

Loewendahl, Henry

Research Report

A new foreign direct investment accounting methodology for economic development organizations

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Editor-in-Chief: Karl P. Sauvant (Karl.Sauvant@law.columbia.edu)

Managing Editor: Maree Newson (mareenewson@gmail.com)

A new foreign direct investment accounting methodology for economic development organizations

by

Henry Loewendahl*

Governments and international organizations use the International Monetary Fund (IMF) and Organisation for Economic Co-operation and Development (OECD) accounting method to measure and report on foreign direct investment (FDI) flows and stocks. The IMF/OECD method recommends defining FDI as 10% or more foreign equity in a local entity. The United Nations Conference on Trade and Development measures FDI performance as a country's share of global FDI relative to its share of gross domestic product.

There are approximately 10,000 economic development organizations (EDOs), including investment promotion agencies, in the world with a remit for investment promotion.¹ Government expenditures worldwide for attracting FDI are an estimated US\$50 billion a year.²

Because FDI is critical for economic development and a significant amount of taxpayers' money is being spent on attracting FDI, this raises a key question: how are EDOs accounting for FDI?

The author consulted with national and subnational EDOs in developed and developing countries and with international organizations involved in FDI. Ten common elements in EDO accounting methods were identified:

1. Mandate to promote greenfield FDI only.
2. Announced FDI is recorded, not only realized investment.
3. Focus on FDI projects, jobs and capital investment not FDI flows.
4. Capital investment defined as the total amount the company is investing, even if the capital is raised locally.
5. FDI defined as more than 50% foreign equity.

6. The location of the ultimate parent firm's headquarters is recorded as the source country.
7. Qualification that announced investments will take place through evidence that the company will make the investment and has started the investment process.
8. Validation over time that announced investments have been realized.
9. Recording the role of the EDO in securing the project.
10. Assessing the quality of investment attracted, typically based on size of projects, average salaries and research and development and headquarters operations.

While there is homogeneity in the common elements in FDI accounting, every EDO does it differently. Most EDOs have developed accounting methods ad-hoc or not at all.

As the official IMF/OECD accounting method is not designed for investment promotion, there is a clear need for an internationally accepted FDI accounting method for EDOs. As one EDO from a developing country put it: "Most EDOs do not know the criteria that should be used for the qualification of FDI successes or for evaluating their role in the success." Another EDO from a developed country stated that: "If the government is going to give you \$10 million you need to show the return on investment."

I propose therefore a standardized accounting method for EDOs to attract greenfield FDI based around eight key areas:

1. **Company information:** Company name; type (public/private); percentage foreign equity; origin country of the ultimate parent.
2. **Project details and status:** Project type (new/expansion/merger and acquisition/joint venture); project status (announced/opened); description of the project.
3. **Location and sector information:** Location of the investment down to site address; the International Standard Industrial Classification sector code or similar for each project, together with the business function.
4. **Investment and employment:** Total capital investment and jobs to be created within three years; validation of investment and jobs over time.
5. **Qualification that announced investments will happen:** Evidence from investors that their projects will happen (project information; business plan; an official press release or written declaration) and/or that the investment process has started (company registration; proof of a real estate transaction and recruitment).
6. **Evidence of EDO involvement in securing the investment:** Inbound enquiry from EDO marketing activities; meeting the companies and providing business case information or an incentives package *before* companies announced their investments; organizing site visits for companies; providing services to help facilitate their investment.
7. **Quality of investment:** The technology level of each project using international definitions; average salary levels; identifying strategic projects that are high tech and have high levels of investment and job creation.

8. **Return on investment:** Key metrics are cost per project, cost per job and the investment multiplier relative to EDO budgets. Return on investment of incentives should also be calculated.

By adopting a uniform accounting methodology for greenfield FDI, EDOs would have a framework for how to record and measure such FDI, organizational performance and return on investment. If EDOs publish their FDI results, FDI trends and EDO performance could be compared consistently across and within countries.

The accounting method can be further developed for EDOs that have a mandate to promote other types of FDI (e.g., by measuring safeguarded jobs in the case of acquisitions) and to encompass a wider evaluation of the direct and indirect impact of FDI.

* Henry Loewendahl (henry.loewendahl@wavteq.com) is CEO of WAVTEQ Limited. The author is grateful to Maria Borga, Magnus Runnbeck and Mira Wilkins for their helpful peer reviews. **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 Author's estimate.

² Including investment promotion budgets, incentives awarded to foreign investors and investor development (training, skills, R&D, infrastructure, utilities, supplier development). See www.incentivesmonitor.com for volume of incentives.

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For further information, including information regarding submission to the *Perspectives*, please contact: Columbia Center on Sustainable Investment, Maree Newson, mareenewson@gmail.com.

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