French outward and inward foreign direct investment in 2009
New presentation

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The Banque de France currently compiles and publishes foreign direct investment (FDI) statistics for France according to the methods defined by the 5th edition of the IMF Balance of Payments Manual *released in 1993.*[1] *However, the IMF published a new edition of the Manual in 2008 that will lead to a drastic change in the future methods for compiling and presenting foreign direct investment statistics.*[2] *After briefly explaining the main differences between the two compilation and presentation methods, this article presents an overview and an analysis of French foreign direct investment conducted in accordance with the future international statistical standards.*[3]

Annual direct investment flows drawn up according to these future standards have on average been EUR 30 billion lower since 1999 than those drawn up in accordance with the traditional presentation. In addition, recent developments have been different. Under the new presentation, outward investment flows declined significantly in 2009 compared with 2007 and 2008, returning to a level equivalent to that of 2005. In addition, inward foreign direct investment posted a net outflow in 2009, which had never occurred during the past decade.

Keywords: foreign direct investment, FDI, International Group, balance of payments, international investment position.
JEL codes: E01, F21, F23, F36, G12.

1 *Furthermore, the statistics in the various national and international publications and databases on foreign direct investment comply with the rules in the 5th edition of the* Balance of Payments Manual. *The publications and databases in question include the* STAT-INFO *monthly and the Annual Report on* The French balance of payments and international investment position *published by the Banque de France, the French balance of payments statistics in the IMF's* Balance of Payments Statistics, *the OECD* International direct investment statistics yearbook, *UNCTAD's* World Investment Report, *and the direct investment databases of the Banque de France, Eurostat and the ECB.*
2 *The publication deadline for all European Union countries is 2014.*
3 *The Banque de France now publishes direct investment statistics using this methodology in the Annual Report on* The French balance of payments and international investment position *available at:* http://www.banque-france.fr/gb/statistiques/telechar/bdp/annual-report-balance-of-payments-2009.pdf.

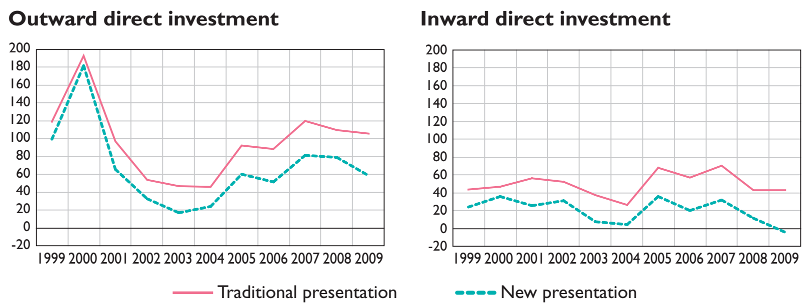
This article analyses direct investment flows (Part 1) and stocks (Part 2) on the basis of a new data series for the period 1999-2009[4] drawn up in accordance with the extended directional principle recommended by the 6th edition of the IMF *Balance of Payments Manual* (see Box and Appendix). Direct investment income is analysed in Part 3.

A new method for compiling and presenting foreign direct investment statistics

The methods for recording inter-company loans in direct investment statistics defined at the start of the nineteen-nineties are still the current dissemination standard. These methods have artificially inflated direct investment flows and stocks, as the international groups have expanded and the use of financing structures located in countries with attractive tax rules started to become more widespread around the middle of the first decade of this century. To remedy to increasing overestimation of direct investment volumes, the OECD and the IMF developed a new method, called the "extended directional principle" method, which consists of reclassifying inter-company loans according to the place of residence (in France or abroad) of the ultimate controlling parent company. This method does not change the net balance of inter-company loans, or the net balance of foreign direct investment, since it merely reclassifies the assets and liabilities recorded using the traditional method. On the other hand, it significantly reduces direct investment flows and stocks (see Charts A and B), insofar as the various lending and borrowing transactions between resident and non-resident companies belonging to the same group are offset.[1] Meanwhile, the impact of the new method on direct investment income is limited to the interest income collected on inter-company debt.[2]

Figures A and B Impact on France's outward and inward direct investment of reclassifying loans between fellow companies according to the extended directional principle rule

(EUR billions)



1 For more details about these methods, see the methodological appendix at the end of this article and Terrien (2009).
2 The French current data collection method does not distinguish interest on inter-company loans from interest on other types of loans, which means that the interest on inter-company loans cannot be compared to the stock of outstanding inter-company loans.

4 An upcoming working paper will provide data on direct investment flows, stocks and income for 1999 to 2009, compiled in accordance with the future international methodology, classified by type of transaction, with breakdowns by geographical zone and business sector.

1| Direct investment flows

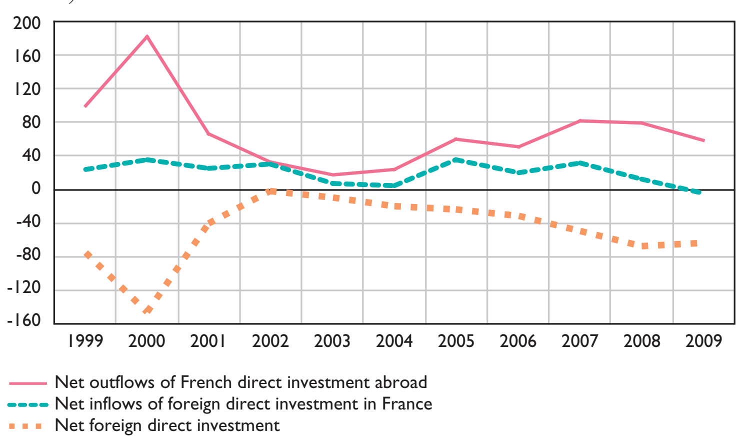
In 2009, direct investment showed a net outflow of EUR 63 billion, compared with EUR 67.5 billion in 2008. However, from a long-term perspective, net outflows remained at a high level in 2008 and 2009. These levels were exceeded only in 1999 and 2000, when the valuation of listed companies resulted in record cross-border M&A activity both in France and abroad (see Chart 1).

