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OUTWARD FOREIGN AFFILIATES SURVEY FOCUSING ON FINANCE AND INSURANCE

7-9 November 2011, OECD Headquarters, Paris

This document is for discussion. It was prepared for item 11.5 of the agenda and will be presented by Bernard Williams.

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OUTWARD FOREIGN AFFILIATES SURVEY FOCUSING ON FINANCE AND INSURANCE

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For information and discussion of:

- *Managing expectations from a client-funded survey.*
- *The impact of confidentiality on analysing survey results.*
- *The difficulty in testing collecting information on non-resident businesses and measuring GATS Mode 3.*
- *The challenge of presenting asymmetrical views of data.*

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OUTWARD FOREIGN AFFILIATES SURVEY FOCUSING ON FINANCE AND INSURANCE

Summary

1. The Survey of Outward Finance and Insurance Foreign Affiliates Trade in Services (SOFI FATS) was run with respect to the 2009-10 financial year. The survey was funded by the Department of Foreign Affairs and Trade (DFAT) but the Australian Bureau of Statistics (ABS) was responsible for all facets of the survey - design, questionnaire dispatch and collection, compilation, dissemination and evaluation.
2. The survey enabled the ABS to provide for outward finance and insurance foreign affiliates;
 - A measure of Australia's economic impact overseas not captured by the standard ABS macroeconomic accounts.
 - Mode 3 of the General Agreement on Trade in Services (GATS) mode of supply.
 - Levels of employment, sales and purchases.
 - Gross Value Added (GVA) and financial intermediary services indirectly measured (FISIM).
3. The survey provided several challenges, particularly in regards to confidentiality restrictions resulting from the small number of units on the frame.
4. Definitions of the various concepts of SOFI FATS, the methodology behind the survey and a summary of results are presented in this paper.

What is SOFI FATS?

5. Australia's economic interaction with the world as captured in the ABS Balance of Payments (BOP) statistics, measures Australia's trade flows (exports and imports), income earned and paid and associated financial flows with the rest of the world. The BOP does not, however, cover all aspects of Australian business overseas. International Investment accounts account for some of the financial flows to and from affiliates, however can miss interactions between foreign affiliates and both their host and other countries.
6. Australia is a significant direct investor abroad, with equity investment (in all industries) of \$306.4 billion invested in affiliated companies around the world at the end of June 2010. Trade by Australia's foreign affiliates abroad (commercial presence) is not explicitly included in ABS BOP and associated national accounts statistics, as it is part of the non-resident economy.

7. However, trade by Australian foreign affiliates in its own right is important in terms of understanding Australia's overall global links with the world economy, in particular for services trade and for trade negotiations. Unlike goods exports, it is often necessary for the Australian service provider to establish a presence in the host economy to deliver the service. A one-off *Survey of Australian Outward Foreign Affiliates Trade* conducted by the ABS in 2002-03 found that the majority (65%) of Australian services delivered overseas were delivered by a commercial presence in the host country.

8. The World Trade Organization (WTO) GATS identifies four "modes of supply" for determining a country's delivery of services to the world to facilitate classification and analysis of barriers to services trade. This is a wider definition of international services trade than used in ABS and other countries' BOP statistics and includes sales and purchases by foreign affiliates.

9. The modes of supply framework was developed by the WTO as barriers to services trade typically arise as regulatory barriers within the host economy and not as traditional tariff barriers as for merchandise goods. These modes of supply have been adopted by the United Nations (UN) in their international statistical frameworks for services and globalisation statistics. The standards are set out in the UN publication *Manual on Statistics of International Trade in Services, 2010* (MSITS).

10. The four modes of service supply are defined as:

- *Mode 1 – Cross border supply* – occurs when a service is delivered from a supplier in their country of residence to a consumer in another country, without either supplier or consumer moving into the country of the other.
- *Mode 2 – Consumption abroad* – occurs when consumers resident in their country move outside their home territory and consume services in another country, such as tourist activities.
- *Mode 3 – Commercial presence (i.e. foreign affiliates trade)* – occurs when a commercial presence abroad is established as a result of direct investment in the host country (i.e. a foreign affiliate is established) to supply services to consumers in their country of residence (i.e. local sales only).
- *Mode 4 – Presence of natural persons* – occurs when an individual has moved into the territory of the consumer to provide a service without becoming a resident of that country.

11. Modes 1, 2 and 4 are recorded as exports and imports in BOP and national accounts statistics. Mode 3 services are not.

