# 5. Direct Investment Income

## Measurement of Direct Investment Earnings

**5.1** The *Benchmark* and the *BPM5* recommend the use of the Current Operating Performance Concept (COPC) to measure direct investment earnings. According to this concept, the earnings of an enterprise consist of its income from normal operations before accounting for nonrecurring items and capital gains and losses. Operational earnings of the direct investment enterprise should be reported after provision for depreciation of capital and income and corporation tax charged on these earnings have been deducted. Direct investment earnings should not include any realized or unrealized capital gains or losses or exchange rate gains or losses made by either the direct investment enterprise or the direct investor. The earnings should also not include write-offs, such as inventory write-offs, write-offs of intangibles, write-offs of bad debts, or write-offs on expropriations without compensation. Many enterprises use the All-Inclusive Concept to measure earnings. On the basis of this concept, income is the amount remaining after all items (including capital gains and losses and write-offs) that cause any increase or decrease in the shareholders' or investors' interests during the period are taken into account. Because data for many countries are available only on an all-inclusive basis, those countries that report earnings on either an operating basis or an all-inclusive basis are recommended to collect and publish supplementary information on holding gains and losses and other extraordinary items. This practice would enhance international comparability for both the transactions data and the position data.

**5.2** Table 5.1 shows the practices used in 2001 by the participating countries regarding the measurement of their inward direct investment earnings, compared with 1997, and also shows a breakdown into OECD and other IMF member countries. (Tables 21 and 22 of Appendix I give the country details for the inward

**Table 5.1. Measurement of Inward Direct Investment Earnings: Application of the Current Operating Performance Concept (COPC)**

| | Earnings Include | | Earnings Exclude | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Number of Countries | Deductions for depreciation of capital | Provisions for host country income/corporation taxes | Exchange rate gains and losses | Write-offs | Realized capital gains | Realized capital losses | Unrealized capital gains | Unrealized capital losses | Fully Apply the COPC |
| Total 2001 (61) | 45 | 45 | 30 | 29 | 28 | 27 | 40 | 38 | 19 |
| Total 1997 (61) | 31 | 29 | 23 | 24 | 21 | 22 | 33 | 31 | 8 |
| Change | +14 | +16 | +7 | +5 | +7 | +5 | +7 | +7 | +11 |
| OECD 2001 (30) | 23 | 22 | 16 | 13 | 12 | 11 | 22 | 20 | 8 |
| OECD 1997 (29) | 16 | 15 | 12 | 11 | 10 | 10 | 16 | 15 | 4 |
| Other 2001 (31) | 22 | 23 | 14 | 16 | 16 | 16 | 18 | 18 | 11 |
| Other 1997 (32) | 15 | 14 | 11 | 13 | 11 | 12 | 17 | 16 | 4 |

FDI earnings and the outward FDI earnings, respectively.) Table 5.1 indicates that 19 countries now fully apply the COPC, an increase of 11 since 1997. Moreover, significantly more countries now apply elements of the concept. Forty-five countries make deductions for depreciation of capital and for provisions for host-country income or corporation taxes (increases of 14 and 16 countries since 1997, respectively). Relatively high numbers of countries also exclude unrealized capital gains (40) or losses (38). However, fewer countries exclude exchange rate gains or losses (30), write-offs (29), realized capital gains (28), or realized capital losses (27), although more countries now do so than in 1997. The disparity in the methodologies used for the measurement of direct investment earnings continues to be an important issue for global discrepancies, because it results in inconsistencies in the data on reinvested earnings.

### *OECD countries*

**5.3** Only eight OECD countries fully apply the COPC for their inward earnings—Australia, Finland, Ireland, Mexico, New Zealand, Sweden, the United Kingdom, and the United States. All these countries, except Mexico, which does not compile outward FDI statistics, also fully apply the COPC for their outward FDI earnings. However, there have been modest improvements across all elements of the COPC since 1997 for the inward data. In 2001, 23 OECD countries made deductions for depreciation of capital, 22 made provisions for host-country income or corporation taxes, 16 excluded exchange rate gains or losses, 13 excluded write-offs, 12 excluded realized capital gains, 11 excluded realized capital losses, 22 excluded unrealized capital gains, and 20 excluded unrealized capital losses.

