

Breakdown of inward FDI positions according to the country of the ultimate investor

Summary

In line with international statistical recommendations (BPM6, BMD4), at present the MNB publishes the country breakdown of stock, flow and income data of direct investments in a breakdown by **immediate** investor and investment. However, among domestic and international users there is also an increasing demand for a breakdown of the inward foreign direct investment position by the ultimate investor. This supplementary statistical breakdown is already made public by many countries on the OECD website as well, in addition to their own websites. Hungary is joining these countries in September 2016, when the MNB is publishing the breakdown of the foreign direct investments in Hungary¹ stock data by the ultimate investing country at the end of 2014. In the future, these supplementary statistics will be included in the MNB's annual data release in September, with a time lag of 21 months (T+21 months).

Chapters I and II below describe the notion of ultimate investor, present the content of the new breakdown, the process of domestic data compilation as well as the international experiences and methodological dilemmas that can be formulated on the basis of other countries' practices. Chapter III contains the presentation of data concerning Hungary: the data according to ultimate investors are compared with the stock data broken down by the immediate investors, which have been published until now as well.

I. The notion of ultimate investor as well as the content and compilation process of data

*The majority **investor** at the top of the ownership chain of the group of companies, i.e. the one **that indirectly or directly has more than 50% of the voting power in the given enterprise and that is not controlled by any other entity** (it does not have any other owner with voting power exceeding 50%) is considered ultimate controlling parent.² An ultimate investor can be a resident or non-resident private person, legal entity or economic agent operating in the form of an organisation without legal entity.*

- **The breakdown according to the ultimate investor** reallocates **the entire immediate direct investment** position to the ultimate investor **by leaving the value unchanged**. Irrespective of the number of direct investors, the entire foreign direct investments of the resident enterprise is allocated to the only³ ultimate controlling parent that is on the top of the majority ownership chain. Accordingly, at national level, the value of the FDI stock allocated to the ultimate investors equals

¹ For the time being, statistics with similar content (breakdown by 'ultimate investment') that can be compiled in the case of investments in the other direction, i.e. foreign direct investments abroad, are among the items to be worked out on the research agenda of the international community of statisticians. At present, no country publishes statistics with such content.

² OECD Benchmark Definition of Foreign Direct Investment, Fourth Edition 2008, page 23, Section 32.

³ If the ultimate investor cannot be identified because there is not one on the basis of the rules (for example, the ratio of investors is 50% each, i.e. there is no majority ownership chain) or no information from any source is available beyond the immediate investor(s), the stocks remain on the country of direct investor(s).

the size of the FDI stock allocated to the immediate investors. The country breakdown according to the ultimate investor shows the countries of residence of the investor that exercises the **ultimate supervision and control** over the foreign direct investments in Hungary.

- Contrary to the country breakdown that takes into account the immediate partner, **the country of the ultimate investor can be Hungary as well**. This case is called **round tripping**. It means that in fact a Hungarian majority investor invests in Hungary through a foreign company (companies). Accordingly, by separating the **round tripping** within stock data, the breakdown by the ultimate investor allows the identification of “foreign” investment sources that are actually not new for the country. In economic terms, round tripping is a specific type of capital in transit, which may be related to tax optimisation, just like in the case of other capital in transit.
- The principle of allocating the inward FDI stock according to the ultimate investing country applied by the MNB is **in line with⁴ the rules of allocating the indicators⁵ of the Inward Foreign Affiliate Statistics⁶ (Inward FATS)** made public by the HCSO **allocating to the country of the ultimate investor**. Accordingly, by the joint use of these two types of statistics, the analysis of the operation of affiliates under foreign control may provide a more comprehensive picture for analysts.
- The new country breakdown of the inward FDI stock will be made available by the MNB on its website broken down by instruments, separately for equity and debt as well, although only for the range of companies that does not include special purpose entities (SPEs).
- These supplementary statistics will be included in the MNB’s annual data release in September with a time lag of 21 months (T+21 months), and in line with the normal revision practice they will be revised and considered final one year later in the T+33rd month. Due to lack of retrospective information necessary for preparing the breakdown, compilation of backdata is not possible; therefore, 2014 is the first period for which the MNB is able to produce it.
- Inward FDI stock data broken down by the ultimate investor are available on the OECD website for the countries that already compile them. At present, there are 6 countries like that, but their

⁴ In practice there may be some difference between the Ultimate Controlling Institute (UCI) of the Inward FATS statistics and the Ultimate Controlling Parent (UCP) applied upon the allocation to the ultimate investor. According to the guidelines in the FATS Manual, upon determining the UCI, in unclear, special cases, one should strive for identifying the ultimate decision-maker in the group of companies, while the UCP is the ultimate investor at the top of the group of companies over whom no other investor exercises control (irrespective of the decision-maker and his role within the group of companies). Complete algorithms are recommended for special cases in the FATS Manual, while there is no such detailed guidance for determining the UCP.

