Background Notes *(updated February 2015)*

Introduction

This release updates the annual statistical series on Foreign Direct Investment (FDI) which was introduced in December 2003. The data presented show annual direct investment flows over the reference year along with end-year stocks (or positions) for Ireland broken down geographically by region and by country. The release includes tables with further analyses of the FDI flows and stocks broken down by the principal economic activity (using the NACE Rev.2 classification) of the resident direct investment enterprise. These results form part of the range of Balance of Payments (BOP), International Investment Position (IIP) and related statistics published by the CSO. The figures presented are methodologically consistent with the data already presented in the quarterly balance of payments and IIP releases.

International statistical standards

Taken together, the underlying methodologies used to compile these FDI as well as the various related statistics are consistent and follow as far as possible the recommendations of the IMF's *Balance of Payments Manual - 6th Edition* (BPM6) published in 2009. These recommendations were prepared in close co-operation with the European Commission (Eurostat), the OECD and other international organisations.

The BOP and IIP releases include descriptions of the overall collection, compilation and presentation methodologies used. Further important details which specifically concern Direct Investment are given below.

Data collection

The general data collection and compilation arrangements are described more fully in the BOP and IIP releases. BOP-related data collection is statutory and surveys are conducted by the CSO and by the Central Bank of Ireland (CBI). Other data obtained from administrative sources are also used. Following the introduction of a redesigned BOP data collection system in 1998 and up to 2007, the CSO undertook all the necessary survey collection and compilation required. However, following a joint initiative involving the CSO and the CBI to rationalise statistical data collection and compilation for the financial sector and also to reduce the burden on data providers the data collection arrangements have changed. As a consequence, since 2008 the data required from licensed banks (credit institutions) and from investment funds (including money market funds) to meet BOP, IIP, external debt, foreign direct investment and other statistical demands on both organisations are being collected quarterly by the CBI under its legislation as well as European legislation[1]. The data are supplied by the CBI to CSO for statistical compilation purposes. As a consequence the CSO has discontinued its surveys of credit institutions and investment funds but continues to collect the required data from other financial enterprises as well as non-financial enterprises using its ongoing quarterly statutory surveys. These are conducted under the Statistics (Balance of Payments and Financial Accounts) Order, 2010 (S.I. No. 206 of 2010) made under the Statistics Act, 1993.

In all about 2,000 enterprises are covered for FDI. Many of these are financial enterprises most of which are engaged in internationally-traded financial service activities and are broadly known as IFSC enterprises. In addition, some information on investment in residential and commercial properties abroad has been collected from general sources and the relevant estimates are included in the figures (see *Definition of Foreign Direct Investment* below).

Definition of Foreign Direct Investment

Direct investment is a category of international investment that, based on an equity ownership of at least 10%, reflects a lasting interest by a resident in one economy (the direct investor) in an enterprise resident in another economy (the direct investment enterprise). Using this criterion, a direct investment relationship can exist between a number of affiliated enterprises whether the linkage involves a single chain or a number of chains. It can extend to a direct investment enterprise's subsidiaries, sub-subsidiaries and associates. Once the direct investment relationship is established, all subsequent financial flows between the related entities are recorded as direct investment transactions, regardless of the type of financial instrument used in the financing arrangement (except for financial derivative contracts, and financial intermediary affiliates among which direct investment transactions are limited to those involving equity and permanent debt). The components of direct investment transactions are *equity capital*, *reinvested earnings*, and *other capital*. *Equity capital* comprises investment in branches, shares in subsidiaries and associates (except non-participating preferred shares that are treated as debt securities) and other capital contributions. *Reinvested earnings* consists of the off-setting entry to the corresponding current account income item: it is the direct investor's share of the undistributed earnings of its branches, subsidiaries and associates. *Other capital* covers all other inter-affiliate financial transactions (borrowing and lending of funds) including debt securities and suppliers' credits (i.e. trade credits). Following the recommendations of the IMF, ECB, EUROSTAT and OECD, direct investment statistics are recorded on a *'directional basis'* rather than the more usual assets/liabilities basis. *Direct investment abroad* covers *net* investment by companies resident in Ireland in their foreign branches, subsidiaries and associated companies. *Direct investment in Ireland* covers the *net* investment by foreign companies in their affiliates located in Ireland.

The compilation system for direct investment also includes investment by Irish private residents (households) in residential and commercial property abroad. Such properties are regarded as constituting notional direct investment enterprises overseas and are treated accordingly in the system, both in terms of any relevant financial account investment flows and any current account flows (services or income). In addition, foreign investment in bloodstock breeding activities in Ireland as well as associated income flows are now reflected in the BOP statistics.

Directional Principle for recording direct investment

In line with the quarterly BOP flow and IIP stock data, direct investments of Irish resident investors in foreign enterprises are recorded under the category *direct investment abroad* (which approximates to the assets concept). Similar investments made by foreign investors in enterprises located in Ireland are recorded under *direct investment in Ireland* (which closely equates to liabilities). The essential difference between the directional principle and the assets/liabilities approach centres on the treatment of reverse investment by a direct investment enterprise in its parent (direct investor) and on the treatment of transactions with other foreign affiliates covered by a direct investment relationship.

