THE BALANCE OF PAYMENTS AND INTERNATIONAL INVESTMENT POSITION: BPM6 IMPLEMENTATION

1. Introduction

Belgium's balance of payments (BOP) is the statistical reflection of the economic and financial transactions between residents and non-residents of Belgium over a set period of time. Up to the reference year 2013, it was compiled in Belgium according to the precepts of the "Balance of Payments Manual – Fifth edition" (BPM5) published in 1993 by the International Monetary Fund. In 2009, the IMF published a new version entitled "Balance of Payments and International Investment Position Manual - Sixth edition" (BPM6). The title was altered to highlight the international investment position (IIP) as an autonomous statistic in addition to the balance of payments. The international investment position reflects the value of the assets and liabilities between residents and non-residents at a given moment in time. BPM6 was compiled in response to certain economic developments that arose after the publication of BPM5. It also clarifies some of the rules set out in BPM5. Furthermore, in BPM6 the level of detail is much higher

BPM6 was drafted in parallel with the System of National Accounts (SNA 2008), i.e. the international standards for establishing the national accounts, with ESA 2010 being the latest European version, which enabled them to be harmonised. Many differences between BPM5 and ESA 1995 in terms of concepts and definitions have been tackled, which leads to greater consistency between the national accounts and the balance of payments. This will facilitate the comparison of the two statistics in the future.

2. Current account

In BPM5, the current account consists of the goods account, the services account, the income account and current transfers. The most obvious change introduced in BPM6, apart from the fact that there are a lot more details, is the disappearance of the "current transfers" component. This item has been largely integrated into the new component "secondary income". The existing income account has therefore been renamed "primary income account".

The current account balance has not undergone any major changes, but reclassifications between the goods, services and income accounts impact the balance of these components.

2.1 **Goods**

Production processes are becoming increasingly widely spread over several countries in order to optimize the use of the available factors of production. This increased globalisation is also reflected in BPM6. To avoid unnecessary inflation of trade flows, the principle of transfer of ownership as the criterion for the registration of imports and exports of goods is applied more strictly in the new Manual than in BPM5. This amendment impacts on the registration of goods for processing, of maintenance and repairs transactions and of merchanting transactions. Goods for processing and maintenance and repair services have been reclassified from the goods account to the services account. Merchanting transactions have been reclassified from the services account to the goods account.

Merchanting refers to the purchase of goods by a resident from a non-resident, followed by the resale of these same goods to another non-resident. At no time do the goods actually cross the territory of the merchant. It is a transfer of ownership of the merchandise. Under BPM5, the difference between the sales value and purchase value of these goods is recorded in the services account, when it is really just a transfer of ownership. This discrepancy is corrected in BPM6 where merchanting is recorded in the goods account. In addition, the purchases and sales of these goods are recorded on a gross basis. The purchases of the goods are recorded as negative exports and the sales of the goods are recorded as positive exports. The net export of the goods under merchanting is the difference between the sales and the purchases. In net terms, there is a difference (albeit minimal) between goods under merchanting according to BPM5 and according to BPM6 because BPM5 took inventories into consideration[1]. This is no longer the case in BPM6.

The goods account in the balance of payments is still based on foreign trade statistics, but adjustments are necessary to meet the requirements of BPM6. For example, processing is recorded as a services transaction according to BPM6, whereas it is still recorded as a goods transaction in foreign trade statistics.

2.2 Services

2.2.1 Manufacturing services on physical inputs owned by others (processing)

From a statistical point of view, processing is defined as manufacturing services on goods that do not belong to the manufacturer. Despite the absence of any transfer of ownership, in BPM5 transactions involving processing were recorded as imports and exports of goods. This corresponds to the foreign trade statistics approach which records the value of the merchandise each time it crosses the border. In BPM5, the actual criterion for recording imports and exports of goods is therefore considered to be border crossing. For this reason, the value of the goods before and after processing is recorded in imports and exports of goods, which tends to inflate trade flows. This problem is addressed in BPM6. Since the principle of transfer of ownership is applied more rigorously, only the processing fee is recorded, in this case under imports and exports of services. Moreover, instead of resorting to flows of goods from the foreign trade statistics for the valuation of processing, from now on the valuation of the processing fee will mainly be based on fees collected by the balance of payments surveys on services trade. This change of data source impacts the statistics, leading to a difference between processing under BPM5 and processing under BPM6. The BPM6 implementation has also been utilized to make a few adjustments to improve the quality of the data on processing for the period 2008-2013.

