considered a multinational enterprise is readily identifiable and investment statistics can thereby be linked with those on the activities of multinational enterprises.

Remaining Challenges

12. While significant progress has been made in this revision of the *Benchmark Definition*, there were a number of issues that were not able to be finalised. A research agenda has been developed and prioritised for further work by the Working Group on International Investment Statistics.

13. The areas in which particular attention is focussed in the research agenda are:

- capital in transit;
- ultimate host country; and
- globalisation.

14. The further work on capital in transit is to generate recommendations for ‘looking through’ counterparty SPEs to identify the first non-SPE from which an investment is sourced or into which an investment is made. This work would build on the current recommendations on SPEs and ultimate investing country.

15. While the new edition of the *Benchmark Definition* provides a methodology for attributing an investment to the economy that has ultimate control over the investment decision, it does not provide a methodology for determining the ultimate destination of an investment over which an enterprise has control. Identifying the ultimate host country allows the analyst to identify the country which ultimately benefits from an investment decision.

16. Research on globalisation is to further consider the methods for defining the extent of direct investment relationships and to consider further alternatives that may better align with globalisation statistics. The research on globalisation will also consider developing a typology for transactions other than merger and acquisition transactions.

17. The further research in these areas is to be completed by the end of 2010. As research is concluded and recommendations are made, the outcomes will be released as addenda to this edition of the *Benchmark Definition*.