### *Other countries*

**5.4** Eleven countries now fully apply the COPC for their inward earnings, including Bolivia, Colombia, Costa Rica, Ecuador, Hong Kong SAR, Kazakhstan, Kuwait, Malaysia, and Singapore—seven more than in 1997. (However, in the case of Kuwait some enterprises do not apply some aspects of the COPC.) Nine countries, including all of the above except Ecuador and Kazakhstan (which do not compile data on outward FDI income) plus Slovenia, also fully apply the COPC for their outward FDI earnings. As with the OECD countries, there have been improvements across all elements of the COPC since 1997 for the inward data. In 2001, 22 countries made deductions for depreciation of capital, 23 made provisions for host-country income or corporation taxes, 14 excluded exchange rate gains or losses, 16 excluded write-offs, 16 excluded realized capital gains, 16 excluded realized capital losses, 18 excluded unrealized capital gains, and 18 excluded unrealized capital losses.

## Elements of Direct Investment Income

**5.5** The elements of the FDI income component comprise (1) income on equity (dividends and distributed branch profits), (2) reinvested earnings and undistributed branch profits, and (3) income on debt (interest). Dividends comprise all dividends that, in an accounting period, are declared payable to the direct investor, less dividends declared payable by the direct investor to the direct investment enterprise. Reinvested earnings and undistributed branch profits comprise the direct investor's share—in proportion to equity held—of (1) earnings that foreign subsidiaries and associated enterprises do not distribute as dividends, and (2) profits that branches and other unincorporated enterprises do not remit to direct investors. Income on debt comprises the interest accrued during the accounting period by the enterprise to the direct investor, less the interest accrued during the same period and owed by that direct investor to that enterprise.

**5.6** Table 5.2 shows that there have been improvements since 1997 in the number of countries now disseminating data on direct investment income—improvements across all three elements of the FDI income component and for both the inward data and the outward data. In 2001, 54 of the 61 countries that participated in the 2001 SIMSDI update disseminated inward data on income on equity, an increase of 10 countries since 1997, 11 more countries disseminated inward reinvested earnings data (45 countries), and an additional 10 countries disseminated data on inward data on income on debt (42 countries). The increase in the number of countries disseminating data on outward FDI income since 1997 was slightly smaller—an additional seven countries now disseminate outward data on income on equity (47 countries), an additional eight countries now disseminate data on outward reinvested earnings (37 countries), and an additional seven disseminate outward data on

**Table 5.2. Elements of Direct Investment Income Included in the Disseminated FDI Statistics**

| Number of Countries | Income on Equity (Dividends and Distributed Branch Profits) Inward | Outward | Reinvested Earnings Inward | Outward | Income on Debt (Interest) Inward | Outward |
|---|---|---|---|---|---|---|
| Total 2001 (61) | 54 | 47 | 45 | 37 | 42 | 36 |
| Total 1997 (61) | 44 | 40 | 34 | 29 | 32 | 29 |
| Change | +10 | +7 | +11 | +8 | +10 | +7 |
| OECD 2001 (30) | 28 | 27 | 24 | 23 | 25 | 23 |
| OECD 1997 (29) | 27 | 26 | 22 | 20 | 22 | 21 |
| Other 2001 (31) | 26 | 20 | 21 | 14 | 17 | 13 |
| Other 1997 (32) | 17 | 14 | 12 | 9 | 10 | 8 |

income on debt (36 countries). Table 23 of Appendix I gives the details by country for 2001.

