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International data reconciliation when MNEs and MNE groups allocate their activities across countries without creating separate legal units


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**Abstract:** MNEs and MNE groups may allocate their activities across countries without creating separate legal units. In this case, according to the SNA 2008 and the ESA 2010, a branch may be identified as an institutional unit, that is a part of the enterprise by which it is created, that is located in a different country from the enterprise’s head office, and has substantial operations over a significant period of time. Since no separate legal entity exists, specific issues arise in relation to the international reconciliation of the data related to the branch. In fact, this unit resides in the country where it is located, but it is not required to compile and publish annual balance sheets or income statements, even if it could be meaningful to do so from an economic point of view. Therefore, a first issue is the very identification of the activity run in one country by a non-resident unit as a branch, both by the country where it is located and by the one where the enterprise’s head office is. This involves recognising a part of an enterprise as a separate institutional unit and distinguishing the branch from affiliates and subsidiaries, which are separate legal units. Moreover, both concerned countries need to be aware of the existence of the branch. However, this may not be obvious, given that the branch has no obligation to compile public reports and that in general the branch’s flows and stocks are not measured separately from those of the rest of the enterprise in its annual balance sheets and income statements. Finally, the activity of the branch needs to be included in the GDP of the country where it resides and the income flows generated by it towards the enterprise’s head office need to be included in the GNI of the head office’s residence country and in the balance of payments of both countries. In our experience, all three issues create problems for an exhaustive and consistent measurement of GDP and GNI in all countries concerned.

In this presentation and paper, we analyse the impact of these issues in the work done so far in Italy on Italian branches of foreign enterprises and on foreign branches of Italian enterprises, for both national accounts and an always higher coherence between national accounts and balance of payments, considering both the results, and the difficulties identified and still not overcome. Among the most relevant of them, it is worth mentioning those related to the use of shared criteria for the identification of branches across countries; the correct assignment of the branch’s economic activity; the economic ownership of the means of production used by branches, especially in the case of cruises; and the specificities of branches in the sector of passenger air transport across countries.

Part of the work on which the paper is based has been carried out in the contexts of the inter-institutional working group between Istat and the Bank of Italy aimed at achieving the maximum coherence between national accounts and balance of payments, and the Eurostat GNI MNE Pilot Exercise.
1. Introduction

1. Multi-national enterprises (MNEs) and MNE groups may allocate their activities across countries without creating separate legal units.

2. In this case, according to the System of National Accounts 2008 (SNA 2008)\(^2\) and the European system of national and regional accounts in the European Union 2010 (ESA 2010),\(^3\) a branch may be identified as an institutional unit, that is a part of the enterprise by which it is created, which is located in a different country from the enterprise’s head office, and has substantial operations over a significant period of time.\(^4\)

3. Since no separate legal entity exists, specific issues arise in relation to the international reconciliation of the data related to the branch. In fact, this unit resides in the country where it is located, but it is not required to compile and publish annual balance sheets or income statements, even if it could be meaningful to do so from an economic point of view.

4. Therefore, a first issue is the very identification of the activity run in one country by a non-resident unit as a branch and the assessment of its residence country, both by the country where it is located and by the one where the enterprise’s head office is. This involves recognising a part of an enterprise as a separate institutional unit and distinguishing the branch from affiliates and subsidiaries, which are separate legal units.

5. Moreover, both concerned countries need to be aware of the existence of the branch. However, this may not be obvious, given that the branch has no obligation to compile public reports and that in general the branch’s flows and stocks are not measured separately from those of the rest of the enterprise in its annual balance sheets and income statements.

6. Finally, the activity of the branch needs to be included in the GDP of the country where it resides. This involves, in particular but not only: the classification of its economic activity and production; and the assessment of whether the economic owner of the means of production is the branch of another part of the enterprise. Furthermore, the income flows between the branch and the enterprise’s head office need to be included in the GNIs and the balance of payments of both countries. In our experience, all three issues create problems for an exhaustive and consistent measurement of GDP and GNI in the countries concerned.

7. In this paper, we analyse the impact of these issues in the work done so far in Italy on resident branches of foreign enterprises and on foreign branches of resident enterprises for national accounts.

8. This work is part of all the initiatives, projects, infrastructures that are currently being carried out and created internationally to increase the coherence and exhaustiveness of the measurement of MNEs and MNE groups across and within countries.

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\(^4\) The SNA 2008 definition also specifies that: “either a complete set of accounts for the unit exists or it would be meaningful from an economic point of view to compile them”; the “production based in the territory is undertaken or intended for one year or more in a territory other than that of its head office”; and “the operations are recognized as being subject to the income tax system, if any, of the economy in which it is located even if it may have a tax-exempt status” (see SNA 2008, 4.47). The same specifications are in ESA 2010, 18.12.
9. Within the EU, in particular, they include the Early Warning System, EuroGroups Register, EU Profiling, and GNI MNE Pilot Exercise, all organized and managed by Eurostat.

10. The Early Warning System aims at identifying early important MNE groups’ restructuring cases, and to agree a common recording among the EU Member States involved, preferably before the changes materialise or need to be incorporated in business statistics, balance of payments or national accounts. The purpose is to ensure the coordination and consistency of the applied methods and statistical production and communication in all the above listed domains across EU Member States.

11. The EuroGroups Register (EGR) is a unique international business register of MNE groups that have more than one enterprise within the EU. It contains information on ownership, activity, persons employed, structure and turnover for each of these groups’ enterprise.

12. The EU Profiling is a method to analyse the legal, operational and accounting structure of large and complex MNE groups at the national and EU level, to identify the statistical units within these groups, their links, and the most efficient structures for the collection of statistical data. It uses the EGR as a starting point to acquire a first view of the legal units concerned and an understanding of how MNE groups are structured and controlled. And it deepens the knowledge on these groups characteristics and improve this knowledge timeliness with respect to the EGR.

