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***REFLECTIONS ON THE
RELATIONSHIP BETWEEN SPECIAL
PURPOSE ENTITIES (SPEs) AND
THE OWNERSHIP OF IPPs***





- *Residency vs nationality*
- *Starting from experiences*
- *Methodological issues*
- *Some related questions*
- *Conclusions*

RESIDENCY VS NATIONALITY 1.



- You can find – among others like market valuation – two important concepts in recent manuals (SNA2008, BPM6, BD4): economic ownership and residency.
- In a world of ordinary businesses the economic ownership is a question of nature of transaction – who is the principal and the contractor, who owns raw materials and IPPs...
- ...but globalization means much more than complex transactions – there are global production chains, pass-through activities and special types of firms: holding companies, SPEs, branches etc.
- At firm level the question is whether which assets it possesses legally vs economically.
- GNI includes all receipts earned by a firm on its assets (and expenditures payable by a firm on its liabilities) but economically it does matter whether production or (primary) income account is concerned.

RESIDENCY VS NATIONALITY 2.



- As a result, concepts of residency and economic ownership in some cases face each other...
- ...and the latter rather seems to be retired: there are exceptions from the concept of the economic ownership for the sake of easing the compilation of residency based statistics: (many of) holding companies, SPEs, branches etc.
- Due to users' needs (raising mainly after the crisis of 2008), the concept of economic ownership recently strikes back.
- It is reflected by the fact that supplementary and rivalrous presentations appeared:
 - ultimate investing and host countries;
 - consolidation by eliminating pass-through transactions;
 - formulary apportionment method to reallocate production activities between countries etc.

RESIDENCY VS NATIONALITY 3.



- In sum, nationality based statistics are also under discussion and planning.
- The relationship between SPEs and ownership of IPPs is particularly interesting from the point of view of economic ownership.
- **Question:** what will be the role and the economic meaning of residency based statistics under these circumstances?
- What is follows should be considered as a point of view on possibilities of residency based statistics as regards relationship between SPEs and IPPs.

- Hungary compiles separated balance of payments for SPEs since 2006.
- It follows the definition of OECD BD4 for SPEs (resident and legal entity but it has no or few relationships, employees, production and physical presence in the host economy and its core business is group financing or holding activities, that is – viewed from the perspective of the compiler in a given country – the channelling of funds from non-residents to other non-residents).
- These criteria were (and are) interpreted by our (residency based) point of view that SPEs should not hold any non-financial asset for production in the host economy.
- In (our) practice, some SPEs legally hold some non-financial assets and carry out some non-financial activities – they are, however, reallocated to non residents in our statistics (together with recording the same activity under FDI incomes).
- The keyword is: ***branch!***



- Branches are widely discussed in recent manuals (SNA2008, BPM6, BD4).
- Their main features are that they should be separated from their (non-resident) head offices and *should undertake activity on a significant sale in their host economies.*
- Branches may be either real or notional units in the resident economy – if it is necessary they should be imputed.
- As mentioned, both SPEs and branches are excepted from the concept of economic ownership since in most cases they are not autonomous players ...
- ... but resident activity should be attributed to branches either real or notional!

