Changes in the methodology and classifications of the balance of payments and the international investment position statistics

BPM6 Implementation
In October 2014 Eurostat starts data dissemination according to the requirements of the sixth edition of the Balance of Payments and International Investment Position Manual (BPM6), which was released by the International Monetary Fund (IMF) in 2009 and follows the fifth edition (BPM5) released in 1993. The BPM6 provides the standard framework for the compilation of statistics on transactions (balance of payments – BOP) and positions (international investment position - IIP) between an economy (individual country, currency union (such as the Euro Area) or economic union (such as the European Union) and the rest of the world. The BPM6 provides and explains concepts, definitions, classifications and conventions for BOP and IIP statistics, enhances international comparability of data through promotion of internationally adopted guidelines and shows the links to other macroeconomic statistics in order to promote consistency between different statistical domains. The BPM6 is consistent with the European System of National and Regional Accounts (ESA 2010) and the System of National Accounts 2008 (2008 SNA), which set the statistical framework for national accounts, and with the fourth edition of the Benchmark Definition of Foreign Direct Investment (BD4) of the Organisation for Economic Co-operation and Development (OECD), which provides additional guidelines for foreign direct investment (FDI) statistics.

The BPM6 reflects changes that have occurred in the global economy since 1993. This period has been characterized by a significant growth in cross-border activity due to removal of trade barriers and capital controls. International corporate structures have become increasingly complex with global value chains, financial linkages and ownership structures. Cross-border financial flows have also substantially risen due to the dynamic growth in the international capital markets. Globalization led to new policy challenges and underlay many changes introduced by the BPM6. Because the transaction volumes often account for only a part of the stocks, the positions are often more useful as an indicator of the external financial situation of the economy. This has been reflected in the new title “Balance of Payments and International Investment Position Manual”, which indicates the growing relevance of IIP.

Sign convention
The BPM6 brings the use of signs in the BOP in line with the national accounts. In the current account and capital account, both credits and debits are presented with a positive sign (even though some exception can occur). In the financial account, the headings have been changed from “credit” and “debit” to “net acquisition of financial assets” and “net incurrence of liabilities”. The new terminology and sign convention for the financial account are consistent with those for the IIP, i.e. a positive sign represents an increase, and a negative sign represents a decrease, in the asset or a liability to which it relates. Thus, for “net acquisition of financial assets” in the financial account of the BOP, a plus sign denotes a net increase in financial assets, while a minus sign refers to a net decrease in financial assets.

The net is calculated as net acquisition of financial assets - net incurrence of liabilities and may be positive or negative.

The net balance on financial account has the opposite sign in the BPM6 compared to the BPM5 (e.g. a net inflow in the financial account is represented with a minus sign in the BPM6, whereas it has a positive sign in the BPM5).

Nomenclature changes
In general, the ESA 2010/2008 SNA institutional sector and financial assets/liabilities classifications and labels are adopted (e.g. “bonds and notes” and “money market instruments” are replaced, respectively by long-term and short-term debt securities). Term “net lending/net borrowing” is now used for the sum of current and capital account balances or the total net financial account (which should be identical; if not, the existence of net errors...
and omissions is signalled). The term “primary income” is introduced in the BPM6 and corresponds to the BPM5 concept of “income” plus some current transfers’ items (taxes on production and imports, subsidies and rents), while the term “secondary income” corresponds broadly to “current transfers” in the BPM5. These changes make the BPM6 consistent with national accounts. The functional category “financial derivatives” is renamed “financial derivatives (other than reserves) and employee stock options”, as employee stock options are recognised as a separate financial instrument. “Trade credit and advances” replaces the term “trade credits” to better reflect its content. The term “reinvestment of earnings” is used in the financial account to distinguish it from “reinvested earnings”, which continues to be used in the primary income account. In the services account BPM5 item “transportation” is renamed as “transport”, and “charges for the use of intellectual property not included elsewhere” replaces the term “royalties and licence fees”. The term “economic ownership” is introduced in the BPM6. Economic ownership takes account of where the risks and rewards of ownership lie and a change in ownership from an economic point of view means that all risks, rewards, and rights and responsibilities of ownership are transferred. In general, a change in “legal ownership” also involves a change in economic ownership but in some cases, a change of “economic ownership” takes place even though the “legal ownership” remains unchanged (e.g. financial leases or transactions between a mother enterprise and its foreign branches).