13. The GNI MNE Pilot Exercise has been carried out along 2018 and 2019 and it is now at its final stages. It aims at achieving by December 2019 a reasonable understanding of the reliability of the recording of the globalisation impact in EU Member States’ GNI data. It has been based on the analysis of 25 large MNE groups with a relevant presence in the EU, carried out jointly, for each considered group, by all the Member States where units of the group reside, with the participation of their National Statistical Institutes and Central Banks (for balance of payment variables). For each considered group, a leader country has been identified as that of residence of the group’s Global Decision Centre (GDC), which: has collected qualitative and quantitative information on the basis of a pre-defined questionnaire from all the other involved countries; and has compared this information with the published data for the entire MNE group (in particular, from its annual reports) to identify inconsistencies. The sharing of information has been voluntary and has happened through a secure environment and method organised by Eurostat. This has ensured that confidential information has been accessible for each considered MNE group only to the Eurostat responsible persons and the reference experts in the concerned Member States.

14. Part of the work on which the paper is based has been carried out in the contexts of the Eurostat GNI MNE Pilot Exercise just described and the inter-institutional working group between Istat and the Bank of Italy aimed at achieving the maximum coherence between national accounts and balance of payments.

15. The paper is organized as follows: Section 2 considers the work done on resident branches of foreign enterprises, and in particular their inclusion in the Italian national accounts and the employed data sources; Section 3 describes the analyses carried out so far for Italian national accounts on foreign branches of resident enterprises; Section 4 analyses the cases of branches in cruises and air passenger transport; and Section 5 presents some concluding remarks and possible way forward.
2. Resident branches of foreign enterprises: Their inclusion in the Italian national accounts and the employed data sources

16. The activity in Italy by resident branches of foreign enterprises is included in Italian national accounts aggregates.

17. The sources and data used for national accounts differ between the branches carrying out financial and insurance activities (section K of Nace Rev. 2) and all the other ones, because financial and insurance activities are not included in the structural business statistics (SBS) Regulations reference population.\(^5\)

18. More specifically, branches in non-financial sectors included in national accounts are all and only those identified as such by the national business register. This identification is based on the presence of employees and/or tax declarations and it will be described with more details in the following Subsection 2.1. The national accounts aggregates for them are based on the same source used for non-financial enterprises, that is the microdata for all units in SBS the reference population.

19. For financial and insurance activities branches, different identification and data sources are used depending on their activity, as defined at the Nace Rev. 2 2-digit level.

20. For those performing financial service activities, except insurance and pension funding (Nace Rev. 2 2-digit code 64), national accounts consider all and only the resident branches of foreign enterprises which are subject to the Bank of Italy surveillance; and use as data source the aggregate figures supplied by the same institution.

21. Resident branches carrying out insurance, reinsurance and pension funding, except compulsory social security (Nace Rev. 2 2-digit code 65), are identified in national accounts as those both present in the national business register (that is, with employees) and for which there are tax declarations. Their national accounts variables are estimated on the basis of indicators in the tax declarations and the data on insurance premiums collected in Italy by these branches obtained by the Institute for surveillance on private insurances (IVASS) quarterly survey on this variable. Finally, for resident branches of foreign enterprises performing activities auxiliary to financial services and insurance activities (Nace Rev. 2 2-digit code 66), a further distinction needs to be made on the basis of their size. For those below the 100 (until 2016)/250 (starting from 2017) jobs threshold, the identification and data source are the same indicated above for non-financial or insurance sectors. The larger ones, however, are not included in the SBS microdata register. Therefore, they are identified as those both present in the national business register and for which there are tax declarations, that is with the same criterion used for branches with insurance, reinsurance and pension funding activities. For these branches, in fact, tax declarations are the only data source available, due to the lack, common to all branches, of published annual balance sheets and income statements.

22. Resident branches of foreign enterprises in non-financial and insurance activities represent 90% of the total number of these units in the 2016 edition of the national business register (see Table 2.1). While non-financial units are highly concentrated in the very small size classes (81% of them have no more than 5 jobs and only 2% have more than 50 jobs), financial and insurance ones have a much less concentrated distribution. As a consequence, the share of financial and insurance branches on the total number of resident branches ranges from a minimum of 5% in units with a number of jobs between 0.5 and 1 and a maximum of 40% in those with more than 100 jobs. Finally, the much larger number of

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non-financial branches implies that the distribution of the total number of resident branches is very similar to that of the units in these activities.  

2.1. Resident branches of foreign enterprises: how they are identified by the national business register

23. The relevance of the national business register for the identification of the resident branches of foreign enterprises in the national accounts production processes has been highlighted above. Here a more detailed description of the sources and criteria used in this identification process by the national business register experts is presented.

24. This identification is based on an algorithm which makes use of and integrates various administrative sources and which was defined through the work carried out jointly by national accounts and business register experts.

25. This algorithm identifies five types of resident branches, on the basis of the available administrative sources. For the year 2016, Table 2.2 reports the definitions of these five types and for each of them the number of branches and jobs in the national business register. It shows that the largest number of branches and shares of their total jobs are in units identified either through fiscal sources (the regional tax on productive activities, IRAP, declarations and Sector Studies) or that perform operations related to VAT, but not through a fiscal representative, and have employees to whom they pay social contributions.

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6 This paragraph is based on the work done within the already mentioned inter-institutional working group between Istat and the Bank of Italy, and in particular on the work document by Cuicchio and Sciullo (2018). This document aims at classifying the resident branches of foreign enterprises included in the national business register on the basis of the sources used for their identification by the business register experts and share this classification between Istat and Bank of Italy, to ensure the coherence between national accounts and balance of payments.

7 This subsection is based on the on the work document by Cuicchio and Sciullo (2018).

8 See Bracci, L. and C. Viviano (2013).

9 Sector Studies are systematic data collections by the Italian fiscal authorities on the activity and economic context of enterprises and self-employed workers (including members of the liberal professions), aimed at assessing their actual capability to generate income.
Table 2.2. Resident branches and jobs in the national business register by available administrative sources – Year 2016

<table>
<thead>
<tr>
<th>Code</th>
<th>Branch type</th>
<th>Number of branches</th>
<th>Jobs</th>
</tr>
</thead>
<tbody>
<tr>
<td>A1</td>
<td>Units with foreign legal form whose stable organization is identified by the Department of Finances in the Ministry of Economy and Finances: they submit VAT and income tax declarations. They have or do not have employees.</td>
<td>62</td>
<td>420</td>
</tr>
<tr>
<td>B1</td>
<td>Units with foreign legal form whose stable organization is identified through fiscal sources: the regional tax on productive activities (IRAP) declarations and Sector Studies.</td>
<td>1,859</td>
<td>28,359</td>
</tr>
<tr>
<td>B21</td>
<td>Units with foreign legal form whose stable organization is identified on the basis of the Revenue Agency data, but that are not in the Chambers of Commerce’s enterprise register as resident units.</td>
<td>372</td>
<td>2,553</td>
</tr>
<tr>
<td>B221</td>
<td>Units with foreign legal form that perform operations related to VAT, but not through a fiscal representative. Their stable organization is identified through the presence of employees to whom they pay social contributions.</td>
<td>2,034</td>
<td>23,053</td>
</tr>
<tr>
<td>B223</td>
<td>Units with foreign legal form whose stable organization is identified through their income tax declarations and for which there is no VAT declaration.</td>
<td>47</td>
<td>-</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>4,374</td>
<td>54,385</td>
</tr>
</tbody>
</table>

Source: Cuicchio and Sciullo (2018).