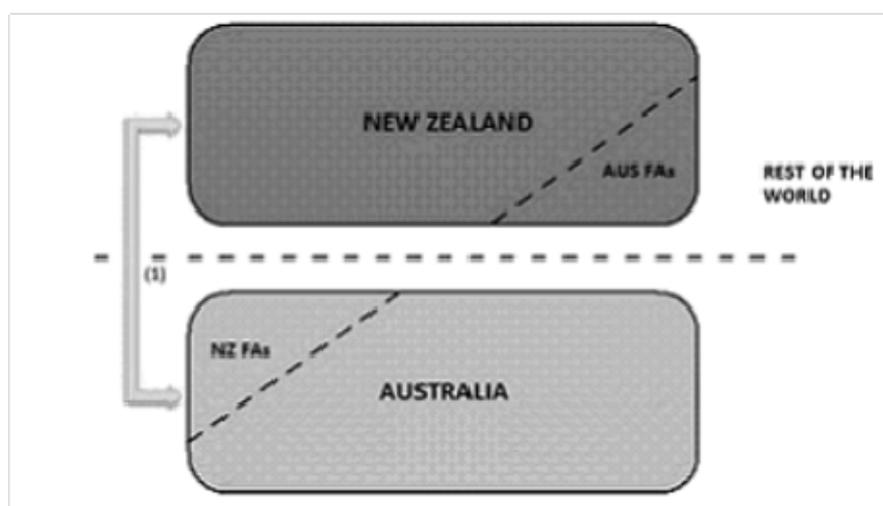
12. The lack of information on modes of service supply and mode 3 in particular has been identified by a range of data users as a gap in the ABS' current trade in services statistics. However, the ABS is not funded to produce the additional data. To address this data gap in current trade in services statistics DFAT commissioned the ABS to conduct a one-off survey of outward foreign affiliates trade in services for the reference period 2009-10. With only limited funding available, the survey covered the finance and insurance sector only, a sector identified in the 2002-03 survey as being one of the key sectors for Australia's outwards foreign affiliates trade in services.

13. Note that this survey only covered *outward* foreign affiliate trade. For a complete picture, an *inward* equivalent would need to be run (i.e. affiliates in Australia owned by non-resident companies). The

ABS believes that it is important to consider this symmetrical view and prepared a diagram to illustrate the relationship between BOP and foreign affiliate statistics.

14. Diagram 1 shows a simplified model of the transactions measured in the BOP between two economic territories defined by residency, in this example Australia and New Zealand. The light shading represents Australia's economic territory (including New Zealand owned foreign affiliates residing in Australia). The dark shading represents New Zealand's economic territory (including Australian owned foreign affiliates residing in New Zealand). Flow (1) shows economic transactions between the two economic territories, *i.e.* between residents of Australia (including New Zealand owned foreign affiliates residing in Australia) and residents of New Zealand (including Australian owned foreign affiliates residing in New Zealand), and vice versa. These economic transactions are measured in the BOP.

DIAGRAM 1 - BOP TRADE VIEW, Australia and New Zealand



Key: AUS FAs refer to Australian owned foreign affiliates; NZ FAs refer to New Zealand owned foreign affiliates; (1) Flow (1) represents trade between Australia (including New Zealand owned foreign affiliates residing in Australia) and New Zealand (including Australian owned foreign affiliates residing in New Zealand). This trade represents modes of supply 1, 2 and 4.

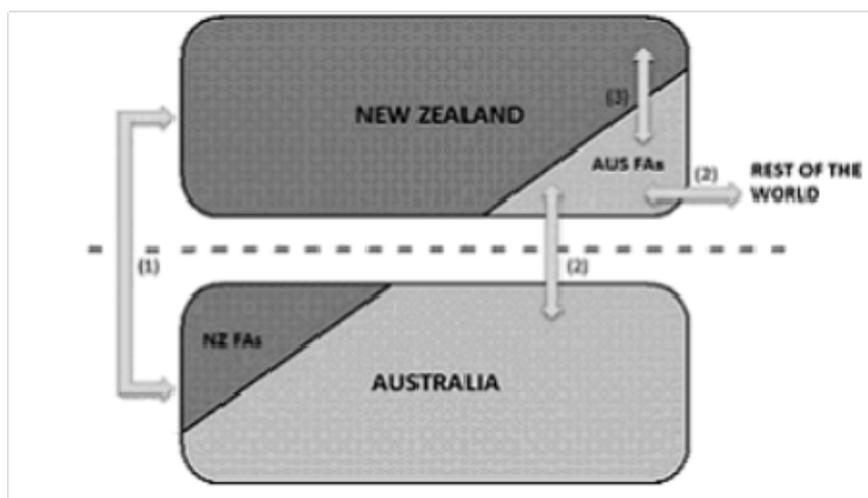
15. The residents of the economic territories defined for BOP purposes can be regrouped on an ownership basis using the same units, concepts and rules. This is consistent with the approach outlined in MSITS.