***OECD countries***

**5.7** All but one of the 29 OECD countries that compile inward FDI transactions data disseminate inward data on income on equity. The sole exception is Denmark. Twenty-seven of the 28 OECD countries that compile outward transactions data[1] disseminate outward data on income on equity, with Denmark again being the sole exception. However, Denmark has disseminated these data in the past. Twenty-four of the 29 OECD countries that compile inward FDI transactions data and 23 of the 28 that compile outward FDI transactions data disseminate data on reinvested earnings. The five countries that still do not are Denmark, Greece, Hungary, Korea, and Spain for the inward data and Denmark, Greece, Hungary, Spain, and Turkey for the outward data. However, three of these countries (Denmark, Greece, and Hungary) do compile these data. Twenty-five of the 29 OECD countries that compile inward transactions data and 23 of the 28 that compile outward transactions data disseminate data on income on debt (interest)—increases since 1997 of three and two countries, respectively. The four countries that do not disseminate inward data for this component are Denmark, France, Italy, and Turkey, although Denmark does compile these data. The five OECD countries that do not disseminate outward data on income on debt are Denmark, France, Italy, Norway, and Turkey, although, as with the other components of FDI income, Denmark does compile these data.

[1]Mexico does not compile outward FDI statistics.

***Other countries***

**5.8** There has been a significant increase since 1997 in the number of countries that disseminate inward FDI data on income on equity, and now all but five of the 31 other IMF member countries that participated in the 2001 SIMSDI update disseminate these data. The exceptions include Israel, Kuwait, Singapore, and Thailand, although the last two countries do compile these data. Although a sizable increase since 1997, fewer countries disseminate outward data on income on equity—20 in 2001 compared to 14 in 1997. Nine additional countries[2] have begun to disseminate inward data on reinvested earnings since 1997, with the result that 21 now disseminate these data.[3] Fourteen countries now also disseminate outward data on reinvested earnings, an increase of five countries since 1997. Smaller numbers disseminate data on income on debt (interest)—17 of the countries disseminate inward data on income on debt, and 13 disseminate outward data on income on debt—increases since 1997 of 7 and 5 countries, respectively.

[2]Bolivia, Botswana, Croatia, Ecuador, Guatemala, Israel, Kazakhstan, the Philippines, and Russia.

[3]The 10 non-OECD countries that do not yet disseminate inward data on reinvested earnings include Indonesia, Kuwait, Malaysia, Nigeria, Singapore, South Africa, Thailand, and Tunisia, although Kuwait, Malaysia, Singapore, and South Africa do compile these data.

**Table 5.3. Time of Recording of FDI Income**

| Number of Countries | Countries That Record Inward FDI Income Transactions: Income on equity (dividends and distributed branch profits) as at the date they are: Payable | Paid | Other | Reinvested earnings in the period in which they are earned | Income on debt (interest) as it is: Accruing | Paid | Other |
|---|---|---|---|---|---|---|---|
| Total 2001 (61) | 22* | 41* | 2* | 44 | 25* | 24* | 3* |
| Total 1997 (61) | 14 | 38 | 2 | 33 | 18 | 18 | 1 |
| Change | +8 | +3 | 0 | +11 | +7 | +6 | +2 |
| OECD 2001 (30) | 8* | 23* | 0 | 20 | 11* | 13* | 3* |
| OECD 1997 (29) | 5 | 22 | 1 | 16 | 9 | 12 | 1 |
| Other 2001 (31) | 14* | 18* | 2* | 24 | 14* | 11* | 0 |
| Other 1997 (32) | 9 | 16 | 1 | 17 | 9 | 6 | 0 |

*Some countries use more than one method of recording dividends and distributed branch profits and/or interest income.