2.2.2 Maintenance and repair services

Similar to processing, BPM5 recorded repairs and maintenance as goods transactions, with the difference that only the fees have been recorded, and not the value of the goods before and after the repair or maintenance. In BPM6, this exception to the transfer of ownership principle is also removed and these transactions are regarded as a service. Instead of using the fees for repair or maintenance as indicated in the foreign trade statistics, the repair or maintenance fees will be mainly based on the fees as collected in the balance of payments surveys on services trade. These fees are in line with the BPM6 methodology. The use of this new source leads to a slight difference between the amounts calculated for repairs and maintenance under BPM5 and under BPM6.

2.2.3 Financial services

The financial services heading contains an important new item. Under BPM5, only costs that are explicitly charged had been recorded under this heading. According to BPM6, costs charged

[1] If the goods had not been sold in the same period, the purchase of goods was not recorded as merchanting on the grounds that this gave rise to a negative commercial margin. BPM5 did not allow this, but BPM6 does.

implicitly must also be included. These charges include asset management costs taken out of income and financial intermediation service charges indirectly measured (FISIM).
Asset management costs taken out of income are the amounts that are automatically and contractually levied on investment income as remuneration for the management of the fund. To compute these management fees, every year an average annual rate of the management costs is estimated on the basis of the annual accounts of resident fund managers. This percentage is also used as a proxy of the rate charged by non-resident fund managers. The percentage is applied to the average amount held by non-residents in resident funds (export of services) and to the average amount held by residents in non-resident funds (import of services).

FISIM are the margins between interest paid and a reference interest rate for loans and deposits (the interbank rate). Financial institutions offer their depositors interest rates that are lower than those they charge to their borrowers. These FISIM are consistent with the FISIM computed in the national accounts.

These two new components influence the services account balance, but they are offset in the primary income account, so the impact on the current account balance is theoretically nil. In practice, however, there is an impact on the current account balance because in our BPM5-BOP, the data recorded in the primary income account was already BPM6-compliant as regards to asset management costs taken out of income, but these had not yet been offset in the services account.

2.2.4 Research and development services

Under BPM6, research and development (R&D) services also comprise outright sales and purchases of the results of R&D [2]. In BPM5, these sales and purchases were registered in the capital account.

2.2.5 Other

There are a few other reclassifications and new subdivisions in the services account under BPM6. For example, postal and courier services are included in transport services according to BPM6, whereas they were recorded as communication services in BPM5. These are just reclassifications between subcomponents, with no impact on the services account balance. The services account is also shown in more detail under BPM6 than it was under BPM5.

2.3 **Primary income**

Under BPM5, the primary income account was called the "income account". According to BPM6, the primary income account encompasses primary income flows between residents and non-residents. This entails the compensation for the supply of labour, the provision of financial assets and for the renting of natural resources

The recording of interest is affected the most in the implementation of BPM6. It is no more the interest paid that is recorded, but the "pure" interest, which does not include any service component, i.e. FISIM and asset management costs taken out of income. The implicit service remuneration is recorded in the services account whereas under BPM5, it was not treated separately but was included in the interest from investment income.

Furthermore, since direct investment is recorded on a gross basis according to the asset/liability principle[3] under BPM6, the associated income flows are recorded on a gross basis, instead of on a net basis as under BPM5. This does not impact the primary income account balance.

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[2] See Capital account (3).

[3] See Financial account (4).

In addition, taxes and subsidies on products and production are recorded in the primary income account and no longer in the current transfers as was the case under BPM5.
Lastly, the primary income account is also more detailed under BPM6, than under BPM5. In particular, direct investment income and portfolio investment income is broken down by instrument.

2.4 **Secondary income**

The "current transfers" heading in BPM5 has been renamed "secondary income" in BPM6 and comprises transfers of income. The content of the heading remains the same, apart from taxes and subsidies on products and production. These are no longer regarded as a current transfer, but as primary income. Furthermore, in BPM6 the amounts paid for transfers of sportsmen are explicitly identified as non-produced non-financial assets, moving them from current transfers to the capital account.

3. Capital account

The capital account has two subdivisions: acquisitions and disposals of non-produced non-financial assets, on the one hand, and capital transfers, on the other. These two subdivisions are kept on in BPM6, but the content of acquisitions and disposals of non-produced non-financial assets has been altered. In BPM6, R&D results (for example, patents and copyright) are no longer treated as non-produced assets, but as produced assets. Therefore, the sales and purchases of these assets are no longer recorded as capital transactions, but as services transactions (more specifically: R&D services). In BPM6, R&D results are clearly distinct from other assets, such as trademarks and logos. The latter are still treated as non-produced non-financial assets, the same goes for CO_2 emissions rights, green certificates and combined heat and power certificates.

