Recording reinvested earnings in balance of payments statistics

Summary

Like any macroeconomic statistics, balance of payments statistics are also prepared in compliance with a set of international methodological standards. These broad conventions ensure the consistency of sectoral statistics (such as balance of payments statistics) with each other and with national accounts, as well as their comparability across countries. One of the most important conventions is accrual-based accounting. With the balance of payments, in particular, this means that the time for recording transactions is linked to the change in ownership of real and financial assets, or the date of the occurrence or extinction of claims and liabilities.

With regard to harmonisation, the Monetary Council of the Magyar Nemzeti Bank decided in September 2002 that it would introduce international methodological principles in two stages starting in 2003 and 2004. 2003 saw a methodological shift with regard to trade in goods, which was followed by changes to income accounting in 2004.

> As regards accounting for trade in goods in the balance of payments, the MNB abandoned the use of cash accounting data obtained from financial statements by companies and credit institutions, and switched to a method based on customs statistics, which reflects on the actual movement of goods. In customs statistics, transactions are registered at the customs frontier – this feature is in closer harmony both with the accrual-based approach and international practice. (Further information about the changes is available on the MNB's website at:
> http://www.mnb.hu/dokumentumok/fm_modszertan_2003_en.pdf

From 2004, income on debt has been recorded progressively, replacing the disclosure of actual payments, in the quarterly current account in line with the accrual-based approach.

Similarly, in view of the publication of 2003 data in March 2004, reinvested earnings from direct investment have also been included in the balance of payments statistics compiled by the MNB. This will eliminate the difference (deriving from the absence of reinvested earnings in earlier statistics) between national accounts income and financial accounts on the one hand, and balance of payments statistics, on the other.

The inclusion of reinvested earnings in the balance of payments is a standard requirement in international statistical methodology. In the majority of OECD countries, including the EU Member States, the current practice of recording reinvested earnings is consistent with the principles of international accounting methodology.

Prior to 2004, reinvested earnings were not included in income on direct investment in Hungarian balance of payments statistics. Only dividend payments were recorded in the current account as direct investment income on equity. Moreover, stock data on direct investment were derived by cumulating flow data.

After discussions with the CSO, the MNB introduced its quarterly and annual questionnaire survey of corporate direct investment in 1999.[1] The dissemination of such data is stipulated by the Act on Statistics and implemented as part of the National Data Collection Programme. Apart from recognising reinvested earnings, direct data provision by companies allows for the replacement of stock data, calculated by cumulating flow data, with stock data reported by enterprises.

Revision of the time series according to the new methodology will go back as early as 1995.

This document presents international methodological requirements considered in laying the foundations for the new practice in Hungary. In this context, Appendix 1 compares, through a simplified example, the balance of payments compiled using the old and the new methodologies, and then enumerates the differences. We will also look at the process whereby corporate direct investment questionnaire responses are transformed into data applicable to balance of payments statistics. Since comparable data series have been recalculated going back to 1995, when such questionnaires did not exist, it also describes the method for estimating data from 1995–1998, based on information gathered from corporate tax returns. The study also gives a description of the estimation method used to calculate income data recorded in the balance of payments in a particular year prior to the availability of questionnaire information. Although the primary purpose of the document is to describe the new statistical methodology, some concluding remarks will also be included using new balance of payments and stock data. The remarks are then placed in an international context in Appendix 2.

Recording reinvested earnings will alter the data source and structure of the balance of payments. In addition, the Bank's practice of data publication and revision will have to be adjusted to the availability of data from direct investment questionnaires, and that of adjusted data from corporate tax returns.