1|1 Outward direct investment

After standing close to EUR 80 billion for two years, outward direct investment flows dropped by roughly EUR 20 billion in 2009 (i.e. 26%) returning to their level of 2005. Within direct investment, equity capital transactions (including real-estate investment) fell by 35% in the wake of the world economic slowdown and the sharp drop in cross-border M&A activity; reinvested earnings, which had already posted a significant decline in 2007 and 2008 due to the weaker results of French companies' foreign subsidiaries, continued to decrease to EUR 2.1 billion; lastly, other capital (inter-company loans) picked up slightly to EUR 18.6 billion, after EUR 15.1 billion in 2008 (see Chart 2).

Chart 1 Direct investment flows between 1999 and 2009

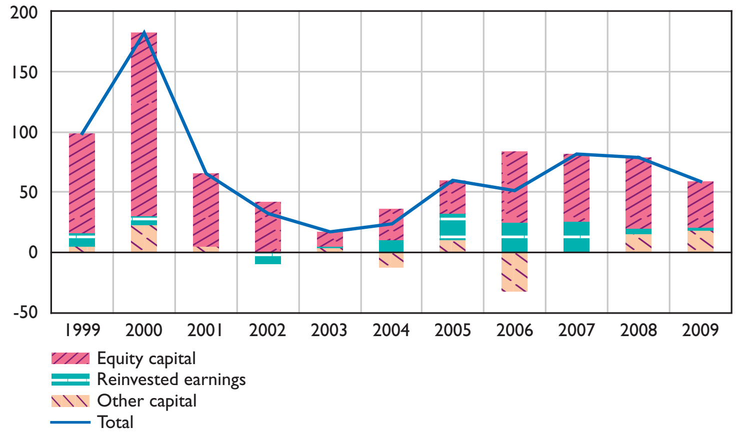
(EUR billions)



NB: to facilitate comparisons with inward direct investment, outward direct investment is presented with an opposite balance of payments sign.

Chart 2 Composition of net outward direct investment flows

(EUR billions)

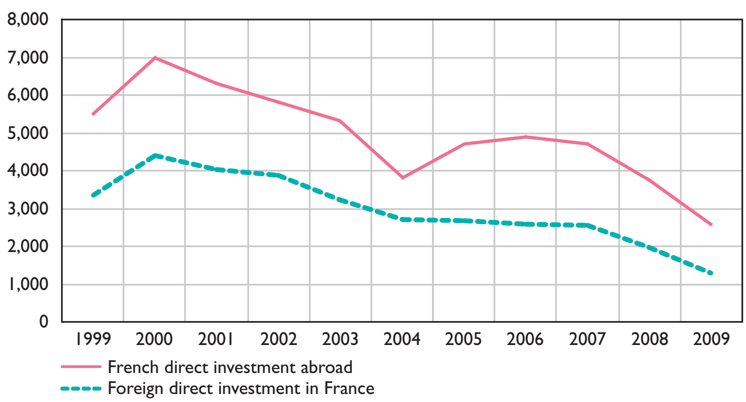


The deterioration in the economic environment and the slowdown in M&A activity in 2009 are not only reflected in the changes in net flows of equity capital transactions but also in the number of investment and disinvestment transactions, which dropped by 31% compared with 2008. In a long-term perspective, this figure is the lowest over the past decade; it is 47% lower than that recorded in 2006, the highest figure of the past five years, and 63% lower than that in 2000 (see Chart 3).

The main outward direct investments in 2009 are: the acquisition by BNP Paribas of three quarters of the capital of Fortis Banque from the Belgian

Chart 3 Number of equity capital transactions (excl. real estate) above EUR 50,000

(number)



government and several transactions conducted by the Électricité de France group in the United Kingdom (takeover of British Energy), in the United States (creation with Constellation Energy of a joint subsidiary specialised in the production of nuclear power) and in Belgium. In addition, the Sanofi-Aventis group made further inroads into the generic drug market by acquiring the Czech company Zentiva and Vivendi launched a takeover bid for the Brazilian telecommunications operator GVT.

From a geographical perspective, according to the immediate counterparty country[5] and all transactions combined, the EU-27 and the other industrialised countries received a large share of outward direct investment in 2009, which amounted to respectively 70% (50% for the euro area) and 12% of net flows, compared with 18% for the rest of the world. Flows towards the euro area are highly concentrated: Belgium and Luxembourg received over 85% of net flows, well ahead of Germany, Ireland and Italy. Among the other countries of the European Union, the main destinations are the United Kingdom, owing to EDF investments, well ahead of the Czech Republic and Sweden. Outside the European Union, the United States, also on account of EDF investments, and Switzerland received 7% and 6% of net flows respectively, while Brazil ranked first among emerging and developing countries with 6% of the total, owing to the Vivendi investments (see Table 1).

The share of emerging countries in total flows remains small, including during the last three years. This can largely be attributed to recording the geographical breakdown according to the first counterparty, which is the basis of the international methodology for direct investment. Although it is difficult to quantify them precisely, a large number of investments made by French groups that are ultimately destined for emerging countries transit through financial subsidiaries located in other industrialized countries such as Luxembourg, Belgium, Switzerland or the United Kingdom.