Under BPM6, the heading "acquisitions and disposals of non-produced non-financial assets" also includes transfers of sportsmen. Before, these sums were recorded as current transfers.

4. Financial account

The financial account is made up of foreign direct investment (FDI), portfolio investment, other investment, financial derivatives and reserve assets. The main change introduced to the financial account by BPM6, concerns the way in which direct investment is recorded.

4.1 **Direct investment**

According to BPM5, direct investment is recorded according to the directional principle and subdivided into direct investment coming into the Belgian economy (*inward FDI*) and direct investment flowing out of the Belgian economy to the rest of the world (outward FDI). *Inward FDI* covers all assets and liabilities between resident direct investment enterprises and their non-resident direct investors. Conversely, *outward FDI* comprises all assets and liabilities between resident direct investors and non-resident direct investment enterprises.

Under BPM6, FDI is recorded according to the asset/liability principle. The concepts *inward FDI* and *outward FDI* are no longer used. All the assets are recorded under assets and all the liabilities under liabilities, regardless of the direction (inward or outward) of the direct investment relationship. Three types of direct investment relationships are identified: investments of direct investors in direct investment enterprises, reverse investments[4] and investments between associated companies. Under BPM5, this distinction is not visible since all these types of investment are netted and

[4] The term "reverse investment" is used when a direct investment enterprise invests less than 10 % in its direct investor. If it invests more than 10 %, it is considered a direct investment relationship.

included in *inward FDI* or *outward FDI*. For example, according to the directional principle (BPM5) a loan granted by a Belgian direct investment enterprise to its French parent company is recorded in the *inward FDI* heading, thus reducing the net balance of this heading. According to the asset/liability principle (BPM6) the gross value of this transaction is recorded, since there is no more distinction between inward or outward FDI. It is recorded as a "reverse investment", on the asset-side.

This new recording method inflates the gross flows, but does not impact the balance of the financial account.

Under BPM6, subordinated loans and bonds of affiliated financial corporations[5] are no longer recorded as direct investment, but as other investment (loans) and portfolio investment (bonds). This new way of recording subordinated loans influences the balance of both direct investment and other investment, but the overall impact on the financial account balance is nil. The new recording for subordinated bonds also influences the balance for direct investment, as well as the financial account balance because the portfolio investment balance remains unchanged[6].

4.2 Portfolio investment

The breakdown of portfolio investment is much more detailed in BPM6 than in BPM5, but the balance of this item remains the same. As mentioned in paragraph 4.1, under BPM6 subordinated bonds of affiliated financial corporations are recorded as portfolio investment and no longer as direct investment. This shift impacts the balance of direct investment, but the balance of portfolio investment remains unchanged because, in BPM5, the Belgian data recorded under portfolio investment were already in line with the BPM6 requirements.

4.3 Other investment

As regards other investment, BPM6 requires the allocation of special drawing rights (SDR) to IMF members to be recorded. BPM5 did not recognise these allocations as transactions, so they were recorded as capital gains in the IIP, but they were not included in the balance of payments.

As mentioned in paragraph 4.1, subordinated loans of affiliated financial corporations are no longer recorded as direct investment under BPM6, but instead as other investment.

4.4 Reserve assets

In reserve assets, the effect of BPM6 is limited to reclassifications between headings and a new subdivision of a subgroup, with no effect on the total.

4.5 Other

Apart from the above-mentioned changes, the entire financial account is presented in a more detailed way under BPM6 than it was under BPM5 with regard to the sectoral classification and the breakdown between short term and long term.

5. New sign convention

BPM6 introduces a new sign convention for the financial account. An increase in assets and liabilities is shown with a positive sign and a reduction in assets and liabilities with a negative sign. The balance of the financial account is equal to assets minus liabilities. In BPM5, an increase in

[5] With the exception of captive financial institutions and money lenders, insurance corporations, pension funds and financial auxiliaries.

[6] See portfolio investment (4.2).

assets and a reduction in liabilities were expressed with a negative sign, and a reduction in assets and increase in liabilities with a positive sign. The financial account balance was thus calculated by adding up assets and liabilities. The financial account balances under BPM6 and under BPM5 have opposite signs. This new sign convention should help avoid any confusion for users.