Methodological changes introduced by the BPM6
Goods and services account
The goods and services account is very extensively affected by the introduction of the BPM6. Some of the major amendments are described below.
Net export of goods under merchanting
In the BPM6 merchanting activity, where a resident trades in goods (buys then sells) with nonresidents outside of the domestic economy, is to be classified under goods transactions within credits (exports); so debits (imports) of goods under merchanting are classified as negative exports. Difference between sales and purchases is recorded in goods exports as “net exports of goods under merchanting”, which means reclassification from services comparing with the BPM5 where any difference between the value of the goods when acquired under merchanting and their value when sold was entered as exports in “merchanting and other trade-related services”. In the case where these goods were kept in inventories from one period to the next, the purchase of goods under merchanting was included in merchandise imports, and the same amount deducted from imports (as negative imports) in the period in which the goods were sold.
Manufacturing services on physical inputs owned by others
In the BPM5 transactions related to goods undergoing processing by an entity other than the owner were included on a gross basis in “goods for processing” in the goods account. In the BPM6, this imputation is eliminated and the only the earnings received for the processing services are included in “manufacturing services on physical inputs owned by others”. Trade in goods is recorded only when the goods change economic ownership, not when they are physically shipped to an economy for processing without a change in economic ownership. For economies where inward or outward processing is relevant, there could be quite significant change in their trade balances and possibly also in the current account. The treatment in the BPM6 will reduce gross exports and imports of goods, and will increase exports or imports of services, with the increase in services equal the value of the processing services performed.
Financial intermediation services indirectly measured (FISIM)
Financial corporations provide some financial services to borrowers and lenders (depositors) for which they are compensated indirectly. Actual interest can be seen as including both an income element (“pure” interest) and “an indirect charge” for services (FISIM). In the BPM5, the FISIM component was not recorded separately from actual interest and was therefore not included in financial services, but instead in the income account. In the BPM6, FISIM are calculated for loans and deposits vis-à-vis some financial corporations and allocated to the
services account. The “pure interest” component of actual interest (excluding the financial intermediation service charge) is still recorded in the primary income account (income account in BPM5) under both the BPM5 and the BPM6.

Other changes

Repairs on goods are to be classified in the BPM6 as a service under “maintenance and repair services n.i.e.” and not under goods. High value goods acquired by travelers are to be recorded as merchandise goods rather than under travel services. The BPM5 service category “communications services” no longer exists under BPM6, its subcomponent “postal and courier services” moved to “transport” and “telecommunication services” moved to “telecommunications, computer and information services”.

Compilation of “insurance and pension services” under the BPM6 is more complex than it was under the BPM5. Insurance claims are now changed to adjust for “claim volatility”, which attempts to correct for deviations from a longer-term view of claims behaviour due to exceptionally large claims arising in the short term (catastrophes). “Premium supplements” (investment income earned on assets designated to meet insurance company liabilities to policyholders) are now also taken into account in deriving insurance services. In the BPM6, non-life insurance and reinsurance are treated consistently, while in the BPM5, exports of reinsurance services were, in principle, estimated as the balance of all flows occurring between resident (non-resident) reinsurers and non-resident (resident) insurers. Financial dealers’ margins are clearly presented as a service charge in the BPM6, while its treatment was not specified in the BPM5. Dealers or market-makers in financial instruments may charge for their services, in full or in part, by having a spread between their buying and selling prices. The difference between the reference price and the dealer’s buying price at the time of purchase represents the service charged to the seller. Similarly, the difference between the reference price and the dealer’s selling price at the time of sale represents the value of the service provided to the buyer. The reference price is usually a mid-price between the buying and selling prices.

The results of research and development, such as patents, copyrights and industrial processes, are treated as produced assets and included in research and development services, while under the BPM5 they were treated as non-produced assets and shown in the capital account. This approach is consistent with the ESA 2010/2008 SNA methodology in national accounts.

Primary income account

Main changes in primary income are inclusion of income on reverse investment and investment between fellow enterprises, with income arising from reverse investment to be recorded on a gross basis, rather than net basis, as well as the recording of reinvested earnings on investment funds shares. In the BPM5, only actual income distributed on investment funds shares to their owners was recorded in the income account. Non-distributed income affected the international investment position through the revaluation account. In the BPM6, all income generated by investment funds shares is recorded as attributable to shareholders, either as actually distributed income (dividends) or reinvested earnings. In practice, the treatment of the income generated by investment funds shares is similar to that on foreign direct investment.

Other amendments concern: i) the clarification in the concept of superdividends (exceptional payments to shareholders that are made out of accumulated reserves) and the extension of their treatment as withdrawals of equity (instead of income distribution); ii) the timing for recording dividends, which changes to “ex-dividend date” (from “as of the date payable”); iii) the adjustment of interest income to remove the financial intermediation services changes indirectly measured component, with “pure interest” remaining; iv) the recording of interest on special drawing rights (SDRs) on a gross basis, with the introduction of responsibilities/liabilities for SDR allocations; v) income on reserve assets to be identified separately (previously other investment) and vi) rent and taxes and subsidies on products and production to be included explicitly as primary income items.
Secondary income account
The BPM6 introduces the concept of “personal transfers”, which includes all current transfers in cash or in kind between resident households and non-resident households, independent of the source of income and the relationship between the households. The BPM5 concept of “workers’ remittances” is part of personal transfers and may be presented as supplementary, “of which” item. Secondary income is also affected by changes arising from the enhanced coverage of current transfers on pension contracts and standardised guarantees.

