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OECD Investment Policy Reviews: China 2008

Chapter 2

China's FDI Statistics

International comparability is an indispensible feature of FDI statistics for any country, particularly if it is a major player in the global economy. The OECD's Benchmark Definition of Foreign Direct Investment sets the world standard for measuring FDI. Within that framework, the OECD has established close links with China to provide assistance in best practices through its network of experts. This chapter evaluates recent improvements in China's FDI statistics and makes a number of recommendations based on the Benchmark Definition.

In line with China's prominent role as host for foreign investment, the FDI statistics of China compiled and disseminated by the Chinese Ministry of Commerce (MOFCOM) were traditionally limited to inward investments only. A new publication, jointly prepared by MOFCOM and the State Administration of Foreign Exchange (SAFE), was released for the first time in 2005 enumerating and analysing China's outward direct investment. This initiative was welcomed by policy analysts and other users of FDI statistics who need comprehensive data with which to monitor and assess the role of China as investor country. Chapter 3 of this *Review* provides a full analysis of China's outward investment since the early days of its open door' policy.

In addition to MOFCOM's FDI statistics, SAFE publishes balance of payments and international investment position statistics which include aggregate totals for direct investment but do not provide detailed information on partner countries and on industry classification.

The OECD's Benchmark Definition of Foreign Direct Investment sets the world standard for measuring FDI. Within that framework, the OECD has established close links with China to provide assistance in best practices through its network of experts, the Working Group on International Investment Statistics of the Investment Committee (WGIIS), who have the technical responsibility for setting the methodological recommendations.

At end-2006 MOFCOM visited OECD headquarters in Paris to establish the foundations of a China/OECD Dialogue on FDI statistics for policy making. Senior officials from OECD member governments also attended this meeting. The purpose of the co-operation is to promote an exchange of views and experiences between Chinese and OECD experts and provide assistance to China to improve its statistics on inward and outward FDI flows and stocks. Experts attending the meeting agreed that FDI statistics form an important and necessary component for the analysis of the global economy, keeping in mind the undisputed role of FDI for development as set out by the Monterrey consensus.

As a conclusion of the exchange of views, China endorsed the practical co-operation framework on FDI statistics proposed by Mr. M. Schekulin, Chairman of the Investment Committee, who recalled that "better investment statistics and better analysis of investment data for a more rational investment policy making" is one of the Committee's four priority areas. He indicated that a China-OECD Dialogue on FDI statistics should aim at: *a)* establishing a

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framework for continued networking between Chinese and OECD experts for FDI statistics; and *b)* developing medium-term priorities.

The practical application of this programme was articulated in four concrete proposals:

1. Identifying a group of core experts composed of Chinese and OECD officials, the OECD Secretariat, and other international organisations.
2. Enabling visits, discussions and meetings of experts, including by:
   a) inviting Chinese officials to regular OECD WIIS meetings,
   b) organising visits by OECD experts to meet Chinese officials,
   c) organising seminars/meetings to inform Chinese statisticians and the analysts of the standards adopted by the OECD *Benchmark Definition of FDI*; to provide assistance to Chinese statisticians on practical implementation issues; to introduce FDI globalisation indicators; to discuss analytical interpretation of FDI statistics; to respond to other requirements.
3. Other concrete outputs:
   a) Translation of the *OECD Benchmark Definition of FDI, 4th edition*, into Chinese.
   b) Incorporating the FDI statistics of China in OECD's FDI Statistics Yearbook (using standard framework at an advanced stage of the co-operation when China adopts some of the basic recommendations).
   c) Presenting special papers for discussion and publication.
   d) Exchange of staff.
4. Programme assessments: Regular reports to China and to OECD Investment Committee using the self-evaluation tools established by the Committee for its outreach activities.

The first step for the implementation of this programme was a seminar on "Measuring FDI to promote a harmonious society" organised at the occasion of the 11th China International Fair for Investment and Trade (CIFIT) in September 2007. The seminar was organised as a parallel event at CIFIT, under the auspices of the OECD WGIIS in co-operation with MOFCOM.