16. In Diagram 2, the economic territories of Australia and New Zealand are regrouped to reflect units under common ownership. The light-shaded group consists of Australian resident enterprises that are owned by Australia and Australian owned foreign affiliates residing in New Zealand. The dark-shaded group consists of New Zealand resident enterprises that are owned by New Zealand and New Zealand owned foreign affiliates residing in Australia.

17. In this context, Australian/New Zealand ownership refers to enterprises that are majority owned by the Australian/New Zealand resident enterprises (more than 50% of the ordinary shares or voting stock). This includes offshore subsidiaries, branches and majority-owned foreign joint ventures.

18. The foreign affiliates of Australian enterprises (AUS FAs) have majority Australian ownership. Trade between these affiliates and the residents of Australia is included in the residency-based BOP (Diagram 1) but is excluded from flows measured in the ownership-based FATS (Diagram 2). However, trade between these affiliates and other residents of New Zealand and New Zealand affiliates in Australia, is included in FATS.

DIAGRAM 2 - OWNERSHIP TRADE VIEW, Australia and New Zealand



Key: AUS FAs refer to Australian owned foreign affiliates; NZ FAs refer to New Zealand owned foreign affiliates; (1) Flow (1) represents trade between Australia (including New Zealand owned foreign affiliates residing in Australia) and New Zealand (including Australian owned foreign affiliates residing in New Zealand). This trade represents modes of supply 1, 2 and 4 and reflects the BOP view; (2) Flow (2) represents trade between Australian owned foreign affiliates in New Zealand and the rest of the world (including Australia). This is presented as 'non-resident' trade in the SOFI FATS publication. (3) Flow (3) represents trade between Australian owned foreign affiliates residing in New Zealand and other residents of New Zealand. This is presented as 'local resident' trade in the SOFI FATS publication (mode 3).

19. Data by mode of supply include flows from both the residence-based grouping and the ownership-based grouping in Diagrams 1 and 2. In both diagrams, from the Australian perspective, flow (1) represents modes of supply 1, 2 and 4, *i.e.* exports to and imports from the rest of the world (including New Zealand). In Diagram 2, from Australia's foreign affiliate's perspective, flow (2) represents modes of supply 1, 2 and 4. Flow (3) represents mode of supply 3, *i.e.* commercial trade between Australian owned foreign affiliates residing in New Zealand and other New Zealand residents.

20. While the ownership and modes of supply presentations are useful for some analytical purposes, they can be misleading if they are seen as an alternative view of the balance of payments. Including the sales by foreign affiliates as exports (outward trade) without including imports from resident foreign affiliates (inward trade) is asymmetrical and leads to an illusory improvement in trade balances. The SOFI FATS publication only provides statistics on an outwards basis and only for finance and insurance foreign affiliates. For a broader perspective of Australia's economic relationship with the rest of the world, clients need to refer to the balance of payments.

21. The SOFI FATS questionnaire was sent to all Australian enterprise groups who were thought to have foreign affiliates that traded primarily in finance and/or insurance. Thirty enterprises were in scope with results being published by the ABS on 27 June 2011 in the publication *Australian Outward Finance and Insurance Foreign Affiliate Trade, 2009-10* (cat. no. 5485.0). All the major Australian financial and insurance companies with affiliates overseas completed the survey.

22. The survey only included finance and insurance affiliates where Australia had a majority ownership (more than 50% of the ordinary shares or voting stock) unless ownership restrictions in the host economy prevent the Australian head office from acquiring a 50% stake in the affiliate. In these cases finance and insurance affiliates with slightly less than 50% Australian ownership were also included in the survey.