6. International investment position

The implementation of BPM6 does not result in major alterations of the international investment position. All the changes regarding the financial account of the balance of payments apply to the IIP. Direct investment is thus recorded according to the asset/liability principle, inflating the gross amounts, although without an impact on the balance. However, the recording of the allocation of special drawing rights to IMF members in the BOP has an impact on the IIP balance. Whereas BPM5 only takes assets into consideration, under BPM6, these allocations must also be recorded as liabilities, a method that leads to an increase in liabilities and a reduction of the net IIP.

Owing to a wider sectoral classification, the IIP is more detailed under BPM6 than it was in BPM5.

BPM6 provides a more transparent link between the IIP and the financial flows in the balance of payments. The IIP for period t consists of outstanding amounts at period t-1 plus financial transactions in the balance of payments and any other variations registered during period t. Under BPM5, it was not necessary to identify these other variations, which made any direct comparison between the IIP and the financial transactions in the balance of payments rather difficult. Under BPM6, these other variations are identified separately and are subdivided into revaluations due to exchange rate fluctuations and revaluations due to price fluctuations.

7. Changes unrelated to BPM6 changes

The switchover to BPM6 has provided an opportunity to make several other adaptations in order to improve the quality of the data.

7.1 **New survey on imports and exports of natural gas**

In April 2013, a specific survey was introduced to measure transactions involving natural gas (gaseous, not liquid, state) between residents and non-residents. The objective of this monthly survey is to exclude transit transactions to get a better idea of long term contract prices and the exact country of the counterparty. As of the reference year 2014, these data are used in the balance of payments to replace those from the foreign trade statistics.

7.2 **Update of insurance services ratios**

For estimating insurance services in the balance of payments, ratios are applied to premiums paid or received as declared in the surveys on services. The ratios determine the breakdown of these premiums between the services account, on the one hand, and the financial account (for life insurance and pension services) or current transfers (for all other insurance), on the other hand. These ratios have been updated and the method of calculation has been slightly adjusted, in accordance with ESA 2010. The inclusion of premium supplements is a new factor in the calculation method. This concerns income generated from investment of technical reserves. Under BPM5, this income did not have to be taken into consideration but, under BPM6, it has to be included in the calculation of insurance services. The ratios are considerably different from the previous ratios because they are based on more recent data, fostering greater consistency in this area between the balance of payments and the national accounts.

Since the ratios determine the breakdown of premiums between the services account and the financial/current transfers account, updating them impacts the balance of the different accounts. In the case of non-life insurance, there is an increase in the services account and a reduction of current transfers. Regarding life insurance and pensions services, there is a reduction in the services account and an increase in the financial account.

These new ratios have been used for all the publications under BPM6.

7.3 New source for outstanding insurance technical reserves

For all publications in accordance with BPM6, outstanding insurance technical reserves as published in the financial accounts will be incorporated in the other investment heading of the IIP. Previously, these amounts were estimated by accumulating the flows recorded in the balance of payments.

7.4 New calculation method for income from direct investment: dividends and reinvested earnings

Income on investments recorded in the balance of payments had in the past been compiled in a macroeconomic framework as part of the National accounts. The revenue and expenditure recorded for a given year had been estimated on the basis of the various components of the international investment position. The estimation procedure consisted in determining a reference yield by instrument, mainly based on interest rates, stock market trends and exchange rates. This annual result was then broken down over the different months using a seasonal pattern which relied on a historical analysis.

As far as income from direct investment (more specifically: dividends and reinvested earnings) is concerned, from 2013 onwards, a more microeconomic type of approach was developed to maximise the use of the direct reporting of resident enterprises companies. It concerns data relating to dividends and reinvested earnings.

The reported dividends received and dividends paid are examined individually if they exceed a certain threshold. Some exceptional transactions may be considered as “super-dividends”. Super-dividends should not be recorded in the income account, but in the financial account, as an increase or reduction of equity. The IMF states: “exceptional payments by corporations to their shareholders that are made out of accumulated reserves or sales of assets should not be treated as dividends” (BPM6, paragraph 11.27). Owing to the use of micro data there is an increase in the quality of the statistics.

The adjustment stated above is implemented from 2013 onwards, which causes a statistical break in the time series

Concerning reinvested earnings, past practice involved using the reinvested earning of the previous year as a proxy. This approximation led to significant biases and major revisions. It was decided to also use the microeconomic approach from now on, so as to compile more up-to-date statistics more rapidly than before.