The seminar attracted a rather large audience, most of whom were Chinese. Following a presentation of its analysis of recent FDI trends and developments, the OECD Secretariat discussed the importance of measuring the FDI activity. This presentation was complemented by Japanese experience and by China's presentations of its inward and outward statistics. The Netherlands presented the challenges ahead for enterprises (both as direct investors and as direct investment enterprises) in the process of information gathering for FDI statistics. MOFCOM is the principal body responsible for

China's FDI statistics. Inward and outward FDI statistics are dealt by different MOFCOM departments.

MOFCOM has put the following concrete programme proposals to the OECD which are currently under consideration and discussion: *i)* An evaluation of China's FDI statistics; *ii)* a study on off-shore/free port jurisdictions, also looking at hedge funds and private equity funds; *iii)* co-operation with China for implementing an inward direct investment survey; *iv)* co-operation with China to implement FDI stock statistics as well as merger and acquisition (M&A) statistics.

The methodology for compiling foreign direct investment statistics can be very complex. Applying internationally agreed standards is the only means to achieve comprehensive statistics which are comparable across countries. International comparability is an indispensible feature of FDI statistics for any country, particularly if it is a major player in the global economy.

A recurring question is that of whether China's FDI statistics are internationally comparable.[1] The continuing absence of metadata[2] is a major gap while there is no descriptive information on the methodology China uses to compile these statistics. This lack of transparency leaves a number of questions unanswered and therefore has a direct impact on the quality assessment of the statistics. In consequence, it is not possible to declare objectively that China's FDI statistics are in line with the methodology recommended in the OECD Benchmark Definition of FDI (fully consistent with IMF's recommendations). OECD has a fully-fledged objective assessment tool, the Survey of Implementation of Methodological Standards for Direct Investment (SIMSDI). China was invited in early 2008 by the OECD to take this survey in response to the request by MOFCOM for a review of its statistical system. The result of this exercise will allow developing metadata for inward and outward FDI statistics of China, to deepen the understanding of the data and to identify areas for improvement.

Having formulated this general point of prime importance, the following observations can be made, based on MOFCOM's publications relating to China's FDI statistics which appear to be deviations from international standards:

1. The formats used for disseminated inward and outward foreign direct investment statistics of China are different. Even if inward and outward FDI are not treated in the same department of MOFCOM, tabular presentations and accompanying labels can be standardised. FDI outflows by partner country (or by industry) are presented in a single table for several years, a format which could be usefully applied as a model for inward investments. All OECD countries provide their statistics based on similar standardised presentations recommended by international organisations. It is notable

also that the statistics showing outward investments by partner country exclude investments in the financial sector, while MOFCOM does not separately publish similar information on this sector of the economy. As a result of a recommendation in the 2003 investment review of China, MOFCOM established the "invest in China" website (*www.fdi.gov.cn*), which provides monthly cumulated flow statistics. Nevertheless, annual data is difficult to track from this website, which presents differences in coverage between the Chinese and English versions. Regarding inward investment, China distinguishes between "contracted FDI" and "realised FDI", although the former is in the process of being abandoned. The distinction between the two concepts is not clearly described and there is some concern that the latter may correspond to inflows of funds which do not necessarily comply in all cases with FDI criteria. This important conceptual distinction requires explanatory information.

2. Classifying direct investment by industry sector provides valuable information to analysts. China's inward and outward FDI are also presented by industry. Nevertheless these data are classified according to a national classification which is not in line with International Standard Industry Classification (ISIC) which is required for international comparability of the data, for example with OECD countries. Sectoral time series are difficult to compile and assess because the industrial classification used for all past years is not totally uniform. Moreover, it is essential to indicate in notes whether the industry classification used is that of the direct investor or of the direct investment enterprise.

3. China provides information on FDI stocks, both for inward and outward investment. What is published as inward FDI stocks are only cumulated flows. These figures should be used with caution. While cumulated flows may indicate general trends of FDI in the absence of actual stock data, they cannot be considered as proxy for a structural analysis of FDI. On the other hand, it is not possible to comment on outward FDI stocks in the absence of any metadata. The Chinese government is invited to consider implementing a survey system – the primary source used by OECD countries – to compile accurate FDI stock statistics.

4. China's FDI statistics do not provide information on direct investment income. There is no published information on direct investment income on equity (dividends and reinvested earnings) and income on debt (interest), which is the standard presentation recommended by the Benchmark Definition of FDI and applied by OECD countries.