26. Furthermore, one of the results of the work carried out within the already mentioned inter-institutional working group between Istat and the Bank of Italy is the sharing by Istat of its list of resident branches of foreign enterprises with the Bank of Italy to ensure coherence between national accounts and balance of payments.

27. Finally, at the moment, the inclusion of the activities performed by resident branches of foreign enterprises in the Italian national accounts is not checked for its coherence with the national accounts of the countries of the enterprises to which the branches in this country belong. Therefore, we do not know if national accounts figures aggregating Italy and these foreign countries are correct with regard to this aspect.

3. Foreign branches of resident enterprises: the work done so far for Italian national accounts

28. As already mentioned in Section 2, Italian national accounts supply side aggregates are mainly based on the Istat register containing the microdata for all the enterprises in the reference population of the SBS Regulations. These data, according to the Regulations, should consider only the domestic part of the activity (and related variables) of the reference population statistical units. Hence, in particular, they should exclude the activities performed by branches abroad of resident enterprises. However, at the moment, it seems that there are at least some cases where the microdata include also the activities (and related variables) of branches abroad. A correction of the SBS microdata to exclude the components related to these activities is done, so far, only for a limited number of enterprises.

29. Therefore, some analyses have been carried out by national accounts experts to study if and how foreign branches of Italian enterprises can be identified and their activities measured on the basis of the available data sources.

30. A first exploratory analysis has considered as possible data sources a statistical one, the Istat survey Outward FATS, and an administrative one, the Italian regional tax on
productive activities (IRAP). The second one is the same that is currently used for the just mentioned limited corrections of the SBS microdata. This study has aimed at being a first check of the consistency of the two sources with respect to the identification of foreign branches of Italian enterprises.

31. The Italian Outward FATS survey complies with the EU Regulations and produces statistics on the foreign affiliates of Italian enterprises.

32. In particular, on the basis of the Eurostat Recommendation Manual for the survey, Outward FATS “target population of statistical units is composed of all foreign affiliates that are controlled by an institutional unit resident in the compiling country. The target population of reporting units contains all resident institutional units that control affiliates abroad. The statistical units are the enterprises and all branches abroad that are controlled by an institutional unit resident in the compiling economy”. Moreover, in article 2 of the main Regulation, for Outward FATS a foreign affiliate is defined as “an enterprise not resident in the compiling country over which an institutional unit resident in the compiling country has control”. While branches are defined as “local units not constituting separate legal entities, which are dependent on foreign-controlled enterprises. They are treated as quasi-corporate enterprises”, that is similarly to, even if much more concisely than, in SNA 2008 and ESA 2010.

33. In the Istat survey, the reporting units are the head units of enterprise groups residing on the national territory, and the survey is a census of them.

34. The analysis has been done on Outward FATS data for 2015, at the maximum available level of disaggregation. In particular, it has based its identification of branches on a variable that is a component of the one (including also SPEs and affiliates) actually used in the production and dissemination of FATS official statistics. In this way, 895 branches abroad belonging to 257 Italian enterprises have been identified. The larger shares of these branches and jobs are in construction, wholesale trade and retail trade (Table 3.1). In total, the foreign branches in these three economic activities are 59% of all foreign branches found in the considered data and have 86% of all jobs in the thus identified foreign branches.

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10 This analysis was done by C. Sciullo and A. Forte and presented in the work document by the same authors, Forte and Sciullo (2018). The description in this section is based on this work document.


12 Eurostat (2012).
Table 3.1. Outward FATS foreign branches of Italian enterprises and their jobs by economic activity
Year 2015

<table>
<thead>
<tr>
<th>Economic activity</th>
<th>Number of branches</th>
<th>Number of jobs</th>
<th>Share of total branches</th>
<th>Share of total jobs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Construction</td>
<td>258</td>
<td>44,052</td>
<td>29</td>
<td>70</td>
</tr>
<tr>
<td>Wholesale trade</td>
<td>170</td>
<td>3,286</td>
<td>19</td>
<td>5</td>
</tr>
<tr>
<td>Retail trade</td>
<td>102</td>
<td>6,595</td>
<td>11</td>
<td>11</td>
</tr>
<tr>
<td>Other activities</td>
<td>365</td>
<td>8,828</td>
<td>41</td>
<td>14</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>895</strong></td>
<td><strong>62,761</strong></td>
<td><strong>100</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>


35. The Outward FATS economic data on foreign branches were not available at the level of each branch, but aggregated by controlling Italian enterprise, Nace Rev.2 2-digit code, and country of residence of its branches, SPEs (special-purpose entities) or affiliates. Therefore, it has been possible to directly estimate them only for the Italian enterprises that in a given combination of Nace Rev.2 2-digit code and country of residence of its branches, SPEs or affiliates had only branches. Furthermore, in the cases of an enterprise with more than one branch in a given combination of Nace Rev.2 2-digit code and country of residence, these data are aggregate over all these branches. The enterprises that in a given combination of Nace Rev.2 2-digit code and country of residence of its branches, SPEs or affiliates had only branches were 211 (that is, 82% of all those for which foreign branches were indicated in the survey), with in total 636 branches (78% of all found branches). These branches had 47,366 jobs (75% of the total in Table 3.1), turnover of 7,209 million euros and value added of 2,280 million euros.