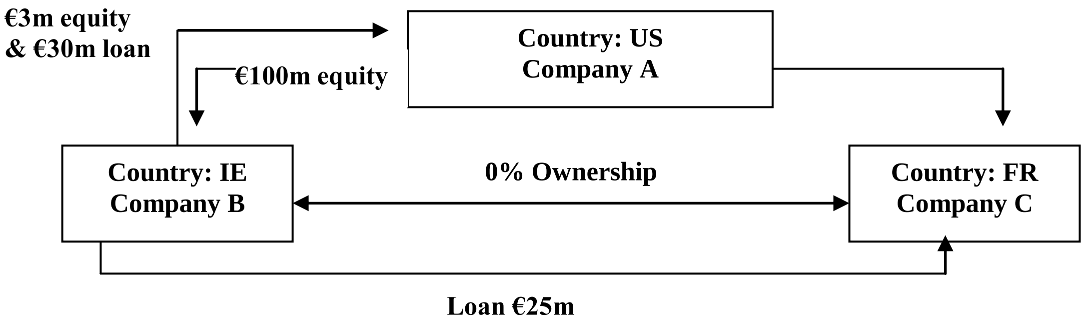
In the Irish context, reverse *equity* investment in a parent enterprise is rare and tends to be relatively small. However, substantial flows (and positions) under the category *direct investment – other capital* can take place. These predominantly take the form of inter-affiliate loans but trade credits and transactions in financial securities between affiliates are also included.

The treatment of reverse investment has to be considered under three scenarios:

- First, for *reverse equity investment for holdings of 10% or more of the voting capital,* such transactions are regarded as separate direct investment in their own right for both the equity and non-equity involved.

- Second, for *reverse equity investment for holdings of less than 10% of the voting capital,* the transactions involved, whether in equity or non-equity instruments, are regarded as offsetting (or netted against) any existing direct investment by the parent in the enterprise. For example, if a US direct investor A invests €100m in a direct investment enterprise B located in Ireland and B acquires a small reverse equity investment of €3m in its parent (A) then the value of *direct investment in Ireland-equity* is €97m (i.e. €100m less €3m). Extending this example, if B advances a €30m loan to parent, A, *direct investment in Ireland-other capital* is €30m lower. Overall *direct investment in Ireland* from A to B is therefore €67m (i.e. €100m - €3m - €30m).

- The third scenario concerns a *non-equity transaction between enterprises related other than through equity ownership* (e.g. between 'sister' or 'cousin' companies). Given a number of considerations, there is some flexibility in the international standards regarding the treatment of this situation. In Ireland's case and in order to ensure that all inward and outward flows (and stocks) arising from an initial inward direct investment are retained within the *direct investment in Ireland* category, the same principle as for reverse equity or non-equity investment with a parent company is applied. The transaction referred to is therefore treated as offsetting any existing *other capital* investment. Again extending the earlier example, if resident direct investment enterprise, B, advances a loan of €25m to a sister company, C, located in France, *direct investment in Ireland – other capital* is lowered by €25m and overall *direct investment in Ireland* from A to B amounts to €42m (i.e. €100m - €3m - €30m - €25m) – see diagram below. Cases occur on an ongoing basis where the outward investment flows or positions of B (or other sister direct investment enterprises located in Ireland) exceed the amounts attributable to A under *direct investment in Ireland*. The equivalent treatment is applied for similar situations categorised under *direct investment abroad.*



Geographical allocation principle

In line with the international recommendations, direct investment flows and stocks are geographically attributed on the basis of country of location of immediate ownership of the direct investment enterprise rather than that of the ultimate beneficial owner. Therefore, if a US investor directly invests in a direct investment enterprise located in Ireland, the origin of the investment as presented in these statistics is US. If the US investor indirectly invests, through its Cayman Islands subsidiary, in an enterprise located in Ireland then the origin of the investment is Cayman Islands. In both cases, the country of location of the ultimate beneficial owner is US. This may have a significant impact on the geographic analysis of FDI statistics**.**

Economic Activity Classification

Tables 5 – 8 show an activity classification according to the principal economic activity of the resident direct investment enterprise. The results were compiled using the NACE Rev. 2 classification[2].

[1] ECB Regulation on the Assets and Liabilities of Investment Funds (ECB/2007/8) of 27 July 2007, the ECB Balance of Payments and International Investment Statistics Guideline (ECB/2004/15) of 16 July 2004, as amended by (ECB/2007/3) of 31 May 2007, and the ECB Guideline on Monetary, Financial Institutions and Markets Statistics (ECB/2007/9) of 1 August 2007

[2] For more information and a detailed description of the classification see: http://ec.europa.eu/eurostat/web/nace-rev2