## Time of Recording of Direct Investment Income

**5.9** In principle, all FDI income flows should be recorded at the time such flows accrue. Income on debt (interest) should be recorded on an accrual basis as this method of continuous recording matches the cost of capital with the provision of capital. Reinvested earnings should be recorded in the periods in which the underlying profits are earned. The time of accrual of dividends depends on the date selected by enterprises for distributing income or making transfers. According to *BPM5,* dividends are to be recorded "as of the date they are payable." This recommendation could be misunderstood to mean the dates on which dividends are "due for payment." This issue was addressed in the IMF *Balance of Payments Textbook,* which uses the term "declared payable,"[4] in accordance with the accrual principle for the time of recording dividends. However, the *Benchmark* recommends that dividends be recorded as they are "due for payment."[5] The issue of differing recommendations of the *BPM5* and *Benchmark* on the time of recording dividends has been addressed in subsequent discussions of the OECD WPFS where it was agreed to align the concepts with the recommendations of *BPM5.*

[4]Refer to paragraphs 397 and 406 of the IMF *Balance of Payments Textbook* (1996).

[5]*Benchmark,* paragraph 28.

**5.10** Table 5.3 provides information for the 2001 update and for the 1997 survey on the time of recording inward FDI statistics for income on equity, reinvested earnings, and income on debt (interest). (Tables 24 and 25 of Appendix I provide details by country for 2001.) Table 5.3 indicates that although 8 more countries than in 1997 now record their income on equity (dividends and distributed branch profits) on the date they are payable, 73 percent of the 59 countries that compile data on this FDI income component still record at least part of these data either on the date they are paid or at some time other than the date they are payable. The table also indicates that there has been a significant increase since 1997 in the number of countries that record their inward reinvested earnings data in the period in which they were earned—an additional 11 countries, bringing the total to 44 countries, or 83 percent of the 53 countries that compile these data. There has also been an increase in the number of countries that now record some part of their income on debt as it is accruing although 56 percent of the 48 countries that compile these data still record some part of this income on debt as it is paid or use some other method.

### *OECD countries*

**5.11** Only 8, or 28 percent, of the 29 OECD countries that compile data on FDI income on equity record some part of that income on the date it is payable although, with the exceptions of Australia and New Zealand, these countries have not specified whether they record them on the date they are "declared payable," as opposed to the date they are "due for payment."[6] Twenty-three of the 29 countries that compile these data record at least some part of these data on the date they are paid. That high number reflects, in part, the fact that many European countries use a cash-based ITRS as their primary data source for compiling their FDI statistics. Twenty, or 74 percent, of the 27 OECD countries that compile, if not disseminate, inward data on reinvested earnings record them in the period in which they are earned. The exceptions are Denmark, France, Italy, Japan, Mexico, and Turkey. Information on the time of recording for the data for Hungary will not be available until the data begin to be disseminated. Only 11, or 42 percent, of the 26 OECD countries that compile data on income on debt record the interest as it is accruing, an increase of only 2 countries since 1997. The numbers for the outward data on FDI income are very similar to those for the inward data.

#### *Other countries*

**5.12** Fourteen, or 47 percent, of the 30 countries that compile data on inward FDI income on equity record some part of these data on the date they are payable, an increase of 5 countries since 1997. However, more than half still record some part of these transactions at the time they are paid or at some time other than the date they are payable. A higher proportion of these countries than OECD countries record reinvested earnings in the period in which they are earned—24, or 92 percent, of the 26 countries that compile, if not disseminate, data on inward reinvested earnings. A considerably higher proportion than OECD countries record inward FDI income on interest as it is accruing—14, or almost two-thirds, of the 22 countries that compile, if not disseminate, data on inward FDI income on debt, record the interest at the time it is accruing, an increase of 5 countries since 1997. For the outward FDI statistics, 52 percent of the 25 countries that compile data on income on equity record the dividends on the date they are payable; all but 2 of the 20 countries that compile data on reinvested earnings, or 90 percent, record them in the period in which they are earned; and 61 percent of the 18 countries that compile data on income on debt record the interest as it is accruing.

[6]Australia and New Zealand record dividends on the date they are declared payable.

## Items Included in the Data on Direct Investment Income on Debt (Interest)

**5.13** The data on FDI income on debt (interest) should cover interest income from all relevant debt instruments, namely, bonds and money market instruments, long-term loans, short-term loans, and trade credits. The international standards recommend that income from financial derivatives, such as interest-rate swaps, be excluded from FDI income on debt and instead classified under the new category of the *Financial Account* of the balance of payments statistics for financial derivatives.[7] The international standards also recommend that the data exclude interest from deposits, loans, and other claims and liabilities related to the usual banking and financial intermediation activities between affiliated banks and between affiliated financial intermediaries.