36. As indicated above, the considered administrative source is the Italian regional tax on productive activities (IRAP), for which the dataset of the microdata at the level of fiscal codes for 2015 (the same year as the Outward FATS data) was available. In this source, the total production to be declared is defined as the actual total production minus the costs which are deductible for the tax. Therefore, the IRAP production variable is similar to the value added as defined in the SNA 2008 and ESA 2010.

37. Because the IRAP tax is based on the region where the productive activities take place, for resident economic units the basis of assessment does not include the production generated abroad. While for non-resident economic units the tax basis covers only the production within the Italian territory, by region. As a consequence, the IRAP dataset records contain the information on whether each resident economic unit subject to the tax generates also production abroad and which percentage of its total IRAP production is abroad. Therefore, the IRAP dataset can also supply a measure of a variable similar to the value added as defined in national accounts. However, although the IRAP dataset includes also the figures for total production and total costs for each fiscal code, it does not allow to distinguish, for these two variables, the parts generated in Italy and abroad.

38. It is worth mentioning that while the SNA 2008 and ESA 2010 definition of branch requires that the economic activity in the country where the unit is located is carried out for at least one year, in IRAP the enterprises subject to the tax need to declare their production activities abroad when these last at least three months. Therefore, the identification in the IRAP dataset of Italian enterprises with production activity abroad can imply an overestimation of the number of enterprises for which at least one branch abroad can be defined according to the SNA 2008 and ESA 2010 definition.

39. While the IRAP dataset contains records for natural persons, partnerships, capital companies, non-commercial bodies and public administration and bodies, the analysis,
initially including all the records, has then focused only on capital companies and partnerships. This is due to their good representativeness, in terms both of number of units and turnover share, of all the units declaring production abroad.

40. Among capital companies and partnerships (in total, 1,445,386 enterprises), those declaring to have done production abroad were 642. Of these enterprises with production abroad, 39% had at least 100 jobs and they produced 61% of the total turnover of this set of units. Almost all the 642 enterprises were capital companies (95% of the total number), and they generated an even larger share (99.7%) of the total turnover.

41. Only 70 of the 257 enterprises identified in Outward FATS as having branches abroad has been found to be also among the 642 ones which indicated to have carried out production abroad for at least three months in the IRAP tax declarations. Of this small set of enterprises present in both sources, 76% had at least 100 jobs and they generated almost all (97%) of the total turnover of the 70 enterprises.

42. The shorter constraint on the length of the activity abroad in IRAP can have a role in the smallness of the number of enterprises identified as having or, in the IRAP case, possibly having a foreign branch in both considered data sources. A similar consideration could be made also for the use of a variable that is a component of the one actually employed in the production and dissemination of FATS official statistics for the identification of branches in Outward FATS data.

43. However, we intend to continue our work on these sources, to gain a better understanding of both of them and thus explore the possibility of obtaining better results.

44. Nevertheless, the results reached so far, although preliminary, highlight the difficulties affecting the identification of foreign branches of Italian enterprises and the measurement of their shares of the variables of interest for national accounts in the figures for the entire enterprises.

45. These difficulties underline the relevance of establishing stable and safe communication channels among National Statistical Institutes across different countries through which information on branches could be shared through well defined and routinely used procedures, despite the existence in the EU of the already mentioned infrastructures, practices and pilot exercise.

46. The analysis just described aimed at comparing the possibility to identify all Italian enterprises with branches abroad in the two considered sources, irrespectively of whether the enterprises belong to groups or not. A further exploratory analysis, only on branches abroad of Italian enterprises that are parts of groups, is presented in the following subsection 3.1. This restriction may be relevant especially in some economic activities (e.g. construction).

3.1. The identification of foreign branches of Italian enterprises: an exploratory analysis

47. A further combination of statistical sources has also been explored to investigate if they could help in identifying the branches abroad of Italian enterprises belonging to groups: the EGR and the Italian statistical register of groups (in the following, ASIA Groups), both for the year 2016.

48. This second source includes all enterprises, residing both in Italy and abroad, that belong to groups in which there are also Italian enterprises. It also includes the Italian branches of foreign enterprises of these groups. However, the foreign branches of Italian enterprises are in the ASIA Groups only if they are in the EGR. The groups’ GDCs can be
in Italy or abroad. For each unit present in the register, the data reported include information on: the structure of the group (affiliates, parent companies, GDC); the country of residence of each considered group’s component; for the units residing in Italy, also their economic activity and a size measure (in jobs). The data are disseminated outside Istat only for the units residing in Italy, but can be accessed in its entirety within Istat.

49. In the EGR, using the flag that indicates if a unit is included in it as a branch, and the countries of residence of both the branch and the unit considered in the register as its “parent”, it has been possible to identify 1,516 units classified there as branches not residing in Italy and with “parent” in Italy. The EGR “parent” could be either the enterprise of which the branch is a part in another country, or a different enterprise, controlling either the one of which the branch is a part or the unit identified as branch and which is actually an enterprise. The availability in the EGR of the national statistical register identification code of the “parent” has allowed to link the information extracted from the EGR to the data in ASIA Groups.

50. This, in its turn, has allowed an exploratory analysis of the 1,516 possible branches abroad of Italian enterprises, aimed at: checking whether they are actually branches abroad of Italian enterprises; and identifying the Italian enterprises of which they are parts.

51. For only 40 of these 1,516 cases, the unit classified in the EGR as the branch and its “parent” actually have the same corporate name. Hence, in these cases (corresponding to 3% of the initially identified possible branches) the conclusion reached so far has been that the EGR correctly identifies both a branch abroad of an Italian enterprise and the enterprise to which it belongs.

52. For all the remaining units identified in the EGR as branches abroad of Italian enterprises, a search in Asia Groups has been carried out to check whether in the groups to which the EGR “parent” belongs there appears to be an Italian enterprise whose corporate name matches that of the EGR branch.

53. In 1,196 cases (corresponding to the 79% of the initially identified possible branches), the unit classified in the EGR as a branch has the same corporate name of a unit classified in ASIA Groups not as a branch of the EGR “parent”, but rather as a separate legal unit, controlled by the EGR “parent”.

54. For few of these cases, where the unit residing abroad and identified in the EGR as branch appears from the EGR to have a substantial number of employees, a further control of whether an Italian enterprise with the same corporate name exists has been carried out using TELEMACO, the Chambers of Commerce service allowing access to their registers of Italian enterprises and the available official documents on the events (structural changes, legal procedures, …) regarding them, which is considered an updated and reliable source. However, in all the considered cases, no such Italian enterprise seems to exist.