1|2 Inward direct investment

Inward direct investment, which had ranged from EUR 20 billion to EUR 40 billion between 2005 and 2007, plunged over the last two years to stand EUR 11.7 billion in 2008, representing a 63% drop compared to the previous year, followed by net disinvestment in 2009. Among the various direct investment components, real-estate investment was steady at EUR 4.3 billion in 2009, after dropping sharply in 2008. This steadiness boosted the resilience of the French market in a difficult international environment. According to the estimated data currently available,

5 *See methodological appendix.*

Table 1 Geographical breakdown of direct investment flows since 2007 (according to the immediate counterparty country)

(EUR billions)

	Outward direct investment			Inward direct investment		
	2007	**2008**	**2009**	**2007**	**2008**	**2009**
European Union (EU-27)	**-69.1**	**-40.5**	**-41.1**	**31.1**	**6.1**	**-8.0**
Economic and Monetary Union (16 members)	-63.7	-51.2	-29.3	24.6	8.3	-4.3
o/w: Germany	-6.8	0.3	-1.2	10.4	3.1	-5.9
Belgium	1.5	-43.2	-17.1	5.0	6.9	5.0
Spain	-6.0	0.9	0.1	3.5	-5.4	-0.2
Ireland	-0.6	0.0	-0.8	1.0	2.9	-1.2
Italy	-17.6	-3.6	-0.8	-0.4	-1.0	-0.3
Luxembourg	-3.4	0.0	-8.4	5.7	-1.0	-2.9
Netherlands	-29.8	-3.8	1.4	-0.5	1.2	1.5
Other EU countries	-5.4	10.7	-11.7	6.5	-2.2	-3.7
o/w: Poland	-1.0	-0.3	-0.7	-0.3	0.6	-0.3
Czech Republic	-0.7	-0.8	-1.4	-0.1	-0.1	0.4
Romania	-0.7	-1.1	-0.4	-0.1	0.1	0.1
United Kingdom	-1.6	16.6	-8.0	6.2	-3.1	-3.5
Sweden	-0.1	-2.9	-1.4	0.1	-0.1	-0.4
Other industrialised countries	**-4.4**	**-11.4**	**-7.1**	**0.2**	**6.6**	**0.0**
o/w: United States	-12.5	-12.1	-3.9	1.2	4.1	0.5
Japan	-0.4	-0.1	0.1	0.1	1.1	0.4
Switzerland	0.8	0.7	-3.8	1.4	1.3	-0.5
Rest of the world	**-8.3**	**-27.3**	**-10.6**	**0.7**	**-1.0**	**3.8**
Total	**-81.7**	**-79.2**	**-58.8**	**32.0**	**11.7**	**-4.3**

reinvested earnings posted a positive balance of EUR 2.1 billion in 2009, after posting a negative balance in 2008. Equity capital transactions, excluding real-estate investment, which had already been small in previous years, were down by 29% compared to 2008, at EUR 7.7 billion. Finally, "other capital" transactions posted a net negative balance of EUR 18.3 billion, which represented a very large increase compared to 2008. Given the rules applied to the classification of inter-company loans in this article, the negative balance means that, on the whole, French subsidiaries of foreign groups lent more than they borrowed to their parent companies or non-resident entities of their group in 2009. A similar pattern had already been seen in previous years, especially in 2006 and 2003, but never on the same scale (see Chart 4).

Inward equity capital investment, excluding real-estate investment, also showed a decrease in the number of transactions in 2009, declining by 35% compared to 2008. Over the longer period, this component declined steadily over nine years and its level in 2009 was 71% lower than in 2000 (see Chart 3).

There were few major inward direct investment transactions in equity capital of note in France in 2009. Such transactions appeared more as

Chart 4 Composition of net inward direct investment flows

(EUR billions)

the counterpart to French direct investment transactions abroad, rather than actual investments initiated by investors located in other countries. This was the case for the allocation of BNP Paribas shares to the Belgian government in exchange for its 75% equity stake in Fortis Banque. In another case, two Luxembourg-based investment funds belonging to the American investment bank Goldman Sachs took equity stakes in Eurotunnel after subordinated debt securities previously issued by Eurotunnel were redeemed in shares.

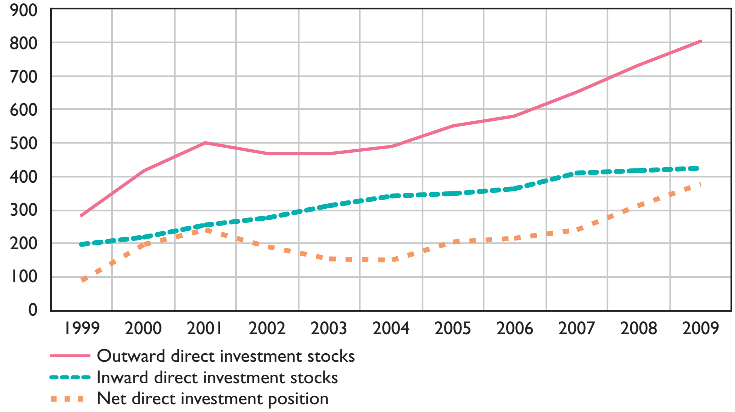
The geographical breakdown according to the immediate investor country principle shows that nearly all countries' direct investment transactions in France in 2009 were close to equilibrium. The three leading investor countries were Belgium, the Netherlands and the United Arab Emirates, but the cumulative amount was less than EUR 10 billion, whereas the countries that made the largest contribution to net disinvestment were Germany (EUR 5.9 billion), the United Kingdom (EUR 3.5 billion) and Luxembourg (EUR 2.9 billion) (see Table 1).