Capital account
In a world of increasingly mobile individuals there are several modifications included in the BPM6. The residence of households is to be based on “predominant center of economic interest,” while cross-border movements of personal effects (such as bank balances or real estate ownership) during migration are no longer to be recorded as transactions but as reclassifications in “other changes in volume” in the IIP, given that no actual transaction takes place. In the BPM5, transactions were imputed when persons changed residence. There are also some changes to non-produced, non-financial assets, namely “patents and copyrights” which are no longer included (they are classified as produced assets and appear under research and development services), while internet domains are identified as possible economic assets. Debits and credits for acquisitions and disposals of non-produced non-financial assets are to be recorded separately, not netted. Insurance claims may be treated as capital transfers in the case of catastrophes.

Financial account – direct investment
The most relevant change in transactions in foreign direct investment (FDI) is the move from “directional principle” concept to the “assets/liabilities” concept in the standard presentation. This increases both the net acquisition of financial assets and the net incurrence of liabilities. Investment between fellow enterprises is also added in the BPM6. The concepts of direct investor and direct investment enterprise remain broadly unchanged, whereas “fellow enterprises” are those entities under the control or influence of the same immediate or indirect investor, but which do not control or influence each other (i.e. they are not themselves in a direct investment relationship). Insurance technical reserves are included in FDI (debt instruments), while all debt transactions (including the BPM5 concept of permanent debt) between affiliated financial corporations (deposit-taking, investment funds and other financial intermediaries except insurance corporations and pension funds) are excluded from FDI transactions. New presentation has an impact on total (acquisition of) assets and (incurrence of) liabilities but it does not have an impact on net FDI (transactions and positions). However, the recognition of investments between “fellow enterprises” will have some impact on net FDI.

Financial account – other changes
Assets/liabilities concept in the standard presentation concerns all functional categories in the financial account. Transactions in portfolio investment are mostly affected by the “reinvestment of (undistributed) earnings” on investment funds shares, which in the BPM6 affects the IIP via transactions and not via “revaluations” as in the BPM5. In the BPM6, interest income is adjusted to remove the financial intermediation services charges indirectly measured component, with “pure interest” remaining. This methodological change has an impact on transactions (accrued interest) in deposits and loans recorded in the other investment category. New allocations (or cancellations) of SDRs are now recorded as “net incurrences of liabilities” by monetary authorities in other investment. Transactions in other equity not included in direct investment (e.g. equity participations in international organisations) are now identified separately in other investment.
**International investment position**
Several assets and liabilities are added to the system, which therefore has a direct effect on the international investment position. The new "gross" presentation of foreign direct investment (FDI) has a major impact on the IIP, whereby financial investment assets and liabilities (reverse investment) are presented separately, i.e. not netted out as prescribed under the directional principle (BPM5 standard). In addition, investment between fellow enterprises has now been introduced, while in the BPM5 it was spread across the other functional categories, depending on the nature of the investment.

New financial assets and liabilities are added to the system; namely, allocated special drawing rights as a liability of central banks (monetary authorities), and pension entitlements and provisions for calls under standardised guarantees.

**BPM6 impact on the major aggregates (goods and services account, current account, capital account and financial account transactions and international investment position)**
In general the impact of the introduction of the new, BPM6-based methodology on the main aggregates/balancing items is expected to be limited for both the EU aggregates and individual Member States.

The overall balance of goods and services is not expected to change substantially, but on the individual accounts (goods and services separately) the changes will have a considerable impact, mostly because of the new treatment of merchanting, goods for processing and research development services, as well as the treatment of financial intermediation services changes indirectly measured (impacting services). The balance of primary income will mostly be affected by the new treatment of undistributed income attributable to holders of investment funds shares and reclassification of FISIM to services. The balance of secondary income should remain broadly unchanged. As majority of changes in current account concern reclassifications among its sub-accounts, the impact of introduction of the new methodology on total net current account should be minor.

The capital account balance will change, mostly because of the new treatment of migrants’ transfers (which are recorded as reclassifications in ‘other changes in volume’ in the IIP) and patents and copyrights (which are recorded as research and development services). The financial account will be affected by transactions in the new financial assets and liabilities (not expected to be substantial), as well as by the new treatment of reinvestment of earnings in investment funds shares.

In the international investment position, in addition to the new assets and liabilities, the recording of foreign direct investment on a “gross” basis will result in substantial increases in both assets and liabilities, although the net IIP is not affected by this change.