55. Therefore, for these 1,196 cases our conclusion so far is that the units identified in the EGR as branches of Italian enterprises are actually separate legal units residing in other countries and controlled by Italian enterprises.

56. For the remaining 280 cases out of the 1,516 possible EGR branches (corresponding to 18% of the total), no enterprise has been found in ASIA Groups with the same corporate name as the EGR branch. Therefore, it would seem that these may be further cases where the EGR branch label may be incorrect. However, no further control in TELEMACO or other sources available in Italy has so far been carried out on them. Hence, our conclusion for these cases is to be considered as preliminary.

57. We intend to complement and integrate this exploratory analysis with those based on Outward FATS and IRAP. However, the results reached so far would seem to suggest
that the criteria used in different EU countries to identify a unit as a branch are not always consistent and possibly in some cases not fully in line with the SNA 2008 and ESA 2010 definition.

58. This analysis, although so far only exploratory, would seem to suggest that the EGR, that is the EU infrastructure to share routinely and in predefined ways information among the Member States on all MNE groups that have more than one enterprise within the EU, may need improvements in order to supply all the information needed for an exhaustive and coherent measurement of MNE groups’ activities across all Member States.

4. The cases of branches in cruises and air passenger transport

4.1. Economic ownership of means of production and its implications: The case of cruise ships

59. One of the MNEs studied in the Eurostat GNI MNE Pilot Exercise operates in the leisure travel sector. More specifically, its main activities consist in cruises around the world and in supplying the on board services to the cruise passengers. Italy was the Leader Country for this MNE within the Pilot Exercise, due to the residence in its territory of a large enterprise of the group. This enterprise, however, is not the group’s GDC, that is outside the EU. Moreover, a relevant part of the MNE’s units reside outside the EU.

60. Even within the geographical area considered by the GNI MNE Pilot Exercise, the EU, the group is characterized by the presence of many branches, both of the group’s companies carrying out the cruises and of those performing the auxiliary on shore and on board services. Some of these branches represent almost the entire enterprise (especially those performing the auxiliary services), but some are only a (bigger or smaller) part of it.

61. The Exercise on this MNE has highlighted a number of issues paradigmatic for branches in general and the economic sector in particular: a possible double counting of value added and employees between Italy and the EU country where two of the branches of the Italian large enterprise reside; the attribution of the economic ownership of part of the fleet of cruise ships legally owned by this Italian enterprise and of the employees working on these ships (hence also of their labour cost) to its head office in Italy or to one of the previously mentioned branches; as a consequence, the correct classification of this branch economic activity; the apparent lack of data on investment income flows from the branches’ countries to the head office one.

62. This branch is included and correctly identified as such a unit in the EGR and the EU country where it resides includes the branch’s activity in its value added and, as a consequence, in its GDP. However, this activity seems to be included also in the Italian value added and GDP, since no adjustment for production abroad by the branch is performed in SBS, nor in national accounts (see Section 3). Moreover, the classification and measure of this activity appear as possibly incorrect and there seem to be a possible

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13 A more in depth analysis of this Pilot Exercise is presented in the confidential Final Report of the GNI Pilot exercise for this MNE, accessible in a Secure area in the CIRCABC Eurostat site only to the specifically allowed persons in the NSIs and CBs in the EU countries where units of the MNE reside. The work on the Pilot exercise has been carried out through a collaboration involving various people, in Istat national accounts and business statistics and register directorates and in the Bank of Italy balance of payments division. The author has coordinated the part by the Istat national accounts experts of this Final Report.
incompleteness of the income flows in the balance of payments of the two countries, with consequences on the accurateness of their GNIs.

63. As mentioned above, we have found in various economic activities cases where a foreign branch of an Italian enterprise seems to be included also in the Italian value added and GDP, giving rise to possible problems of incompleteness of the balance of payment income flows and biases in GNI. However, both in maritime and air transport, specific difficulties arise, related to the distinction between legal and economic ownership: in particular, the correct identification of the economic owner of the part of enterprise’s fleet used by the branch that manages the cruises (or, more generally, the maritime or air transport activities) abroad. The consequences of the economic owner identification range from the correct economic activity classification of the branch to the measurement of a number of variables, including value added and GDP, employment, labour cost, balance of payments and GNI.

64. It is clear that the legal owner of the entire fleet of the Italian large enterprise is the enterprise itself and, therefore, the legal ownership has to be attributed to its head office in Italy.

65. However, the identification of the economic owner of the enterprise’s fleet is less straightforward. While for the majority of the ships there are no doubts that this role needs to be attributed to the Italian part of the enterprise, for a substantial number of ships at the moment it is not clear if the economic owner is the Italian head office or a branch in another EU country. This uncertainty is due to, so far, insufficient information on the actual activities of this branch and, hence, on how the fleet economic ownership is distributed along the MNE’s productive process.

66. On the recording of shipping activities in national accounts and the balance of payments, Eurostat has drafted the handbook *Maritime Cluster Guidance for BoP Data Compilers*,\(^\text{14}\) that treats the complexity of activities and transactions related to companies operating in the maritime cluster (that is “a group of interconnected companies that are involved in the provision of the maritime transportation services”). Furthermore, it has instituted and coordinated, between March 2018 and June 2019, a Task Force on the recording and compilation of maritime transactions in national accounts and balance of payments. Both the handbook and the Task Force refer to all sea transports, including those of passengers and freight. The Task Force has also explicitly considered cruises in its last meeting.


68. In particular, it reports that “[t]he BPM6 in paragraph 4.31 and 4.136 indicates that the activities of the ship-operating enterprise (being also the economic owner of the vessel) are included in the economy where the operator is resident, unless a branch is recognised for substantial operations in another territory. Table 8.2 in the BPM6 CG\(^\text{16}\) [Compilation Guide] describes that equipment operating in international waters should be recorded under

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\(^{14}\) See Eurostat, Maritime Cluster Guidance For Bop Data Compilers - Recording of shipping activities in balance of payments, working version, 2018. This handbook will be revised by Eurostat in 2020, with the collaboration of the participants in the Task Force on the recording and compilation of maritime transactions in national accounts and balance of payments.