Overall, having analysed the data, it may be concluded that, as a result of the new methodology, the recorded current account deficit is higher over the entire period. This is, first of all, ascribable to the fact that net income accruing to direct investors (after-tax profits), (which, with the registration of reinvested earnings, will be recognised as income on equity) is higher than dividends actually paid recorded so far as income in the current account. Secondly, direct investment in Hungary is far in excess of that by Hungarian residents abroad. Indeed, recording income in accordance with international practice will show a stronger presence of foreign capital in the Hungarian economy in terms of explicit equity investment, insofar as non-resident owners' income, reinvested into the enterprise based on their decision, is also recorded as an increase in equity. The increase in reinvested earnings is an indication of foreign investors' positive attitude towards the Hungarian economy – they continuously retain part of their earnings in resident enterprises in addition to the original investment.

[1] The questionnaires are available (in Hungarian) on the MNB's web-page at http://www.mnb.hu/dokumentumok/vegl_OSAP_2004_k9.pdf (pp. 203-247, reports M19-M22).

Table 1 **Changes in the current account due to recording of reinvested earnings**

Title	Corporate tax declarations				FDI questionnaires				
	based data								
	1995	1996	1997	1998	1999	2000	2001	2002	2003
	Euro million								
Current account balance (publ.)	**-1240**	**-916**	**-578**	**-1977**	**-2301**	**-3152**	**-1967**	**-2771**	**-4166**
Dividends and distributed income, credit	9	17	14	17	12	31	22	28	36
Dividends and distributed income, debit	158	207	391	809	799	855	888	1077	814
Dividends and distributed income, net	-149	-190	-377	-792	-787	-824	-867	-1050	-778
Current account balance (rev.)	**-1266**	**-1408**	**-1812**	**-3026**	**-3531**	**-4380**	**-3613**	**-4900**	**-6488**
Reinvested earnings and dividends, credit /1	20	15	20	12	-9	75	16	53	68
Reinvested earnings and dividends, debit /1	116	698	1631	1870	2027	2145	2555	3211	3291
Reinvested earnings and dividends, net	-96	-683	-1611	-1859	-2035	-2069	-2539	-3158	-3223
Change in FDI equity income (rev.-publ.)	**53**	**-492**	**-1234**	**-1067**	**-1248**	**-1246**	**-1672**	**-2108**	**-2444**
Tax on dividends (current transfers)	n.a.	n.a.	n.a.	n.a.	36	42	52	69	61
Other revisions	-79	0	0	17	-18	-25	-26	-90	61
	percent								
Current account balance (publ.)/GDP	**-3.6**	**-2.5**	**-1.4**	**-4.7**	**-5.1**	**-6.2**	**-3.4**	**-4.0**	**-5.6**
Current account balance (rev.)/GDP	**-3.7**	**-3.9**	**-4.5**	**-7.2**	**-7.8**	**-8.6**	**-6.2**	**-7.0**	**-8.7**
Change (rev.-publ.)	**-0.1**	**-1.4**	**-3.0**	**-2.5**	**-2.7**	**-2.4**	**-2.8**	**-3.0**	**-3.1**
o/w: caused by recording of reinvested earnings	**0.2**	**-1.4**	**-3.0**	**-2.5**	**-2.8**	**-2.5**	**-2.9**	**-3.0**	**-3.3**

/1 If credit or debit < 0, than total after tax income is negative.
2003 reinvested earnings figure is estimate.

From what has been said above it follows that the importance of disclosing reinvested earnings does not, in effect, lies in accounting for reinvested earnings itself. Rather, it is necessary because it is the only way to account for corporate income in the balance of payments and the related IIP statistics. As long as only dividend payments appeared as income, it was obvious that the income actually earned by direct investment enterprises and hence invested capital were underestimated. (As regards direct investment by residents, this connection does not materialise in actual figures, due to the difference between the currency of recording in earlier statistics and that used in book-keeping. As a result, the effect of recording reinvested earnings is offset by revaluation caused by exchange rate changes. For further details, see subsequent sections.)

