Columbia FDI Perspectives

Perspectives on topical foreign direct investment issues by
the Vale Columbia Center on Sustainable International Investment

No. 55 January 9, 2012

Editor-in-Chief: Karl P. Sauvant (Karl.Sauvant@law.columbia.edu)
Managing Editor: Jennifer Reimer (FDIPerspectives@gmail.com)

FDI stocks are a biased measure of MNE affiliate activity: A response

by
Mira Wilkins[*]

In a recent *Perspective,*[1] Beugelsdijk, Hennart, Slangen, and Smeets warned readers about biases in the measure of FDI stock. They are to be congratulated for pushing readers to be careful in the use of data.

They note "researchers often call the value added (VA) in a host country by firms based in another country foreign direct investment (FDI) and use FDI stocks ... to measure it."[2] They correctly insist that FDI stocks do not correspond with aggregate foreign affiliate value-added.

Their *Perspective* opens up two important topics: the frequently very loose use of the term FDI in the literature (and the genesis of that loose use); and the various measures of multinational enterprise (MNE) activities.

For decades, the literature has often equated FDI and MNEs, using the words "FDI" and "MNE" interchangeably. A book on the "theory of FDI" can be expected to be on the "theory of MNEs." So, too, if this very publication, *Columbia FDI Perspectives,* were renamed "*Columbia MNE Perspectives,"* it is doubtful that the contents would change. Virtually, every student of MNEs would agree that this is a false equation. The formulation should be, MNEs undertake FDI, but MNEs also do many other things, including transferring technology, undertaking research and development, and producing and marketing goods and services. MNEs expect a return on their investment in the business package, not merely on the FDI they undertake.

---

[*] Mira Wilkins (wilkinsm@fiu.edu) is Professor of Economics at Florida International University, Miami, Florida. She has published widely and is the author of four Harvard University Press books, two on the history of American business abroad (published in 1970 and 1974) and two on the history of foreign investment in the United States (published in 1989 and 2004). The third volume of her history of foreign investment in the United States, which will cover 1945 to the present, is currently in process. She wishes to thank the late Robert Lipsey and Ned Howenstine for help on this subject in the past and Jean-Francois Hennart, Geoffrey Jones and Raymond Mataloni for their helpful comments on an earlier text. **The views expressed by the author of this *Perspective* do not necessarily reflect the opinions of Columbia University or its partners and supporters. *Columbia FDI Perspectives* (ISSN 2158-3579) is a peer-reviewed series.**

[1] Sjoerd Beugelsdijk et al., "FDI stocks are a biased measure of foreign affiliate activity," *Columbia FDI Perspectives*, No. 45 (August 29, 2011).

[2] Ibid.

The equation of the terms "FDI" and "MNE" is a short-cut -- with an historical genesis. Early collectors of foreign investment data realized that investments by MNEs were different from foreign investments in traded securities, bonds and stock. Paish's work on British overseas investment before World War I contained fragments of this understanding.[3] But the real understanding emerged in the late 1920s and 1930s as the US Department of Commerce began collecting balance-of-payments data. As such information was assembled in the 1920s, individuals in the Department became aware that investments by MNEs differed from capital moving through bond markets or monies arriving to fuel the rise in United States stock prices. By the late 1920s and 1930s, the Department started to measure FDI stock (as well as flows). Initially, the definition of US outward FDI included all US holdings in those "foreign corporations or enterprises which are controlled by a person, or closely identified group of persons (corporate or natural), domiciled in the United States, or in the management of which such person or group has an important voice;" control was loosely defined and minority interests were included when the US entity had "an important voice."[4]