\(^{15}\) International Monetary Fund (2009).

\(^{16}\) International Monetary Fund (2014).
the economy of residence of the operator, who is also the economic owner of the vessel. For a ship flying a flag of convenience, the economy of the operator is the economy of the company directing the ship's commercial operations, which may not necessarily be the economy of registration (of the ship).”

69. Furthermore, “[a]ccording to the BPM6 CG 12.28 if a parent company transfers mobile equipment to a branch located abroad, the branch is considered the owner, if the equipment is recorded in the books of the branch (for the [balance of payments] purposes)”. 70. Moreover, the handbook identifies the “operator (in some sources mentioned as ship-manager)” as “the enterprise that:

- provides transport services;
- controls the commercial operations of the vessel;
- controls the movement of the equipment (ship);
- receives revenues for transporting passengers and/or freight.

71. The operator is usually responsible for supplying crew, maintaining equipment in proper working order, and deciding when, and to which location, the equipment will be moved. They have the freedom either to provide the above mentioned services by themselves or to outsource some or all of them to one or more management companies”.

72. Currently, in the Italian national accounts the entire enterprise’s fleet is considered as both legally owned and operated by the Italian part of the enterprise, which is therefore identified also as the economic owner.

73. However, the information collected so far within the Eurostat GNI MNE Pilot Exercise on the activity of one of the enterprise’s branches in another EU country casts some doubts on this attribution of the economic ownership of a substantial part of the enterprise’s fleet, while it does not allow to assess whether the above listed criteria are satisfied by this branch or the Italian enterprise’s head office.

74. Direct contacts with the Italian enterprise’s head office in which we have tried to understand the relation between head office and branches, with particular reference to the identification of the actual operator, or ship-manager, of this part of the enterprise’s fleet, have supplied very useful information, but not a clear understanding of the economic ownership issue. The distance between the business accounting and national accounts concepts has probably been a contributing factor in leaving this uncertainty unresolved by these contacts.

75. Moreover, as it can be seen in the EGR, the branch is classified by the National Statistical Office of the country where it resides in NACE Rev. 2 Sea and coastal passenger water transport (code 5010). Hence, it probably does not perform only on shore services for the cruises of the part of the fleet whose economic ownership is in doubt, but it could be the actual operator for these cruises. As a consequence, this branch would be the economic owner of this part of the enterprise’s fleet. If this was the case, the value added and production generated by these cruises should be attributed to the branch, as well as the enterprise’s employees on board these ships and their labour cost.

76. In fact, in our opinion, the economic ownership of the means of production (including fixed capital, here in particular ships, and employees) should be attributed, in general, to the part of the enterprise which actually carries out the activity. This would ensure also the correct calculation of the factors’ productivity.

77. However, at the moment, there does not seem to be an agreement among all EU countries on which are the elements that identify an activity of cruise managing in Sea and
coastal passenger water transport rather than in Service activities incidental to water transportation (NACE Rev. 2 code 5222). This is relevant because only in the first case the production process uses the ships as inputs.

78. The uncertainties on the actual activities of the branch have remained despite the very useful contacts not only with the enterprise’s Italian head office, but also with the colleagues of the National Statistical Office in the branch’s country.

79. As mentioned above, these uncertainties have far ranging consequences.

80. The branch economic activity classification in NACE Rev. 2 Sea and coastal passenger water transport (code 5010) seems correct only if it actually carries out the cruises. This, at the moment, seems fairly probable, but not certain.

81. The value added and GDP generated by the cruises should be included in those of the branch’s country only if the cruises are actually carried out by the branch.

82. This should generate income flows between Italy and the branch’s country in the balances of payments of both countries, which would affect the two countries GNIs.

83. Furthermore, if the branch could be classified in NACE Rev. 2 Sea and coastal passenger water transport and, therefore, considered also as the economic owner of the ships, this would have consequences also on a larger set of variables, including, in particular: stock of fixed capital, employees, labour cost. Moreover, the flows related to the branch’s activity in the balance of payments could involve also other countries, because they would need to include the labour income of the on board employees who do not reside in the branch’s country. This would have in its turn bigger implications on the GNI of the branch’s country and it would affect the same variable of a larger number of countries.

84. To solve these uncertainties, a varied set of steps could be useful.

85. In the context of the GNI MNE Pilot Exercise, a possible arbitration by Eurostat has been suggested by Italy as one of these steps.

86. This intervention could also lead to a more general methodological discussion, either within the EU or in wider fora, aimed at clarifying the definition of economic ownership in the SNA 2008 and ESA 2010 and supplying more clear guidance on how to apply it in practice to the data producers in all statistical domains (including business statistics, national accounts and balance of payments).

87. Finally, more direct contacts with the enterprise concerned (both head office and branch) could be sought. In fact, we believe that only close, in depth, repeated interactions among the two National Statistical Institutes and the enterprise concerned could in the end lead to a robust and agreed solution of the so far remained uncertainties on economic activity, economic ownership and the correct measurement in the two countries of all the related variables. However, interactions of this level have never happened so far among EU countries National Statistical Institutes and MNEs, apart from those, very useful but still not enough to reach, in this case, a final agreed position between the two National Statistical Institutes involved, within the GNI MNE Pilot Exercise. In fact, they seem quite a complex aim to achieve. In particular, in this case, as mentioned above, so far the contacts both between the two National Statistical Institutes and with the enterprise’s head office have been very useful but not enough to clarify the issues discussed here. To the best of our knowledge, no explicit contact with the branch involved has so far taken place on these topics. The contacts with the enterprise and its branches could benefit from the experience and guidelines developed in the context of the EU Profiling and Large Cases Units on how to make them less burdensome for the enterprise and more useful for the National Statistical Institutes, also with respect to the need to bridge the gap often existing between business
accounting and national accounts concepts. The issue of whether the existing EU legal framework would need to be extended to include an obligation for MNEs’ EU units to interact with and respond to the EU National Statistical Institutes, when approached with the aim to acquire information needed for their production processes, but not already available either publicly, or directly to the National Statistical Institutes themselves, or in administrative data, is also being considered in the GNI MNE Pilot Exercise.