⁵ Indicators: number of active enterprises, turnover, number of persons employed, production value, value added at factor cost, total purchases of goods and services, total purchases of goods and services purchased for resale in the same condition, personnel costs, number of employees, gross investment in tangible goods.

⁶ The Inward Foreign Affiliate Statistics (Inward FATS) data are available at: http://www.ksh.hu/stadat_annual_3_2 the publication: <http://www.ksh.hu/docs/hun/xftp/idoszaki/pdf/kulfleany13.pdf> unfortunately it is available only in Hungarian

Information on FATS statistics available on the Eurostat website:

<http://ec.europa.eu/eurostat/web/structural-business-statistics/global-value-chains/foreign-affiliates>

number is increasing steadily: Austria, Czech Republic, France, Italy, United States and Iceland. Although the country breakdown of Inward FDI position according to the ultimate investor is already compiled in another 10 countries, it is not published yet. However, according to an OECD survey, several countries plan to disclose the data **in the near future**. The data reporting required by the OECD contains the following breakdowns: by types of instruments: equity and debt, within that according to assets and liabilities, countries and economic activities, excluding special purpose entities (SPEs), for special purpose entities and including special purpose entities. In its 2016 annual data reporting the MNB is also reporting data broken down by ultimate investor as well to the OECD.

- The register information reported by the data suppliers is used for identifying the country of the ultimate investor. The data received this way are checked and compared to various external sources as well. Inter alia, we use the information regarding the largest corporate units engaged in consolidation included in the notes to the financial statements of the annual corporate e-reports. In this field as well, we cooperate with the HCSO, which has been significant experience of several years in tracking down ultimate investors during the compilation of FATS statistics.
- Assistance in checking and tracking down the ultimate investor is provided by the **Euro Group Register (EGR)** introduced by Eurostat in 2009. The Register lists the companies that are residents in EU Member States, economic agents that are legal entities and the multinational corporate groups in which at least one member is resident in an EU or EFTA Member State. For compiling the 2014 data we also used the ultimate investors found by the HCSO but not included in the EGR.
- As in the case of balance of payments statistics, in the case of the breakdown by ultimate investor, **residence of the entity is authoritative and not the nationality or the citizenship**. Everyday thinking often classifies an investment empire as belonging to a particular country (e.g. Hungary) on the basis of the individuals' nationality or citizenship, but if an originally Hungarian individual investor changes the territory of his/her principal dwelling to another country, as a result he/she becomes the resident of this country, then this latter country – and not Hungary – has to be regarded as the ultimate investing country.

II. International outlook, experiences

The OECD already formulated recommendations for its member countries for the compilation of these supplementary statistics when the previous international statistical standards (BPM5/BMD3) were applied. In addition, the EU's balance of payments statistics regulation amended in 2016⁷ allows 3 years of pilot studies, and it will impose the obligation of producing a breakdown of stock allocated to the ultimate investor on the member countries depending on the findings of the studies. The agreed

⁷ Regulation (EU) 2016/1013 of the European Parliament and of the Council of 8 June 2016 amending Regulation (EC) No 184/2005 on Community statistics concerning balance of payments, international trade in services and foreign direct investment.

methodology has to be formulated and adopted, and the conditions of data compilation have to be ensured with the involvement of the international institutions concerned in the preparatory period.

1. For lack of agreed international methodology, the practices of the countries concerned vary in terms of the methodology of the country breakdown of the Inward FDI position by the ultimate investor. Already in the time of the old BPM5/BMD3 methodology, the breakdown of the investment stock by ultimate investor **on the basis of the OECD's recommendations** was compiled and published in some countries (e.g. Austria and Switzerland). **According to the OECD recommendation,**⁸ investments have to be allocated to the **ultimate investing country** in proportion to the shares of direct investors. This method **makes it necessary to identify as many ultimate investors as the number of direct investors of the resident company.** The procedure in these countries is also different in terms of whether they carry out the allocation to the ultimate investors only for the equities (e.g. Switzerland), or debt instruments are also involved in the allotment.

In terms of feasibility, the disadvantage of this method is that **in practice information on the ultimate investor of the minority direct investor's chains is rarely available.** Therefore, mostly **due to lack of information** – in line with the OECD recommendation – it is **left allocated to the immediate investor** or published as unallocated stock. In the case of several direct investors, the allocation to the ultimate investor of debt instruments related to fellow enterprises is also problematic.

