Implementing the latest international standards for compiling foreign direct investment statistics

ASSET/LIABILITY VERSUS DIRECTIONAL PRESENTATION

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In 2014, many countries implemented the latest international guidelines for compiling FDI statistics. While implementation of these guidelines results in more meaningful FDI statistics, the changes to the statistics can make them difficult to interpret. In this note, we explain one key feature of the new standards and what it means for users of FDI statistics. The note begins with an explanation of the two measures for presenting aggregate, or global, FDI statistics: the asset/liability presentation and the directional presentation. This is followed by examples of the two presentations for 2013 for two countries—the United States and France. The note ends by examining FDI statistics according to the two presentations for a set of countries.

The OECD's *Benchmark Definition of Foreign Direct Investment, 4th edition* (BMD4) and the IMF's *Balance of Payments and International Investment Position Manual, 6th edition* (BPM6) provide guidance on the compilation of FDI statistics. BPM6 and BMD4 recommend that aggregate FDI statistics, which are included in Balance of Payments (BOP) and International Investment Position (IIP) accounts, be presented according to the asset/liability principle rather than the directional principle as has been the recommendation in previous editions of these international guidelines. On an asset/liability basis, direct investment statistics are organised according to whether the investment relates to an asset or a liability for the country compiling the statistics. For example, a country's assets include equity investments by parent companies resident in that country in their foreign affiliates because those investments are claims that they have on assets in foreign countries. Similarly, a country's liabilities include foreign parents' equity investments in affiliates resident in that country because those investments represent claims that foreigners have on assets in the reporting country. The asset/liability presentation does not show the direction of influence as the directional presentation does.

Under the directional presentation, the direct investment flows and positions are organised according to the direction of the investment for the reporting economy—either outward or inward. So, for a particular country, all flows and positions of direct investors resident in that economy are shown under outward investment and all flows and positions for direct investment enterprises resident in that economy are shown under inward investment. Figure 1 shows the building blocks used to construct the asset/liability and directional presentation of the FDI positions; the presentations of flows would follow the same pattern. The figure shows that the building blocks used are the same—both presentations cover the same flows and positions—but they are organised and combined differently.

The first difference between the two presentations is how the pieces are organised. Under the asset/liability presentation, the asset side includes all assets of both resident parent companies and of resident affiliates, and the liability side includes all liabilities of both resident parents and resident affiliates. In contrast, the outward investment position consists only of positions of resident parents, and the inward investment side consists only of positions of resident affiliates.

Figure 1: Constructing the asset/liability and directional presentations of FDI positions

Country's direct investment assets are equal to	Country's direct investment liabilities are equal to
Resident parents' equity in and lending to foreign affiliates	Foreign parents' equity in and lending to resident affiliates
plus	plus
Resident affiliates' equity in and lending to foreign parents	Foreign affiliates' equity in and lending to resident parents

Country's outward investment is equal to	Country's inward investment is equal to
Resident parents' equity in and lending to foreign affiliates	Foreign parents' equity in and lending to resident affiliates
minus	minus
Foreign affiliates' equity in and lending to resident parents	Resident affiliates' equity in and lending to foreign parents

The second difference is in the treatment of reverse investment. Reverse investment is when an affiliate invests in its parent. Under the directional presentation, reverse investment is subtracted to derive the amount of total outward or inward investment of the reporting country. So, if a resident parent borrows money from one of its foreign affiliates, this is subtracted in calculating the reporting country's outward investment because it reduces the amount of money that that country's parents have invested in their foreign affiliates. Similarly, if a resident affiliate lends money to its foreign parent, this is subtracted when calculating inward investment because it reduced the amount of money that the foreign parent has invested in that country. While reverse equity investment is to be treated the same way as reverse debt investment, it is so rare that most of the difference between the two presentations is due to differences in the treatment of reverse debt investment.

The change to recording aggregate FDI statistics on the asset/liability basis was recommended to make FDI statistics consistent with other macroeconomic statistics in general and with the statistics for other functional categories of investment in the BOP and IIP statistics.[1] This change in measurement facilitates macroeconomic analyses, such as examining the compositions and size of a country's liabilities and assets to assess its vulnerability to crises. By providing consistent information on the composition and size of assets and liabilities by functional category of investment (for example, direct investment or portfolio investment) and by instrument (for example, equity or debt), a country's IIP provides important insights into how vulnerable its economy is to external market conditions. Measuring direct investment on an asset/liability basis facilitates such analyses. For example, assessing the share of total debt liabilities in direct investment is important because the returns to creditors of debt liabilities in direct investment depend on the performance of the debtor. In contrast, the returns to creditors on debt liabilities in portfolio investment do not depend on the performance of the debtor but are required even if the debtor is in difficulty, and, hence, pose a greater risk to the economy.