4.2. The specificities of branches in passenger air transport across countries

88. In view of the Harmonized Benchmark Revision 2019 of national accounts, the foreign passenger air transport enterprises that also fly between Italy and other countries and, in some cases, fly as well both departing from and landing in Italian airports have been analysed with careful attention. This work has also been done in and benefited from the inter-institutional working group between Istat and the Bank of Italy. As a result, the treatment of these cases in national accounts has improved.

89. The main issues on branches highlighted by this work are related to: the assessment of whether the activities by these foreign enterprises on the Italian territory satisfy the criteria for the identification of resident branches; the classification of both economic activity and production done on the Italian territory.

90. The analyses and work to these aims have been done, so far, with very limited contacts with only few of the countries where the passenger air transport enterprises whose flights at least depart from or land in Italy reside. Therefore, in contrast with the cases considered in the Eurostat GNI MNE Pilot Exercise, included the one described in the previous Subsection, here the conclusions reached for the Italian national accounts have not in general been checked with the counterpart countries and therefore no assessment of their coherence with the national accounts of these countries has so far taken place. This work could constitute one of the objectives to be pursued for the Harmonized Benchmark Revision 2024 of national accounts.

91. With respect to the issue of whether a branch in Italy can be identified, we have concluded that the cases of foreign enterprises that carry out also a substantial number of flights both departing from and landing in Italian airports need to be treated differently from those of the enterprises whose interaction with the Italian territory is limited to international flights, either beginning or ending in this country.

92. More specifically, a branch on the Italian territory has been identified for each of the few foreign enterprises that carry out also a substantial number of flights both departing from and landing in Italian airports. In fact, because these enterprises do not just international flights beginning or ending in Italy, but also passenger air transport services between Italian airports, their activities in Italy satisfy the criteria that define a branch in the SNA 2008 and ESA 2010. In particular, their operations on the Italian territory are substantial and over a significant period, and they involve a significant physical presence in this country. Moreover, they have a fiscal domicile in Italy and they are subject to the Italian income tax system, for the flights both beginning and ending in this country. Therefore, their Italian bases can be classified as branches.

More specifically, the part of work done within the above mentioned working group between Istat and the Bank of Italy has been carried out by a sub-group composed by Nadia Di Veroli, Marina Sorrentino, Paolo Forestieri and Giancarlo Lutero for Istat, and Enrico Tosti and Simonetta Zappa for the Bank of Italy. This Subsection is based on this work and its consequences on the production of national accounts aggregates.
93. However, the other enterprises, carrying out only international flights, either beginning or ending in Italy, only perform much more limited operations on the Italian territory and therefore have a much less relevant physical presence in this country, as testified, for example, by the substantially fewer employees. Furthermore, they do not have a fiscal domicile in Italy, because the earnings from flights either beginning or ending in this country are not subject to its taxation. Therefore, they do not satisfy the criteria that identify their Italian activity as determining the existence of a branch in this country. However, because there are, also in these cases, parts of the foreign enterprises residing in Italy, their production on the Italian territory is included in the country’s GDP.

94. The economic activity classification in national accounts of both the Italian branches and the Italian parts of foreign enterprises in the two just described cases needs to be coherent with that in the national business register. Therefore, both the branches and the parts of foreign enterprises residing on the Italian territory are classified as performing passenger air transport activities (Nace Rev. 2 code 5110).

95. The product classification in national accounts, however, distinguishes between the activities carried out for and on flights both beginning and ending in Italy and those for international flights either beginning or ending in this country. In the first case, the production is classified as passenger air transport services (CPA 2008 code 5110); while, in the second case, it is considered as services incidental to air transportation (CPA 2008 code 5223) supplied to the foreign enterprises. Therefore, the Italian branches of foreign passenger air transport enterprises produce both types of services, while the Italian parts of foreign enterprises which are not branches only produce services incidental to air transportation (CPA 2008 code 5223) supplied to the foreign enterprises.

96. Both types of production generated by the Italian branches and the Italian parts of foreign enterprises which are not branches produce balance of payments flows and therefore both affect the Italian GDP (through imports and exports) and determine a difference between the Italian GDP and GNI (due to investment income flows).

97. Therefore, the inter-institutional working group between Istat and the Bank of Italy has worked on the consistency between domestic production and balance of payments imports and exports of passenger air transport services and services incidental to air transportation.

5. Concluding remarks and possible way forward

98. Branches are one of the ways in which MNEs and MNE groups extend their activities abroad. Because they are parts of the enterprises that have created them and not separate legal units, they do not publish annual balance sheets or income statements. Moreover, usually their activities are not reported separately from those of the remaining parts of the enterprises to which they belong in these enterprises annual balance sheets or income statements. Therefore, branches pose specific problems in their identification, the assessment of their residence country, and in the classification and measurement of their activities in the countries where they reside and in those where the enterprises to which they belong are located. These difficulties can affect business statistics, national accounts and balance of payments of all the countries concerned, and their impact on these domains target variables can be widespread. Furthermore, these difficulties may be non-symmetrical for resident branches of foreign enterprises and branches abroad of resident enterprises. Therefore, they can generate incoherencies in the statistics produced across the various concerned countries.
99. In this paper, these issues have been analysed considering the work carried out so far in Istat on resident branches of foreign enterprises and branches abroad of Italian enterprises, both in general and focusing on the cases of cruises and passenger air transport.

100. The activities performed in Italy by resident branches of foreign enterprises are included in Italian national accounts. This is possible using various sources, depending on the branches economic activity, and in particular on whether they carry out financial and insurance activities (section K of Nace Rev. 2), which are not in the SBS reference population, or not.

101. However, at the moment, we do not check the coherence of this inclusion with the national accounts of the residence countries of the enterprises to which the Italian branches belong. Therefore, we do not know if Italian national accounts figures are coherent with those of the involved foreign countries with regard to this aspect.

102. At the moment, it would seem that the Istat microdata source on which Italian national accounts supply side aggregates are mainly based include also foreign branches activities at least in some cases. Therefore, national accounts experts, also in the context of the inter-institutional working group between Istat and the Bank of Italy, have begun carrying out analyses to study if and how foreign branches of Italian enterprises can be identified and their activities measured. These analyses have considered various data sources: Outward FATS and the Italian regional tax on productive activities for all the branches abroad of resident enterprises; and the EuroGroups Register and Italian statistical register of groups, for those of resident enterprises belonging to groups. Although these analyses are so far only preliminary, the results reached until now have highlighted the difficulties affecting the identification of foreign branches of Italian enterprises and the measurement of their shares of the variables of interest for national accounts in the figures for the entire enterprises.