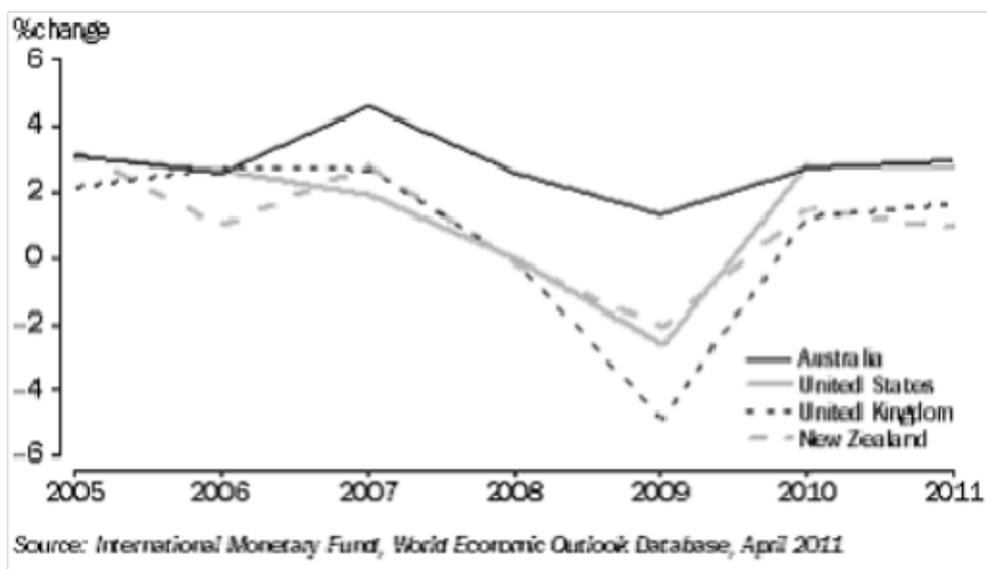
23. It is difficult to capture the activities of foreign affiliates of Australian enterprises and their effects on their host economies and their own parent enterprises. Only a few countries collect comparable statistics at present, including the United States of America, Canada and a limited number of European countries.

Why did the ABS focus on outward finance and insurance?

24. In 2003, the ABS conducted the Survey of Outward Foreign Affiliates Trade (SOFAT) which measured the economic activity of foreign affiliates of Australian enterprises for all industries. The results were published in *Australian Outward Foreign Affiliates Trade, 2002-03* (cat. no. 5495.0). Additionally, the publication *Economic Activity of Foreign Owned Businesses in Australia, 2000-01* (<http://www.abs.gov.au/ausstats/abs%40.nsf/mf/5494.0>) (cat. no. 5494.0) measured the economic activity of foreign owned affiliates in Australia in 2000-01.

25. The results from the 2002-03 SOFAT revealed that the finance and insurance division was one of the most significant for foreign affiliates in terms of employment and revenue. Due to the significance of the division, the interest in developing markets for services industries and the cost of conducting a full FATS survey, the ABS and DFAT jointly decided to focus a foreign affiliate trade survey specifically on the outward activities of the finance and insurance division. The results provide free trade agreement negotiators and other analysts with a more complete picture of the reach of Australian enterprises beyond Australia's economic territory.

26. The 2009-10 financial year is the reference period for the SOFI FATS survey. This period was characterised by global instability. Major economies around the world (including the US, UK and NZ) experienced sharp declines in Gross Domestic Product (GDP) in 2009. As a consequence, the results of the 2009-10 SOFI FATS may be neither typical for other periods nor reflective of the performance of Australian resident enterprises over the same period (see Graph A).

GRAPH A - PERCENTAGE CHANGE IN GDP GROWTH, by selected countries, 2005-11

Collection and Compilation methodology

27. The frame of the survey was all Australian owned foreign affiliates in the finance and insurance industries. The starting point to compile the frame was finance and insurance units that have direct investment abroad, according to the ABS International Investment Survey (IIS). Investigation (primarily using annual reports) into the non-financial units on the IIS frame that also had direct investment abroad was undertaken to determine if they had finance and insurance affiliates.

28. The concept of direct investment abroad used in IIS is 10% or more of the ordinary shares or voting stock power in a non-resident business, whereas the foreign affiliates definition relates to majority control, *i.e.* more than 50% of the ordinary shares or voting stock. This led to the number of units in scope of foreign affiliates being smaller than the initial frame indicated. There was a high overall response rate (95%), but a 100% response rate was achieved for the largest and most significant contributors.

28. Excluding overheads, the survey was conducted and processed at an approximate cost of 1.7 full time equivalent employees over the 2010-11 financial year, with an additional cost of approximately 1 full time equivalent for software design and programming.

29. The initial plan for survey despatch was for the survey to be completed by the foreign affiliates themselves (not the parent company) due to the 2002-03 causing significant provider burden on the parent companies. As such form testing was done for two different groups - major parent companies, and affiliates of foreign companies located in Australia. The ABS designed a form with a great amount detail, with the expectation that feedback would indicate that the detail asked was either too time intensive or not

available. The parent companies and affiliates did indicate this, and the detail requested was significantly decreased.

30. Affiliates of foreign companies located in Australia were tested, however they would not be included in the final frame. Resources restricted the ABS from testing foreign affiliates overseas, and the intent was that affiliates in Australia would be able to provide a 'like-for-like' comparison of potential feedback for the survey. These affiliates did provide valuable feedback in terms of form structure and content, however the major feedback came from the major parent companies of Australia, where there was a unanimous decision for them to complete the survey and not the affiliates.