2. In a number of countries, the introduction of allocating the inward foreign direct investment stocks to the ultimate investor took place following the methodological change. These countries, **including Hungary,** believe that in terms of interpretation it is more expedient to **identify only one ultimate investor as the ultimate controlling parent (UCP) of the resident company,** and to allocate the entire stock of foreign direct investment to this one ultimate investor. This approach is in line with the requirement concerning the information necessary for the classification of debt between fellow enterprises according to the direction of investment and determining the resident status of the ultimate investor as set out in the new international methodology, where multiple ultimate investors are also not allowed.

Accordingly, **the already used notion of ultimate investor appears with the same content** both in the classification of fellow enterprises according to the direction of investment and in the allocation of the inward investment stock to the ultimate investor, and users will not be confused by possible different contents of the notion of ultimate investor. In addition, **the inward investment stock indicator according to the ultimate investor is in harmony with the indicators of inward FATS prepared and published by the HCSO.** Connecting these indicators may allow the expansion of the analysis of the operation of affiliates under foreign control.

⁸ OECD Benchmark Definition of Foreign Direct Investment, Fourth Edition 2008, Annex 10 Ultimate Investing Country, page 210.

3. Similarly to standard FDI statistics, countries are able to prepare Inward FDI positions according to the country of the ultimate investor with different time lags. The deadline for OECD voluntary data reporting is the 18th month following the year under review (T+18 months), while the **time-limit for compiling the FATS statistics**, which also apply a breakdown by ultimate investor, is **the 20th month following the year under review** as set out in a regulation by Eurostat.

The MNB took into account these deadlines when determining the time of disclosing the stock statistics broken down by ultimate investor as T+21 months, because control data for the data reported by companies are available in both the EGR and at the HCSO only 16–20 months following the year under review. The breakdown by ultimate investor is also published simultaneously with the annual data release in September, but differently from the standard FDI statistics, for data one year earlier. The data broken down by ultimate investor are revised after T+33 months (one year later). According to the normal publication schedule (with breakdown by the immediate partner), annual data are first disclosed in the 9th month following the year under review, in line with the processing of the annual data collection regarding direct investment. In terms of direct investment statistics, the disclosure of the annual data (publication in September) is of utmost importance, because this is when estimates are replaced by reported annual owner's income and stock data. The breakdown by ultimate investor fits this publication schedule in a way that **the breakdown by ultimate investing country is prepared one year later**, also in September.

In September 2016, the MNB is publishing the year 2015 for FDI income, flow and stock data and their breakdown by the immediate partner for the first time, and revising the 2014 and 2013 data. Supplementing with **publishing the country breakdown of the inward investment stock by ultimate investor for 2014 for the first time**. In September 2017, in addition to the normal revision, the 2014 data broken down by ultimate investing country will also be revised, and in addition to the 2016 direct investment data, for the first time the **breakdown of the 2015 investment stock by ultimate investor** will also be released.

III. What the data show

In the published table The year 2014 investment stocks broken down by immediate and ultimate investors are shown next to one another. As retrospective revision of the time series is not possible due to lack of retrospective information necessary for preparing the country breakdown according to the ultimate investor, this is the first period for which these supplementary statistics can be compiled.

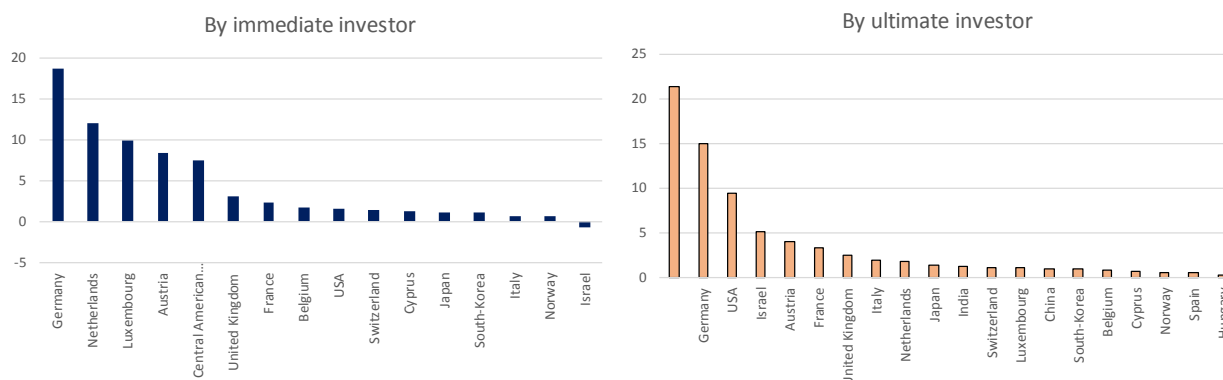
Below is a presentation of the different characteristics of the inward FDI position on the basis of the two types of country breakdown.