There were also studies in the 1930s of US inward FDI. Beginning in 1941, some studies defined FDI as 25% holdings in equity shares, a cutoff that would subsequently be reduced to 10%. Throughout this time there was an attempt to try to define MNE activities. FDI required the possibilities of control -- or at least influence. There were questions on what to include and exclude. Issues of the *Survey of Current Business* tell the story and the changes. Gradually, US definitions became widely accepted by many governments and by the International Monetary Fund. Since 1981, the definition of FDI has been "an investment in which a resident (in the broad legal sense, including a company) of one country obtains a lasting interest in, and a degree of influence over a business enterprise in another country."[5] The phrases "lasting interest" and a "degree of influence" show the difficulties in determining the nature of "control." The words are ambiguous, but retain the notion of FDI involving more than merely financial flows and involving the extension of the firm over borders. Over the years, other measures of MNE activities emerged, including value-added, employment, number of affiliates, size of assets, revenues, and market share. We have data on ultimate beneficial ownership, which aid in deciphering certain complexities. Each of the measures has its use, depending on the questions being asked. Each measure offers a different story line.

Yet, biases notwithstanding, unlike these other measures, we have long -- albeit imperfect -- series on FDI stock for many countries. Handled with care, these series provide *one* very useful measure. If we are aware of what is included (and excluded) in the data, that is, the data limitations, FDI stock continues to be an excellent indicator of MNE activities and one that can be used as public policies are formulated.

---

[3] Paish's seminal articles in *The Statist* and the *Journal of the Royal Statistical Society* (1909-1914) have been republished in Mira Wilkins, ed., *British Overseas Investments 1907-1948* (New York: Arno Press, 1977).

[4] Robert L. Sammons and Milton Abelson, *American Direct Investments in Foreign Countries -- 1940* (Washington, DC: US Department of Commerce, 1942), p. 2.

[5] Jeffrey H. Lowe, "Direct investment, 2007-2009: Detailed historical-cost positions and related financial and income flows," *Survey of Current Business*, vol. 90 (September 2010), p. 57. See also US Direct Investment Abroad, 1977 (Washington, DC: US Department of Commerce, 1981), p. 2.

For further information please contact: Vale Columbia Center on Sustainable International Investment, Jennifer Reimer, FDIPerspectives@gmail.com.

The Vale Columbia Center on Sustainable International Investment (VCC – www.vcc.columbia.edu), led by Dr. Karl P. Sauvant, is a joint center of Columbia Law School and The Earth Institute at Columbia University. It seeks to be a leader on issues related to foreign direct investment (FDI) in the global economy. VCC focuses on the analysis and teaching of the implications of FDI for public policy and international investment law.

Most recent *Columbia FDI Perspectives*

- No. 54, Kenneth P. Thomas, "Investment incentives and the global competition for capital," December 30, 2012.
- No. 53, Francisco Sercovich, "Knowledge, FDI and catching-up strategies," December 19, 2011.
- No. 52, Nandita Dasgupta, "FDI in retailing and inflation: The case of India," December 5, 2011.
- No. 51, Persephone Economou and Margo Thomas, "Greek FDI in the Balkans: How is it affected by the crisis in Greece?," November 21, 2011.
- No. 50, John Evans, "Responsible business conduct: Re-shaping global business," November 7, 2011.
- No. 49, Thilo Hanemann and Daniel H. Rosen, "Chinese FDI in the United States is taking off: How to maximize its benefits?," October 24, 2011.
- No. 48, George Kahale, III, "The new Dutch sandwich: The issue of treaty abuse," October 10, 2011.
- No. 47, Manfred Schekulin, "Shaping global business conduct: The 2011 update of the OECD Guidelines for Multinational Enterprises," September 26, 2011.
- No. 46, Geraldine McAllister and Joel H. Moser, "Beyond treasuries: A foreign direct investment program for U.S. infrastructure," September 12, 2011.
- No. 45, Sjoerd Beugelsdijk, Jean-François Hennart, Arjen Slangen, and Roger Smeets, "FDI stocks are a biased measure of foreign affiliate activity," August 29, 2011.

All previous *FDI Perspectives* are available at http://www.vcc.columbia.edu/content/fdi-perspectives.