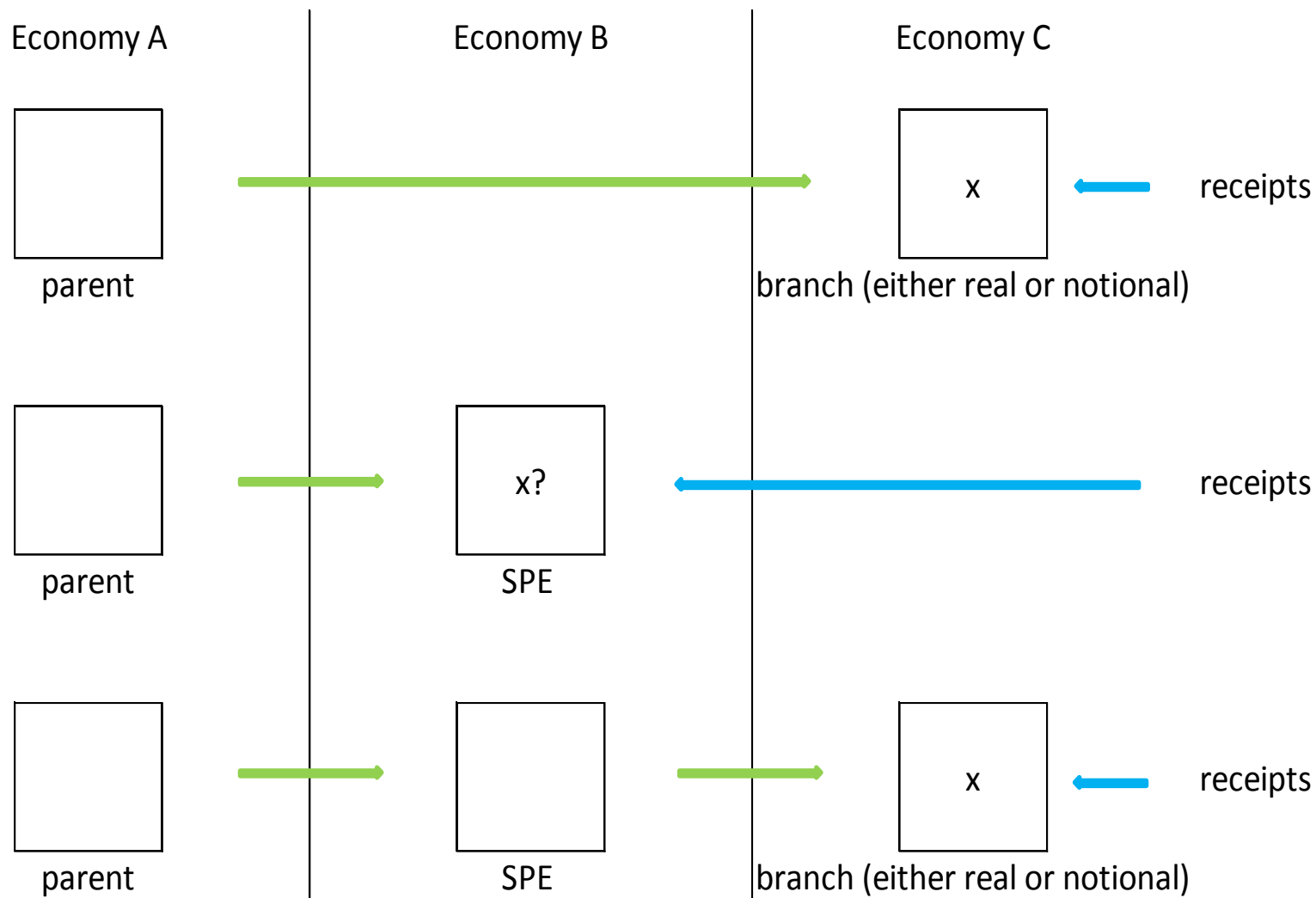


- In other words, branches have production, domestic relationships and often physical presence and the number of employees in the host economy.
- There is an international discuss on SPEs but – in the statistical domain – it is agreed that they are established to pass through assets and liabilities between their partners – i.e. it is not just a transaction of a firm, it is its *special purpose*.
- **In sum, an SPE is a channel while a branch is (or at least has) a port in their host economy.**
- As a consequence, theoretically SPEs and branches are mutually excluding each other ...
- ... but they can be in connection with each other easily.

METHODOLOGICAL ISSUES 3.



METHODOLOGICAL ISSUES 4.



METHODOLOGICAL ISSUES 5.



- There is a parent companies in Economy A, an SPE in Economy B and a branch (either real or notional) in Economy C (in practice Economy A and Economy C may be the same).
- This is a stylized figure representing that SPEs and generally MNEs have a single ultimate parent (i.e. Economy A is not by all means is the immediate partner) and SPEs are involved in pass-through activities.
- MNE operates in Economy C and can earn receipts both from inside and outside it.
- It can be supposed that this activity is large enough (compared to activity in Economy B) to create a branch – even statistically as a notional unit – in Economy C (see e.g. the point 4.31 in BPM6: *„if the operations in a territory outside the home base are substantial enough, they meet the definition of a branch”*).
- X in some boxes means that the unit (legally) holds non-financial assets (including IPPs). Blue lines mean services, green lines mean FDI income flows.
- SPE in Economy B fulfils the criteria of SPEs discussed in BD4.



- In the first case it is obvious that the parent earns FDI income from its branch and the activity of the branch is attributed to the GDP of Economy C in residency based statistics.
- In the second case non-financial assets (IPPs) are attributed legally to an SPE in Economy B so (the same) receipts from Economy C now are in the scope of the GDP in Economy B – what is the consequence?
- Upon economic reasoning and methodology this SPE should have a branch either real or notional abroad – this is reflected in the third case.
- *Ex cursus*: it can be noted that there are activities (e.g. rental services etc.) which can be carried out by even one employee – in the case of SPEs, however, we face the question of valuation which may also attribute value added to Economy B belonging to other countries like Economy A or C.
- Apart from IPPs, in some cases (for e.g. non-produced non-financial assets) branches should be created abroad anyway by definition since natural resources should be in resident hands.