103. Furthermore, they would seem to suggest that the criteria used in different EU countries to identify a unit as a branch are not always consistent and possibly in some cases not fully in line with the SNA 2008 and ESA 2010 definition. As a consequence, it would seem that the EuroGroups Register may need improvements in order to supply all the information needed for an exhaustive and coherent measurement of MNE groups’ activities across all Member States.

104. Moreover, the possible asymmetry between the Italian national accounts inclusion of the activities performed by resident branches of foreign enterprises and possible non exclusion of those of at least some branches abroad of Italian enterprises could lead to a double counting of the activities of these branches abroad by Italian national accounts and those of the countries of residence of these branches. This would happen if the Italian national accounts situation with regard to branches abroad of resident enterprises and coverage of resident branches is similar to those of these other countries.

105. The case of branches in cruises has been studied within the context of the GNI MNE Pilot Exercise, for an MNE group for which Italy was the leader country of the Exercise. It has highlighted the difficulties in attributing the economic ownership of the means of production (in this case, ships and on board employees) to a branch or the enterprise of which it is part. These uncertainties have remained despite the very useful contacts not only with the enterprise’s Italian head office, but also with the colleagues of the National Statistical Office in the branch’s country.

106. In fact, at the moment, there does not seem to be an agreement among all EU countries even on whether the actual carrying out of cruises by a branch implies that the branch is also the economic owner of the ships utilized for this purpose. These uncertainties affect the possibility to reach a correct measurement of a very large set of variables of
interest for national accounts, including, among the others, economic activity classification, production value and its classification, costs, stock of fixed capital, employees, value added, balance of payments flows, in both countries where the enterprise and its branch reside. Therefore, they have an impact of GDPs and GNIs of these countries.

107. This case highlights the need for more clear guidance, at least within the EU and therefore from Eurostat, on how to apply the economic ownership definition in SNA 2008 and ESA 2010 in practice to the data producers in all statistical domains (including business statistics, national accounts and balance of payments).

108. In view of the Harmonized Benchmark Revision 2019 of national accounts, the foreign passenger air transport enterprises that also fly between Italy and other countries and, in some cases, fly as well both departing from and landing in Italian airports have been analysed with careful attention. This work has also been done in and benefited from the inter-institutional working group between Istat and the Bank of Italy. As a result, the treatment of these cases in national accounts has improved, through the distinction of foreign enterprises that carry out also a substantial number of flights both departing from and landing in Italian airports from those of the enterprises whose interaction with the Italian territory is limited to international flights, either beginning or ending in this country.

109. The main issues on branches highlighted by this work are related to: the assessment of whether the activities by these foreign enterprises on the Italian territory satisfy the criteria for the identification of resident branches; the classification of both economic activity and production done on the Italian territory.

110. The analyses and work to these aims have been done, so far, with very limited contacts with only few of the countries where the passenger air transport enterprises whose flights at least depart from or land in Italy reside. Therefore, the conclusions reached for the Italian national accounts have not in general been checked with the counterpart countries and therefore no assessment of their coherence with the national accounts of these countries has so far taken place. This work could constitute one of the objectives to be pursued for the Harmonized Benchmark Revision 2024 of national accounts.

111. The work here described underlines the relevance of establishing stable and safe communication channels among National Statistical Institutes across different countries through which information on branches and, more generally, on MNEs and MNE groups could be shared through well-defined and routinely used procedures, despite the existence in the EU not only of the EuroGroups Register, but also of the Early Warning System, EU Profiling and GNI MNE Pilot Exercise. The experience of this Pilot Exercise cooperation and exchange of microdata among the countries of residence of each considered MNE seems to indicate that this objective requires appropriate legal basis and technological infrastructure to be put in place in the EU.

112. However, as highlighted also by the GNI MNE Pilot Exercise, large MNEs groups often carry out part of their activities, even relevant ones, outside the EU. In some cases, MNEs groups with a relevant presence in the EU have their GDCs outside the EU. Therefore, despite being a much more ambitious aim, it would be highly beneficial for a correct and coherent measurement of MNEs and MNEs groups in national accounts across countries if stable and safe communication channels among National Statistical Institutes could be established also between EU and non EU countries.

113. Moreover, we believe that in many cases the information needed for the measurement of all national accounts target variables of MNEs and MNEs groups is not already available either publicly, or directly to the National Statistical Institutes, or in administrative data. In these cases, only close, in depth, repeated interactions among the National Statistical Institutes of the countries involved and the enterprises and their
branches could allow the acquisition by the National Statistical Institutes of robust information and therefore the production of accurate, coherent, exhaustive statistical aggregates. The contacts with the enterprises and their branches could benefit from the experience and guidelines developed in the context of the EU Profiling and Large Cases Units on how to make them less burdensome for the enterprises and more useful for the National Statistical Institutes, also with respect to the need to bridge the gap often existing between business accounting and national accounts concepts. It is possible that the existing EU legal framework would need to be extended to include an obligation for MNEs’ EU units to interact with and respond to the EU National Statistical Institutes, when approached with the aim to acquire this information. The issue is at the moment being considered in the GNI MNE Pilot Exercise.

114. Furthermore, in our opinion, it has become evident how micro level adjustments of business statistics data to comply with national accounts definitions and compile national accounts aggregates are a necessary precondition to identify possible inconsistencies in the registration of value added of MNEs across countries and to assess their impact on the GDP and GNI. To reduce the need for these adjustments, the implementation of the economic ownership principle, as defined for national accounts, in all business statistics would be of great relevance, as a consistent and coordinated move to the new statistical unit, enterprise, across all statistical domains.

115. Finally, for what concerns the Italian national accounts, in addition to what has already been mentioned in this Section, our aims for the Harmonized Benchmark Revision 2024 of national accounts include the design and implementation of a specially built process for branches within the production process for GDP and GNI.

116. Furthermore, they could also involve addressing with the national business register colleagues the issue of the economic activity classification of the Italian parts of foreign enterprises carrying out only flights either beginning or ending in this country’s airports, to align it with that currently used in national accounts for their production.
REFERENCES