While the presentation on an asset/liability basis is appropriate for macroeconomic analyses, it is not as useful for studying the nature and motivations of foreign direct investment. For example, it is not useful for identifying the source countries of direct investment in a particular country or for assessing the access to specific foreign markets by direct investors in that country. The directional principle is most appropriate for these types of analyses and, thus, both BPM6 and BMD4 recommend that statistics by industry or by partner country or region be shown on a directional basis rather than an asset/liability basis. The statistics classify the direct investment as either outward, which is when a direct investor in the reporting economy has an investment abroad, or inward, which is when a foreign direct investor has an investment in an affiliate located in the reporting economy.

Why can FDI measured on a directional basis be so different from FDI measured on an asset/liability basis?

Differences between directional and asset/liability measures of FDI can be quite large in specific countries or in specific time periods. The differences between the two measures depend on the size and direction of reverse investment. While the same flows are covered by the measures, the different ways they are classified and combined explain the differences. For example, in 2013, the United States recorded USD 408.2 billion in the net acquisition of assets and USD 349.5 billion in outward investment, and France recorded negative USD 0.3 billion in net acquisition of assets compared to USD 10.3 billion in outward investment (table A).

The USD 408.2 billion net acquisition of direct investment assets included USD 14.4 billion in equity investment and USD 337.8 billion in reinvested earnings by U.S. parents in their foreign affiliates as well as lending of USD 23.3 billion from U.S. parents to their foreign affiliates.[2] The net acquisition of assets also included USD 32.8 billion in lending by U.S. affiliates to their foreign MNEs — either their foreign parents or other foreign affiliates of the MNE. This is subtracted in deriving the measure of outward investment because outward investment shows the direction of influence and, so, only includes foreign investments by U.S. parents. There was also USD 25.9 billion in borrowing by U.S. parents from their

[1] There are five functional categories of investment in the BOP and IIP statistics: direct investment, portfolio investment, reserve assets, financial derivatives, and "other" investment.

[2] Debt investment between U.S. parents and their foreign affiliates consists of debt investment between U.S. parents and their foreign affiliates and between any U.S. businesses that the U.S. parent ultimately owns and the U.S. parents' foreign affiliates.

foreign affiliates under the net incurrence of liabilities; this is subtracted from the net acquisition of assets in deriving outward investment because such borrowing reduces the amount of money that U.S. parents have invested in their foreign affiliates. This results in outward investment of USD 349.5 billion.

Table A. Conversion from asset/liability to directional measures of FDI flows of United States and France, 2013 (in USD billions)

	United States	France
Net acquisition of direct investment assets	**408.2**	**-0.3**
Equity investments by resident parents in foreign affiliates	14.4	-2.0
Reinvested earnings by resident parents in foreign affiliates	337.8	14.1
Lending by resident parents to foreign affiliates	23.3	-3.3
Lending by resident affiliates to the foreign MNE	32.8	-9.1
Less: adjustments to convert to directional basis	**58.7**	**-10.3**
Borrowing by resident parents from foreign affiliates	25.9	-1.2
Lending by resident affiliates to the foreign MNE	32.8	-9.1
Equals outward direct investment	**349.5**	**10.0**
Net incurrence of direct investment liabilities	**295.0**	**6.5**
Equity investments by foreign parents in resident affiliates	127.0	17.9
Reinvested earnings by foreign parents in resident affiliates	99.9	5.4
Borrowing by resident affiliates from the foreign MNE	42.3	-15.5
Borrowing by resident parents from foreign affiliates	25.9	-1.2
Less: adjustments to convert to directional basis	**58.7**	**-10.3**
Borrowing by resident parents from their foreign affiliates	25.9	-1.2
Lending by resident affiliates to the foreign MNE	32.8	-9.1
Equals inward direct investment	**236.3**	**16.8**

Source: OECD Foreign Direct Investment statistics (BMD4) database

The USD 245.0 billion in net incurrence of direct investment liabilities included USD 126.9 billion of equity investment and USD 99.9 billion of reinvested earnings by foreign parents in their U.S. affiliates as well as borrowing of USD 42.3 billion by resident affiliates from their foreign MNEs.[3] The net incurrence of liabilities also included USD 25.9 billion in borrowing by U.S. parents from their foreign affiliates. This is subtracted in deriving the measure of inward investment because inward investment shows the