- It can be seen that **the first and the third case are essentially the same**: in the third case just an additional pass-through company was established.
- *In sum, the activity upon IPPs can (should?) be reallocated **by resident compilers in their residency based statistics** in Economy B to non-resident economies where the activity is going on in a greater probability.*
- As a consequence, both the SPE and the branch (either real or notional) find their role: SPE is a *channel* while the branch is a *port* and the activity in Economy C will be the issue of Economy A and C.

SOME RELATED QUESTIONS 1.



- If the firm in Economy B did not fulfil the criteria of SPEs discussed in BD4, the non-financial assets (IPPs) should remain there as is the normal case.
- There is a question is whether what to do if only one or two criteria are not fulfilled but the firm (in Economy B) continues to take a part in pass-through activities (e.g. capital in transit) → the firm is not an SPE in strict sense (just „near-SPE”) but capital in transit should be filtered out from flows and stocks if it is necessary.
- Another question is whether which country this activity upon IPPs is rerouted to: Economy A or C → the residency based statistics in Economy B record receipts of this SPE under FDI income instead of services and do not deal with the relationship between Economy A and C (this is also a general consequence of SPEs).

SOME RELATED QUESTIONS 2.



- The following question is the issue of asymmetries: if the activity upon IPPs is rerouted from Economy B then Economy B and C may release their balance of payments (and national accounts) data by partner countries under different items

→ yes, it is an issue (e.g. supposed „disappearing” GDP at global level) but it should be discussed together with the role of residency based statistics and the method of aggregation and consolidation at international level (anyway, Economy A and Economy C may harmonize with each other as regards reallocation, see the next figure).

SOME RELATED QUESTIONS 3.



Economy A

Economy B

Economy C

original reports (GDP attributed to Economy B)

Credits	Debits
FDI income	

Credits	Debits
Services	FDI income

Credits	Debits
	Services

residency based recording of Economy B ("disappearing" GDP)

Credits	Debits
FDI income	

Credits	Debits
FDI income	FDI income

Credits	Debits
	Services

harmonizing between Economy A and C (GDP attributed to Economy A)

Credits	Debits
Services	

Credits	Debits
FDI income	FDI income

Credits	Debits
	Services

harmonizing between Economy A and C (GDP attributed to Economy C)

Credits	Debits
FDI income	

Credits	Debits
FDI income	FDI income

Credits	Debits
	FDI income

SOME RELATED QUESTIONS 4.



- Asymmetry may arise between Economy B and Economy C (see the second block in the figure) but – if we look through the SPE in Economy B (which is a reasonable option in FDI statistics) – there is also an asymmetry between Economy A and C which is also should be addressed (see the third and the fourth block in the figure).
- This question of asymmetry always arises if there are notional units (either resident or non-resident), transit flows or valuation problem in resident statistics since compilers of macroeconomic statistics in partner countries have possibly no knowledge about it or think this issue differently.
- It is important that this source of asymmetries should be addressed but it seems to be a hard task to harmonize – there may be a *trade-off* between needs of (economically more reasonable) residency based statistics and bilateral asymmetries (which is the ground of international projects like nationality based statistics or TiVA calculations).

SOME RELATED QUESTIONS 5.



- Last but not at least it is also a question (related to the previous one) that what will be the role of definition and criteria for SPEs – whether they will serve rather residency based statistics or international aggregability.
- It can be imagined that different information is needed for these two purposes in the case of SPEs, too – if residency based macroeconomic statistics include (either goods or capital) transit flows or IPP related flows for SPEs they will probably serve well aggregation or consolidation projects at international level but they in themselves probably will be less adequate for analytical purposes.
- It can, however, be argued that nationality based statistics or just simply international aggregation and consolidation can show economically *even more* reasonable data for individual countries and so they require aggregable data from them i.e. including minimum level of bilateral asymmetries as far as possible – it may, however, be an another presentation of residency based data.

CONCLUSIONS



- The OECD BD4 criteria for SPEs help to clarify the different roles of SPEs and branches.
- The formulary apportionment used for nationality based statistics and analysis has a clear message: the production should be rather allocated where there is more staff and sales – residency based statistics can also makes use of this point of view in order to stay economically reasonable.
- Asymmetries arisen from compiling residency based statistics related to SPEs probably can (should?) be handled similarly to other issues (transit trade, Rotterdam effect etc.) distinguishing national and community concept – aggregation and consolidation are made upon „community” concept i.e. data including (originally reported) flows and stocks of resident players but residency based statistics show an economically more reasonable picture.
- Fora, like or similar to FDI Network or Early Warning System, can (should?) deal with this type of harmonization – international cooperation, of course, is necessary for detecting these issues.



Thanks for your attention!