2| Direct investment stocks

At the end of 2009, the net direct investment position at book value stood at EUR 377.7 billion (or 20% of GDP). It was the difference between foreign assets of EUR 802.8 billion and liabilities of EUR 425.1 billion. Since the end of 1999, the France's stock of outward foreign direct investment has increased by a factor of 2.8 and has grown steadily, except for 2002 and 2003, when the "dot-com" bubble burst and flows slowed sharply.

Chart 5 Stocks of direct investment from the end of 1999 to the end of 2009

(EUR billions)



On the other hand, France's stocks of inward foreign direct investment have shown steadier growth since 1999, increasing slightly more than twofold with constantly positive, but slower, growth (see Chart 5).

The reclassification of inter-company loans according to the extended directional principle rule leads to sharp and simultaneous decreases in the stocks of French inward and outward inter-company loans. This means that direct investment stocks are made up almost entirely of equity capital in the presentation used for this article. Equity capital accounted for 87% of outward direct investment at the end of 2009, while real-estate investment accounted for 3% and inter-company loans for 10%. The share of inter-company loans in inward direct investment was even smaller at the end of 2009, at less than 4%, but real-estate investment, boosted by massive purchases and following years of growth, did not decline until 2008 and 2009,[6] standing at nearly 20% of the total.

2|1 Foreign direct investment stocks by sector[7]

At the end of 2009, two sectors accounted for a significant share of outward direct investment: financial and insurance activities, with 31% of the total, of which one fifth was for the activities of holding companies, and

6 *Inward real-estate investment is undoubtedly more accurately tracked than outward real-estate investment, given the legal and regulatory environment.*

7 *The breakdown of direct investment by sector presented here has been compiled for the first time under NAF rev. 2 and backcasted to the start of the period. The sectors used for outward direct investment are the ones of the resident direct investors and the sectors used for inward direct investment are the ones of the direct investment enterprises (see the methodological appendix for more details).*

manufacturing, with 26%. Even though FDI stocks in nominal terms held by French manufacturers have never declined since the end of 1999, with the exception of 2002, their relative share has decreased by 10 percentage points over ten years. On the other hand, the share of financial and insurance activities increased by 13 percentage points between 1999 and 2004, followed by a declining trend after that.

The information and communication sector did not have much of an international dimension at the very beginning of the period. It is now a major investor sector, with 8% of the investments abroad. The wholesale and retail trade and repairs of motor vehicles and motorcycles maintained a steady share of investment of around 6% throughout the period (see Table 2).

The situation for inward direct investment differs little overall, with two dominant sectors at the end of 2009. These were financial and insurance activities, with 31% of the total, of which 40% was for investments in holding companies, and manufacturing, with 24%. The share of direct investment in resident manufacturing enterprises declined by nearly 11 percentage points over ten years, but it is still larger than the share of manufacturing in GDP, showing that direct investors have not deserted this sector of the economy at all. The manufacture of machinery and transport equipment, refining, metal and metal products, wood and publishing are sub-sectors with shrinking shares of total investment over the last ten years, whereas the manufacture of chemicals, motor vehicles and, most importantly, pharmaceuticals have maintained their shares.

Table 2 Foreign direct investment stocks by sector

(as a percentage of the total and in EUR billions for the total)

	Outward			Inward		
	1999	**2004**	**2009**	**1999**	**2004**	**2009**
Agriculture, forestry and fishing	0.0	0.0	0.0	0.1	0.1	0.1
All Industries	55.2	38.6	39.0	36.2	27.2	25.8
o/w: Manufacturing	*35.7*	*29.0*	*26.4*	*35.1*	*26.0*	*24.4*
Construction	0.5	0.5	1.5	0.4	0.4	0.4
Wholesale and retail trade; repair of motor vehicles and motorcycles	5.8	5.7	6.5	7.7	5.2	1.3
Transportation and storage	0.7	0.7	0.7	0.4	0.6	0.7
Accommodation and food services	2.0	1.3	1.0	0.4	0.4	1.6
Information and communication	3.8	3.2	8.2	2.0	3.3	5.3
Financial and insurance activities	25.5	38.1	30.9	30.5	35.7	30.6
o/w: Activities of holding companies	*5.0*	*13.4*	*6.4*	*11.1*	*17.4*	*11.9*
Real-estate activities	2.1	2.8	3.7	11.4	16.2	22.2
Business services	2.3	1.8	5.1	1.6	3.2	8.2
Education, human health and social work activities	0.6	2.3	0.2	2.6	1.5	0.6
Unallocated	1.5	5.0	3.1	6.6	6.2	3.2
Total	**286.0**	**490.9**	**802.8**	**197.0**	**341.4**	**425.1**

One distinguishing feature of France's inward direct investment is the share of real estate. Holdings of real-estate assets per se and inward direct investment in the real-estate sector stood at more than 22% of total investment at the end of 2009. This represents a twofold increase in the share of real estate in ten years and a fourfold increase in nominal stocks. Two other major sectors have shown rapid growth since the end of 1999. The business services sector, which includes temporary worker agencies, increased its share of the total from 1% to more than 5%. Meanwhile, the information and communication sector increased its share from 2% to more than 5%. On the other hand, the share of wholesale and retail trade and repair of motor vehicles saw its share decline by approximately 6 percentage points over ten years to just over 1% at the end of 2009 (see Table 2).