31. As it was the first time this specific survey was being run, a large amount of detail was requested in order to maximise outputs, even after taking in feedback. However, it became clear a lot of the detail was not available or could not be estimated easily. Therefore if this survey is to be run again, less detail will be requested, which should significantly simplify the survey and decrease provider burden substantially. The survey used e-forms and no paper forms were despatched.

32. Reporting units were asked to report for their most recent financial year for which financial accounts were available. The nominal reference period was the 2009-10 financial year, with the reference period for respondents varying from a calendar year ending 31 December 2009 to a financial year ending 30 September 2010. No adjustment was made for estimates to account for differing financial year reference periods.

33. Given the small frame of this survey, there were extensive confidentiality issues at every level of analysis. It was decided that ABS confidentiality policies would be observed by confidentialising at the consolidated affiliate level. The ABS used the perturbation methodology as the main technique to confidentialise the survey output. This technique had already been adopted for ABS trade in services statistics as it maximises the release of data items from the survey. If perturbation was not sufficient to ensure confidentiality, data was collapsed at levels of aggregation in order to comply with the ABS confidentiality policies.

34. The key measures published broadly align with accounting concepts for the finance and insurance industries, as requested by DFAT, in order to provide international comparisons. Sales included income from finance (including direct fees and charges from deposit services and credit granting services), insurance (including fees and premiums/claims received), pension and other services earned. Purchases included expenses from finance (including direct fees and charges from deposit services and credit granting services), insurance (including fees and premiums/claims paid), pension and other services paid. Sales and purchases exclude indirect charges such as financial intermediation services indirectly measured (FISIM), unless otherwise indicated. Future surveys may benefit from using stricter standards aligning with BPM6 and SNA08, and informing clients why these are being used.

Results

35. Main findings for 2009-10 include:

- Australian resident enterprises had 1,245 finance and insurance foreign affiliates which:

- Employed 75,919 staff
- Recorded \$28.1b in sales of finance and insurance services
- Recorded 92% of their sales of finance and insurance services to local residents in the host country of the foreign affiliate, indicating that the foreign affiliates were primarily established to service the markets where they were domiciled.
- Foreign affiliates domiciled in New Zealand, the United Kingdom and the United States of America accounted for more than 54% of the following key measures for Australian finance and insurance outward foreign affiliates:
 - Number of foreign affiliates
 - Employment and wages and salaries
 - Sales of services
 - Purchases of services.
- Foreign affiliates in the insurance and superannuation funds industry had sales of services of \$17.9b (62% of total sales of services).
- Foreign affiliates in the finance industry were the major employer, with 53,034 staff (70% of total employment) and \$4.1b in wages and salaries (61% of total wages and salaries).

For more detailed results, refer to the Australian Outward Finance and Insurance Foreign Affiliate Trade, 2009-10 (cat. no. 5485.0) publication.

Feedback

36. Feedback received for the SOFI FATS project was positive from other government departments (including DFAT and the Reserve Bank of Australia) and addressed some data gaps for private and academic groups. DFAT published an analysis on the data (<http://www.dfat.gov.au/media/releases/department/2011/dfat-release-20110805.html>). Although a time series is the best way to utilise these results (and feedback indicated as such), limitations in funding means that foreign affiliate trade statistics will likely be a sporadic series.

37. The OECD provided comments which were generally positive and will be incorporated in any future studies. Of particular note are the ABS interpretations of modes of supply in regards to purchases for trade purposes and several definitions which will be refined in future studies.

Conclusion

38. The SOFI FATS project delivered interesting results which should be of use to trade negotiations and other analysts. However, the small number of units on the frame limited data available for the analysis, and it is unlikely this survey would be run again at this level. It would be better to run a broader survey (a modified version of the 2002-03 survey) and ask less detailed data items, specifically only asking for basic industry and country level. New systems are currently being developed across the ABS, and any new survey would have to be redesigned to comply with the new statistical infrastructure. In addition, a larger frame and larger sample size would be needed and this would cause the costs to be significantly higher.

39. Measuring the impact of services produced by Australian foreign affiliates has many benefits. In addition to providing a more balanced view of the Australian economy, it also helps businesses understand Australia's place internationally and how Australian firms are engaging internationally. Measuring foreign affiliate statistics also helps trade policy analysts and trade negotiators have a better grasp of their position, particularly given the size of finance and insurance trade.

Australian Bureau of Statistics

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