As expected, in the breakdown by ultimate investor, the order of the countries investing in Hungary by size of the investment becomes significantly rearranged (Chart 1): the largest investors are Germany, the United States, Israel and Austria, while in the breakdown by immediate investor Germany is followed by the Netherlands and Luxemburg as the second and third largest investors, preceding Austria, and the

weight of Central American countries is also significant as a result of a huge capital-in-transit transaction.

Chart 1

**Order of investments by size broken down by immediate and ultimate investors
(EUR billion)**



Investment stock data are concentrated according to both breakdowns by immediate investor and by ultimate investor. One-off stocks, building up in most cases as a result of capital-in-transit or asset portfolio restructuring transactions, play a prominent role in the size of the stock of foreign direct investment in Hungary. They result in outliers in both types of country breakdowns.

At end-2014, **Germany** accounted for 23% of the directly measured investments and **25%** according to ultimate investor, exceeding EUR 20 billion. Based on available data, some of the investments originating from Germany were invested in Hungary through the Netherlands and Austria.

Taking the ultimate investor as a basis, the second largest stock, i.e. **18%** of the investments was received **from the United States**, in a value of EUR 15 billion. A considerable portion of the US investments flowed in through Luxembourg, the Netherlands, the United Kingdom and Austria.

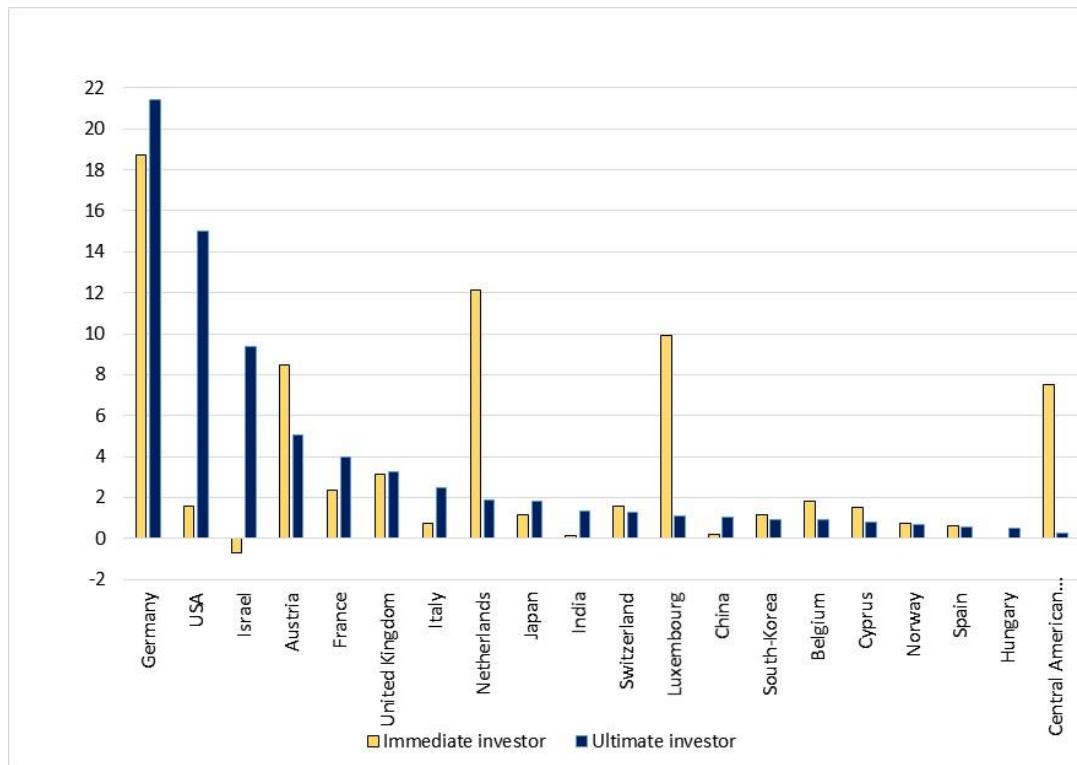
The third largest ultimate investing country is Israel, with 11% of the investments. The Israeli investments flowed into Hungary through a Central American country as well as the Netherlands and Switzerland.

Overall, the breakdown by ultimate investor reduces the weight of the Netherlands and Luxembourg the most: while taking account of immediate investors their share amounted to 15% and 12%, respectively, according to the breakdown by ultimate investor they account for a mere 3% and 1%, respectively.

Hungary also appeared as ultimate investor (round tripping): data suggest that in fact there are Hungarian investors behind 1% of the recorded foreign direct investment position.

Chart 2

Inward FDI position excluding SPEs in breakdowns by immediate and ultimate investors (EUR billion)⁹



Budapest, 23 September 2016

⁹ In the case of the breakdown by immediate investor, Israel's stock is negative as a result of the net asset accounted for on the debt instrument that exceeds the balance of equity investments. It means that within the debt instrument the amount of loans granted exceeded the value of the loans received.