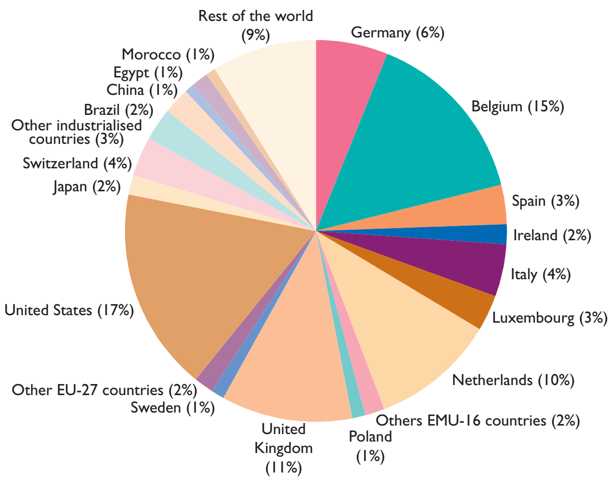
2|2 Geographical breakdown of direct investment stocks

Even though the reclassification of inter-company loans according to the extended directional principle shrank the shares of investment for the main transit countries for investment flows, French investors' preferred destinations for outward direct investment were still the European Union countries, which accounted for 61% of total stocks at the end of 2009. The share of outward direct investment going to other industrialised countries stood at 25% on the same date and the share going to the rest of the world stood at 14%. The United States was, unsurprisingly, the top destination, accounting for 17% of the total, followed by Belgium (15%), the United Kingdom (11%) and the Netherlands (10%). Belgium was the choice of many French groups as a location for their headquarters or their European and global cash management centres. France's leading trading partner, Germany, accounted only 6% of France's stocks of outward direct investment, and Italy accounted for 4%. The leading emerging country, Brazil, accounted for 2% of the stocks and China accounted for only a minor share, with less than 1% of the total (see Chart 6).

Inward direct investment stocks were even more highly concentrated than stocks of outward direct investment. At the end of 2009, the EU countries accounted for three quarters of inward direct investment, with the other industrialised countries accounting for 21% and the rest of the world accounting for only 4%. Inward investment from just six countries: Netherlands, Luxembourg, United Kingdom, United States, Belgium and Germany, accounted for 75% of the total stocks (see Chart 7).

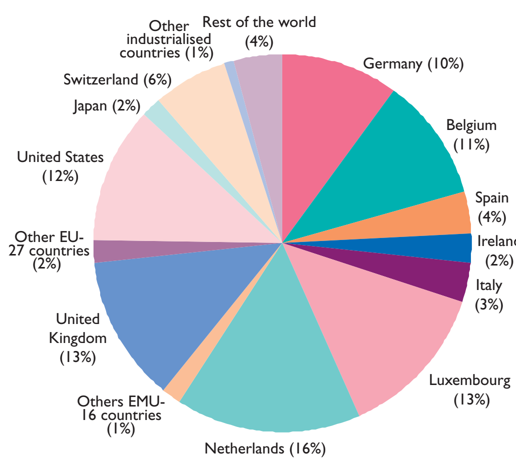
As is the case with flows, the geographical breakdown of direct investment stocks by immediate destination country and immediate investor country does not show the ultimate destination countries or the

Chart 6 Outward direct investment stocks by immediate destination country at end-2009



ultimate investor countries. This means that the breakdown is biased through overrepresentation of hub countries, from which investments are redistributed to other destinations. By allocating all direct investment, including equity capital and inter-company loans, to the ultimate investor country,[8] we correct for this bias. This highlights French groups' large share of inward direct investment stocks, standing at EUR 60.8 billion,

Chart 7 Inward direct investment stocks by immediate investor country at end-2009



8 *The appendix at the end of this article gives a definition of the ultimate investor. A geographical breakdown by ultimate investor could also be made of inward direct investment flows, but this breakdown would be less meaningful than the breakdown of stocks and is not required by the 6th IMF* Balance of Payments Manual.

or 14% of inward direct investment. France's place in the ranks of the leading ultimate investors shows that the adjustments made under the new international standards are still incomplete, since they are only meant to apply to loans between fellow companies. This means that the EUR 60.8 billion in investment attributed to French ultimate investors at the end of 2009 corresponds to investment in equity capital in France by non-resident subsidiaries of French groups or to earnings of non-resident entities of French groups reinvested in their own subsidiaries resident in France.

If we exclude France, the country with the largest increase in its relative share after reclassifying direct investment stocks by the country of residence of the ultimate investor is the United States. The United States ranked fourth among investor countries in France when direct investment is broken down by the immediate counterpart, behind the Netherlands, Luxembourg and the United Kingdom, but, in the breakdown by ultimate investor, it ranks first and its share increases by 7 percentage points to 19%. This is hardly surprising, since American multinational groups have long played a major role in the world and their huge international network of subsidiaries enables them to invest from different regional platforms. The other countries that increased their shares were Switzerland, with a 0.5-percentage-point increase to 7%, Germany with a 2-percentage-point increase to 12% and the United Kingdom, with a 4-percentage-point increase to 17%. On the other hand, the Netherlands, Luxembourg and Belgium saw their share of inward direct investment in France fall to levels that are more consistent with their economic clout and that of their international groups (see Charts 8 and 9).