[3] Debt investment between resident affiliates and their foreign MNEs consists of debt investment between resident affiliates and their foreign parents and any debt investment between resident affiliates that are ultimately foreign-owned and any parts of the foreign MNE.

direction of influence and, so, only includes investments in resident affiliates from their foreign MNEs. There was also USD 32.8 billion in lending by resident affiliates to their foreign MNEs under the net acquisition of assets; this is subtracted from the net incurrence of liabilities in deriving the measure of inward investment because such lending reduces the amount that foreign parents have invested in their affiliates in the United States. This results in inward investment of USD 236.3 billion.

In the case of the United States in 2013, reverse investment increased the amount of borrowing from parents to their affiliates. As a result, the directional measures were less than the asset/liability measures of FDI. However, parents can also repay their debts to their affiliates. This was the case for France in 2013. French parents repaid USD 1.2 billion to their foreign affiliates, and foreign MNEs repaid USD 9.1 billion in lending from their affiliates in France. As a result, the directional measures are higher than the asset/liability measures for France in 2013.

Interpreting the new FDI statistics

While the figures presented under the two measures can differ for specific countries or for specific periods, they do cover the same flows and positions. To examine the relationship between the two measures, we examined statistics for 15 countries that published quarterly figures on both bases from the first quarter of 2013 to the second quarter of 2014 and for four countries that reported annual figures on both bases for 2013.[4] This examination showed that the two measures moved together more than 80 percent of the time. This is not surprising since the major drivers tend to be the same for most countries. Investment by resident parents in their foreign affiliates is usually the most important component of both outward investment and the acquisition of assets and, investment by foreign parents in resident affiliates is generally most important for inward investment and the incurrence of liabilities.

Under the directional principle, it is possible to discuss which countries are the sources of most outward investment and which countries receive the most inward investment. However, under the asset/liability measures, this is no longer possible because, for example, the acquisition of assets combines both investments by resident parents in their foreign affiliates and loans by resident affiliates to their foreign parents. Nevertheless, because the two measures are related, it may be possible to draw some conclusions about the countries playing the largest role in FDI. For the 18 OECD countries reporting both asset/liability and directional measures for 2013, table B below shows the top 5 sources of direct investment and the top 5 recipients of direct investment as measured according to the directional presentation and their ranking under the asset/liability presentation.

The table shows that the largest sources and destinations of investment remain the same, whether measured on the directional basis or the asset/liability basis, with the exception of Germany which ranks as the third largest recipient of FDI flows in 2013 when measured on an asset/liability basis but only ranks eighth when measured on a directional basis.

4 See tables 1 and 2 in the *FDI in Figures* December 2014 issue for the data.

Table B. Top sources and destinations of direct investment in 2013 among 18 OECD countries: Comparison of directional and asset/liability measures

Country	Rank: outward investment	Rank: acquisition of assets	Country	Rank: inward investment	Rank: incurrence of liabilities
United States	1	1	United States	1	1
Japan	2	2	Australia	2	2
Germany	3	3	United Kingdom	3	4
Italy	4	4	Italy	4	5
Austria	5	5	Chile	5	6

Source: OECD Foreign Direct Investment statistics (BMD4) database

Conclusion

The latest international standards for compiling FDI statistics lead to more meaningful measures of direct investment but also lead to significant changes in the FDI statistics that can be hard to interpret. One of the largest changes was to the aggregate, or global, FDI statistics included in the BOP and IIP accounts. The latest guidelines recommend that these statistics be published according to the asset/liability presentation rather than the directional presentation as had been recommended in previous guidelines. This recommendation was made so that the FDI statistics would be more comparable to the other statistics included in the BOP and IIP accounts. However, the directional presentation is more useful for examining the natures and motivations for FDI, so the guidelines recommend that the detailed FDI statistics by country and by industry be published according to the directional presentation.

The two presentations cover the same flows and positions but differ in how they are classified and aggregated. As a result, the two presentations can differ significantly for specific countries and in specific time periods. However, they are related to one another. An examination of statistics for a sample of countries that published both measures revealed that the two measures tended to move together and tended to be of similar magnitude. These tendencies can be of use when analysing FDI statistics published according to the different presentations across countries or over time. ■

This explanatory paper has been prepared by the OECD Investment Division. For queries, please contact: investment@oecd.org. Find data and more detailed FDI statistics at www.oecd.org/investment/statistics.htm.