**5.14** Table 5.4 shows the results of the 2001 SIMSDI update regarding the items covered by the inward data on FDI income on debt (interest). Tables 26 and 27 of Appendix I give the details by country for the inward and outward data, respectively. Table 5.4 shows that of the 48 countries that compile, if not disseminate, inward FDI statistics on income on debt, all 48 countries include interest from long-term loans, 46 include interest from short-term loans, and 30 include interest from trade credits. In addition, of the 47 countries for which such instruments are applicable, 31 include interest from bonds and money market instruments in their inward data. The table also shows that 41 of the 48 countries that compile inward FDI statistics on income on debt follow the international standards regarding the exclusion of interest from financial derivatives, 41 exclude interest from deposits, loans, etc. related to the usual banking activities between affiliated banks, and 37 exclude interest from claims and liabilities related to usual financial intermediation activities between affiliated financial intermediaries.

#### *OECD countries*

**5.15** Of the 26 OECD countries that compile, if not disseminate, inward FDI statistics on income on debt, all include interest from long-term loans, and all

[7]This change to the structure of the balance of payments was promulgated in *Financial Derivatives: A Supplement to the Fifth Edition of the Balance of Payments Manual,* published by the IMF in 2000.

**Table 5.4. Items Covered in Direct Investment Income on Debt (Interest): Inward Data**

| | Data Include Interest from: | | | | Data Exclude Interest from: | | |
|---|---|---|---|---|---|---|---|
| | | | | | | Deposits/loans, etc. related to usual activities between | |
| Number of Countries | Bonds and money market instruments | Long-term loans | Short-term loans | Trade credits | Financial derivatives | Affiliated banks | Affiliated financial intermediaries |
| Total 2001 (61) | 31 | 48 | 46 | 30 | 41 | 41 | 37 |
| OECD 2001 (30) | 16 | 26 | 25 | 14 | 24 | 24 | 20 |
| Other 2001 (31) | 15 | 22 | 21 | 16 | 17 | 17 | 17 |

except Korea include interest from short-term loans. However, only about half include interest from trade credits, and only 64 percent of the 25 countries for which bond and money market instruments are applicable include interest from those instruments. Two OECD countries, Norway and the United Kingdom, do not exclude interest from financial derivatives. Two countries, Denmark and the United Kingdom, do not exclude interest from deposits, loans, etc. related to the usual banking activities between affiliated banks, and six (Belgium, Denmark, Finland, Germany, Hungary, and the United Kingdom) do not exclude interest from claims and liabilities related to usual financial intermediation activities between affiliated financial intermediaries. The numbers for the outward FDI statistics show a similar pattern to the inward data, although somewhat lower numbers of countries follow the international recommendations.

***Other countries***

**5.16** All of the 22 other IMF member countries that participated in the 2001 SIMSDI update that compile inward FDI statistics on income on debt include interest on long-term loans, and all except Kuwait include interest from short-term loans. A higher proportion than OECD countries include interest from trade credits (16 countries, or 73 percent, compared with 54 percent of the OECD countries), and a slightly higher proportion include interest from bonds and money market instruments (68 percent compared with 64 percent of OECD countries). However, five countries (including Botswana, Costa Rica, and Guatemala) do not exclude interest from financial derivatives from their inward FDI statistics on income on debt, and four (including Costa Rica, Guatemala, and Latvia) of the 21 countries for which these transactions are applicable do not exclude interest from deposits, loans, etc. and other claims and liabilities related to the usual banking and financial intermediation activities between affiliated banks and between affiliated financial intermediaries. As with the OECD countries, the numbers for the outward FDI statistics show a similar pattern to the inward data, although fewer countries follow the international recommendations.