Chart 8 Inward direct investment stocks by ultimate investory country at end-2009

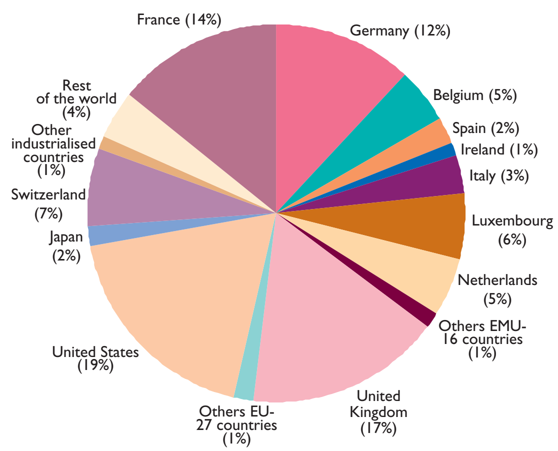
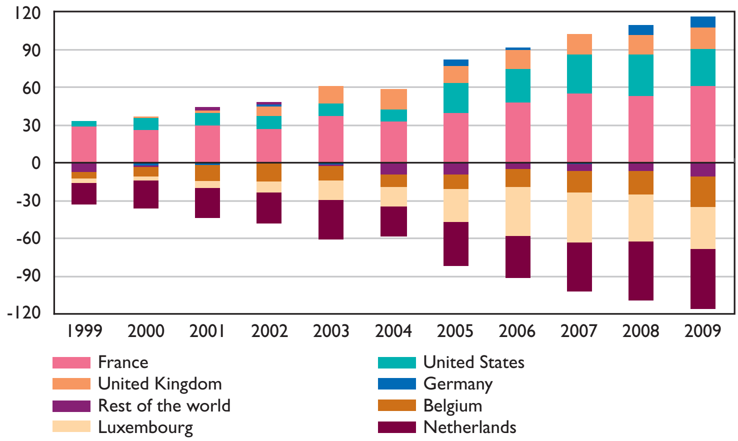


Chart 9 Main disparities between countries after identification of the ultimate investor country

(EUR billions)



An analysis of the data for all years between 1999 and 2009 shows the increasingly large amounts of capital invested in France that have transited through third countries. These amounts rose from EUR 33 billion at the end of 1999 to nearly EUR 110 billion at the end of 2009 (see Chart 9), or from 17% to 25% of total inward direct investment stocks in France. At the start of the period, identifying the country of residence of the ultimate investor revealed the presence of French groups and, to a lesser extent, strengthened the presence of American groups among the ranks of countries investing in France. In recent years, we have also seen that British and German groups make a significant share of their direct investment in France through third countries, especially the Netherlands, Luxembourg and Belgium.[9]

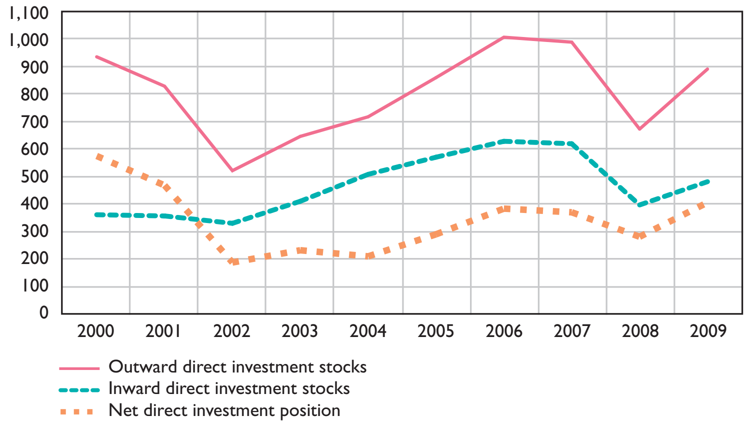
2|3 Stocks of foreign direct investment at market value

The net direct investment balance at market value at the end of 2009 is estimated at EUR 407.3 billion, which represents an increase of nearly EUR 130 billion compared to the end of 2008. This increase can be attributed equally to net direct investment outflows and the price effect, meaning the impact of changes in stock market prices and real-estate prices on the market value of assets and liabilities.

9 *It would, of course, be better to have symmetrical statistics on stocks of outward direct investment by ultimate destination country. But the ultimate destination of funds invested from France cannot be determined using surveys of resident enterprises and other domestic sources.The only way to find such information would be to obtain it from the countries that are the ultimate destinations of the investment.This is not possible at present for legal reasons relating to the confidentiality of data and in view of the current level of international statistical cooperation.*

Chart 10 Direct investment stocks at market value from the end of 2000 to the end of 2009

(EUR billions)



However, it should be noted that plunging stock markets in 2008 caused the net balance at market value to fall by EUR 92 billion between the end of 2007 and the end of 2008, despite net direct investment outflows of EUR 67.5 billion (see Chart 10). At the end of 2009, the market value of France's outward and inward direct investment stocks was once again slightly greater than their book value, in contrast to the situation at the end of 2008, but it was still much lower than the book value multiples seen in 2000 and 2001 or between 2004 and 2007.