5. China's FDI statistics do not show separately the main components of FDI, equity financing (equity and reinvested earnings) and inter-company loans. The analysis of each component by partner country and by industry sector

separately provide valuable analytical information. These breakdowns are recommended by the Benchmark Definition and are applied by OECD countries.

6. Apart from private estimates, there is, to our knowledge, no official measure of "round-tripping" of domestic funds returning back to China in the form of FDI. Any sound analysis will require segregation of such funds. The new OECD Benchmark Definition of FDI provides methodological elements to identify such funds. Moreover, it is useful to compare partner country or territory estimates, such as estimates by Hong Kong, China of round-tripping with China, that may be available.

7. Regarding basic definitions used by China there is no information available. China is invited to apply the definitions and concepts as well as the breakdowns recommended by the revised edition of the Benchmark Definition (see Box 2.1).

Box 2.1. **OECD Benchmark Definition of Foreign Direct Investment, 4th edition**

Foreign Direct Investment (FDI) occurs when a business located in one country (the *direct investor*) invests in a business located in another country (the *direct investment enterprise*) with the objective of creating a strategic and a lasting relationship. Within an effective policy framework FDI can assist host countries in developing local businesses, promoting trade and contributing to technology transfer. Similarly, it can provide greater market access to businesses in home countries. Governments, businesses and other stakeholders need reliable FDI statistics to inform and support their decisions for investments worldwide.

The OECD completed in May 2008 the 4th edition of its *Benchmark Definition of Foreign Direct Investment (BMD4)* which sets the world standard for FDI statistics and provides a single point of reference for statisticians and users of FDI statistics. It is fully consistent with the *IMF Balance of Payments and International Investment Position Manual, 6th edition* The revision largely corresponds to the introduction of new data breakdowns and statistical treatments to adjust the traditional canvas of FDI statistics to rapidly changing business structures as a consequence of the removal of legal and regulatory restrictions. In terms of new breakdowns the Benchmark Definition provides a methodology to classify FDI by type, such as whether mergers and acquisitions or greenfield investments, and to identify the ultimate investor.

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Box 2.1. **OECD Benchmark Definition of Foreign Direct Investment, 4th edition** *(cont.)*

For statistical purposes, it is considered that the lasting interest is evidenced when a direct investor owns 10% or more of the voting power of a direct investment enterprise. In other words, the motivation of the direct investor is to exert some degree of influence over the management of the direct investment enterprise whether or not it entails a controlling interest. Direct investment enterprises are corporations or quasi-corporation which may either be subsidiaries (including branches), in which over 50% of the voting power is held, or associates, in which between 10% and 50% of the voting power is held. The relationship between the direct investor and its direct investment enterprises may be complex and bear little or no relationship to management structures. Direct investment relationships are identified according to the criteria of the Framework for Direct Investment Relationships (FDIR) including both direct and indirect direct investment relationships.

FDI statistics include three main data series: *direct investment positions* (equity including reinvestment of earnings and debt), direct *investment income flows* (distributed earnings, reinvested earnings, interest income) and *direct investment financial flows* (equity, reinvestment of earnings and debt). Market value is the preferred conceptual basis to measure both direct investment positions and flows. FDI statistics are presented for the reporting country according to two standard templates and in each case according to the direction of investments (inward and outward investments): *i)* FDI by partner country; *ii)* FDI by economic activity (according to ISIC4).*

One major worry for users of FDI statistics is the problem of "capital in transit" which may take different forms. Multinational enterprises (MNEs) increasingly have recourse to complex structures to manage their financing. In many cases (although not all) they use the services of what is generically called Special Purpose Entities (SPEs) such as holding companies, shell companies, brass-plate companies or financing subsidiaries. Including the transactions through these entities in FDI statistics distorts the measurement of genuine FDI by: *i)* overstating FDI for the country hosting SPEs; *ii)* overstating overall FDI by double (or multiple) counting; *iii)* misallocating the origin and/or destination of FDI.

* ISIC: International Standard Industry Classification.

Notes

1. See *Investment Policy Reviews: China*, Annex 1, International Comparability of China's FDI statistics.
2. Metadata refers to methodological information, 2003, OECD.