3| Direct investment income

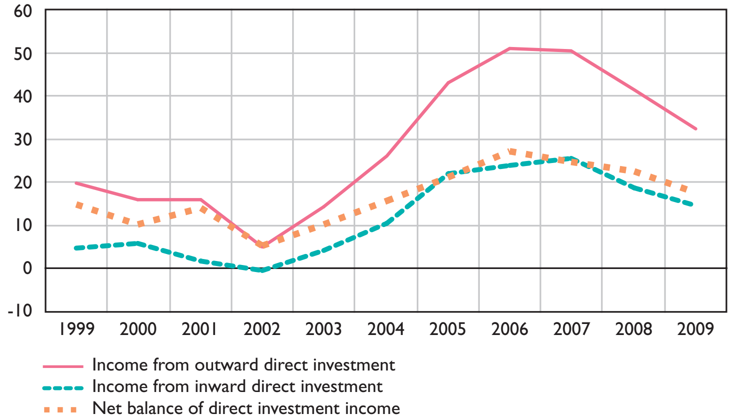
Income from outward direct investment had risen quickly following the end of the "dot-com" crisis in the early years of the decade, partly as a result of improved statistical coverage. It peaked at more than EUR 50 billion in 2006 and 2007, before decreasing by 36% over two years. In the meantime, income on inward direct investment also peaked at more than EUR 25 billion in 2007, and then decreased by 42% over the last two years. All in all, the direct investment income surplus of EUR 17.7 billion in 2009[10] was more than EUR 7 billion smaller compared to 2007 (see Chart 11).

Consolidation of direct investment income shows that income on outward direct investment is highly concentrated. This consolidation involves aggregating the income from all of the companies belonging to the same

10 It should be remembered that the direct investment income figures for 2009 are only estimates and should not be considered definitive.

Chart 11 Direct investment income in the balance of payments from 1999 to 2009

(EUR billions)



group and reclassifying all of the income received or paid by groups where the ultimate investor is resident in France, including reinvested earnings (see methodological appendix), as income on outward direct investment and all of the income received and paid by groups where the ultimate investor is not resident in France as income on inward direct investment. In 2008, the direct investment income of the top 20 French groups came to EUR 32.6 billion, accounting for more than 87% of receipts, while the 36 resident groups in the CAC 40[11] index had combined income of EUR 33.8 billion, representing nearly 91% of net receipts (compared to 89% of net receipts in 2007 and 90% in 2006 and 2005). Between 2005 and 2008, the income from foreign subsidiaries of CAC 40 groups recorded in the balance of payments accounted for nearly 50% of the group's share of net consolidated income, excluding extraordinary items, and even more than 54% in 2008.

Meanwhile, income on inward direct investment appears to be less concentrated than income on outward direct investment. The income of the top 20 foreign investors came to only EUR 7.7 billion (or 52% of net expenditures) and the income of the top 40 foreign investors came to EUR 10 billion, representing barely more than two-thirds of net expenditures. There is nothing surprising about this pattern, which is equally apparent for direct investment flows and stocks. It stems primarily from the fact that it is harder for us to determine the structure of foreign groups than it is to determine the structure of French groups. It also stems from the fact that, in the case of outward direct investment, we measure

11 Meaning the list of companies in the CAC index on 31 December 2008, except for Arcelor Mittal, Dexia, EADS and ST Microelectronics.

concentration within a small group of direct investors, whereas, in the case of inward direct investment, we have measured the concentration of investment in a limited territory, France, by a worldwide population of direct investors.

France is currently one of the few countries to publish direct investment statistics in compliance with the future international standards. This means that these statistics cannot be compared directly to those of our partners. The entry into force of the new methodology prescribed by the IMF and the OECD should provide a set of national statistics that are more meaningful than at present and easier to compare.

Appendix

Foreign direct investment: concepts and definitions

Definition of direct investment

The Banque de France compiles France's direct investment statistics using the conceptual framework that the IMF defined for compiling the balance of payments and the international investment position in the *Balance of Payments Manual* (fifth edition published in 1993 and sixth edition published in 2008). Direct investment is international investment where a resident entity in one economy acquires or holds a lasting interest in an entity resident in another economy. The lasting interest implies a long-term relationship between the direct investor and the direct investment enterprise and a significant degree of influence by the investor on the management of the enterprise. Direct investment covers both the initial transaction between the two entities and all subsequent financial transactions between them.

According to convention, direct investors are deemed to hold a lasting interest in an entity when they own at least 10% of the equity or the voting rights in an enterprise that is resident in another country. Direct investment statistics include all of the financial transactions between enterprises deemed to be in a "direct investment relationship". These statistics cover transactions between companies that are indirectly linked, as well as transactions between companies with direct ownership links that meet the 10% criterion. This means that a financial transaction between a company and a subsidiary that is more than 10% owned by majority-owned subsidiary of the first company counts as direct investment, even though there is no direct ownership link between them. Similarly, all of the financial transactions between fellow companies, meaning companies where the same ultimate investor directly or indirectly owns more than 10% of the equity, but that do not have direct ownership links between them, count as direct investment.

Therefore, direct investment covers more than just purchases of equity interests. It also covers real-estate investment, reinvested earnings (the portion of earnings that is not distributed to direct investors in the form of dividends on the current income of direct investment enterprises) and all of the loans and deposits between resident entities and their non-resident affiliates (parent companies, directly and indirectly owned subsidiaries and fellow companies).[1]

1 *For more details about the notion of residence, the links between direct investment and investment in the system of national accounts, populations of direct investment enterprises and data collection methods, see Nivat and Terrien (2009).*

Geographical breakdowns

According to the IMF balance of payments methodology, geographical breakdowns are made according to the immediate counterpart's country. This means that the country considered to be the destination for the investment is not the ultimate recipient of the funds invested, but the country that receives the funds when they first leave France. Consequently, a French investment in China made through a Dutch subsidiary is counted as French outward direct investment in the Netherlands. This rule applies to direct investment flows and stocks compiled according to the traditional method as well as flows and stocks presented in this article, which are complied according to the extended directional principle rule.

In the case of inward direct investment stocks, however, we can make an additional geographical breakdown that is entirely based on the ultimate investor criterion. This breakdown allocates the equity stocks of its resident subsidiaries to the country of residence of the ultimate controlling parent, along with the stocks of loans and cash flows between the French and foreign subsidiaries of the same group. The ultimate investor is defined as the entity that is origin of the chain of majority ownership links that make up a group. Ultimate investors (or ultimate controlling parents) are identified to get a clearer idea of who ultimately owns and controls resident enterprises in direct investment relationships.

Breakdowns by sector

The breakdown by sector is made according to the activities attributed to the resident entities, which are identified by the SIREN statistical code number in the company register kept by INSEE, France's national statistics institute. The breakdown of outward direct investment is made according to the activities of the resident direct investors and the breakdown of inward direct investment is based on the activities of the resident direct investment enterprises. Direct investment flows and stocks in 2009 were compiled for the first time using a new activity classification that came into force on 1 January 2008 (NAF rev. 2 or NAF 2008). Data from previous years, which were originally published according to NAF rev. 1, were restated for the purposes of comparison. In order to make the breakdown by sector more meaningful, holding companies are reclassified according to the business sector of the ultimate controlling parent, if the parent is a listed company. In order to have a sector structure that was in line with those used by stock market indexes, the Industry Classification Benchmark (ICB) was chosen as the standard system for reclassifying investor holding companies.[2]

2 *The ICB is a sector classification system that was created jointly by Dow Jones and FTSE. It is the standard used to define the business sectors of companies listed on several stock markets that account for approximately 65% of global market capitalisation, including Paris and New York (Euronext-NYSE), along with London. The benchmark is used for the sector indices provided by most of the world's leading stock markets.*

Valuation of stocks of direct investment

Unless otherwise indicated, direct investment stocks presented in this article are expressed at book value. The equity capital data relating to direct investment enterprises are taken from their financial statements. The market value of direct investment stocks is also mentioned, but only for the overall amount and not in the breakdowns by geographical zone or sector. In the case of unlisted companies, the market value of equity capital is estimated using the "capitalisation ratio" method, which calculates median ratios based on the ratio of stock market capitalisation to consolidated equity capital for populations of listed companies and then applies these ratios, subject to certain conditions, to the stocks of equity capital at book value.[3]

Direct investment income

Direct investors receive income from their direct investment enterprises. This income is made up of the current operating income of the direct investment enterprises, which excludes non-recurring items such as foreign exchange gains and losses, gains and losses on asset disposals, etc. This income is made up of two parts: one part that is distributed to direct investors (dividends) and another part that is allocated to the reserves of the direct investment enterprises, which increases the investors' equity when it is positive (reinvested earnings). Reinvested earnings are also recorded with the opposite sign in direct investment flows. Direct investment income is a current account item in the balance of payments and it contributes to gross national income (GNI) in the system of national accounts. Consolidation of direct investment income, which is discussed in the third part of this article, is based on the successive annual versions of the LiFi database on financial links between companies provided to us by INSEE, France's national statistics institute.

The main changes to direct investment statistics resulting from the new OECD-IMF methodology

In the "official" statistics of most countries, including France, loans between fellow companies (meaning enterprises with no direct ownership links between them or where one owns less than 10% of the equity capital in the other) are recorded under the asset/liability principle. Loans made by resident companies to non-resident fellow companies are counted as outward direct investment, while loans from non-resident companies to French fellow companies are counted as inward direct investment.

3 *For details about the method used, see Nivat and Topiol (2010).*

This rule did not raise any particular problems when the current methods for compiling and recording balance of payments flows and international investment position stocks were first defined, but, today, it inflates direct investment because of the creation and growth of special purpose entities (SPEs). Some of these entities were created by international groups to provide the necessary financing to the other companies belonging to the group by issuing securities on international markets or by obtaining bank loans. These structures are usually not located in the country where the ultimate investment is made. In this case, the funds are transferred from the countries where they have been raised to countries where they will be used, with a possible detour via the group's home country or a third country. Each transfer of funds corresponds to an inter-company loan that is recorded as direct investment. SPEs may also be given the task of centralising the group's disposable cash. In this case, they receive funds from companies with cash surpluses and distribute them to companies with borrowing needs. All such transactions are recorded as direct investment transactions.

SPEs also affect direct investment through payment transactions, as in the case of an acquisition by one country in another country that gives rise to payments made to or from cash management centres located in a third country. This disconnection of real transactions from payment flows is all the more pronounced as the degree of regional economic and financial integration increases. Consequently, the disconnection is very pronounced in Europe. Overall, SPEs artificially inflate direct investment flows and stocks by multiplying the loans between companies belonging to the same group and located in different countries.

The OECD and the IMF defined a new method called "extended directional principle," which is set out in the OECD *Benchmark Definition of Direct Investment*, 4th edition (2008) and in the IMF *Balance of Payments Manual*, 6th edition (2008). The new method is intended to reduce the overestimation of direct investment. According to this method, loans between fellow enterprises should be reclassified according to the residence of the ultimate controlling parent.[4] When the parent is a French company, all of the inter-company loans, regardless of direction, are considered to be outward direct investment, which is positive or negative, depending on whether we are dealing with assets or liabilities. When the ultimate controlling parent is a foreign company, the loans are recorded as inward direct investment, with different signs for assets and liabilities. All of the data series on direct investment flows and stocks presented in this article were compiled using the new methodology.

4 *The 5th edition of the IMF* Balance of Payments Manual *(1993) recommended the directional principle method only for inter-company loans between parents and subsidiaries.*

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