From an economic point of view, accounting for reinvested earnings does not affect actual developments in the external equilibrium of the national economy. However, it provides a more accurate picture of the role that foreign direct investment plays in the Hungarian economy, the size of the resulting income and how that income is distributed. The resulting higher current account deficit stems from the nature of recording reinvested earnings. Nevertheless, the higher current account deficit is always financed automatically and, consequently, it does not require additional financing. This also implies that the current account is no longer the only relevant external balance indicator.

Furthermore, the questionnaire-based survey will also change direct investment stock data as compared with the data published so far. Cumulated transaction data, the stock data generated so far, will be replaced by questionnaire data based on corporate balance sheets. Therefore, apart from reinvested earnings, the revision of stock data may also be explained by the replacement of the data source. The values of shares and other equity as well as other investment both in Hungary and abroad will change significantly. As regards equity capital, there will be substantial changes at national levels in stock data for both outward and inward investment.

Table 2 shows stock data for direct investment accounted for using the old and the new methodologies.

Table 2 **Stock of FDI equity capital and reinvested earnings as of end-year (Euro million)**

In Hungary	1994			1995			1996			1997		
	Published	Revised	Change	Published	Revised	Change	Published	Revised	Change	Published	Revised	Change
A. Central Bank	0	0	0	0	0	0	0	0	0	0	0	0
B. General government	0	0	0	0	0	0	0	0	0	0	0	0
C. Other monetary institutions	57	481	423	168	624	456	281	871	590	778	1 203	424
D. Other sectors	5 728	5 755	27	9 236	7 386	-1 850	10 599	8 318	-2 281	12 320	13 059	739
Total	5 785	6 235	450	9 404	8 010	-1 394	10 880	9 189	-1 691	13 099	14 262	1 163

In Hungary	1998			1999			2000			2001		
	Published	Revised	Change	Published	Revised	Change	Published	Revised	Change	Published	Revised	Change
A. Central Bank	0	0	0	0	0	0	0	0	0	0	0	0
B. General government	0	0	0	0	0	0	0	0	0	0	0	0
C. Other monetary institutions	986	1 297	311	1 220	1 419	199	1 361	1 650	289	1 582	2 073	491
D. Other sectors	12 973	14 010	1 037	15 313	18 319	3 006	16 968	19 399	2 431	19 523	23 470	3 947
Total	13 959	15 306	1 347	16 533	19 738	3 205	18 328	21 048	2 720	21 104	25 543	4 439

In Hungary	2002			2003		
	Published	Revised	Change	Published	Revised (estim.)	Change
A. Central Bank	0	0	0	0	0	0
B. General government	0	0	0	0	0	0
C. Other monetary institutions	1 637	2 402	765	1 973	2 850	877
D. Other sectors	21 719	27 251	5 532	20 523	28 227	7 703
Total	23 356	29 653	6 297	22 497	31 077	8 580

Abroad	1994			1995			1996			1997		
	Published	Revised	Change	Published	Revised	Change	Published	Revised	Change	Published	Revised	Change
A. Central Bank	86	86	0	87	87	0	55	55	0	26	26	0
B. General government	50	0	-50	53	0	-53	54	0	-54	58	0	-58
C. Other monetary institutions	8	3	-6	12	7	-5	13	8	-5	27	21	-6
D. Other sectors	96	108	11	233	123	-110	278	151	-127	551	387	-163
Total	240	196	-44	385	217	-168	400	214	-187	661	434	-227

Abroad	1998			1999			2000			2001		
	Published	Revised	Change	Published	Revised	Change	Published	Revised	Change	Published	Revised	Change
A. Central Bank	30	30	0	30	30	0	31	31	0	9	0	-9
B. General government	56	0	-56	61	0	-61	94	0	-94	105	0	-105
C. Other monetary institutions	32	28	-3	69	46	-23	66	45	-22	61	58	-3
D. Other sectors	907	524	-383	1 244	734	-510	1 838	1 251	-586	2 295	1 617	-678
Total	1 025	582	-443	1 404	810	-594	2 029	1 326	-703	2 471	1 675	-795

Abroad	2002			2003		
	Published	Revised	Change	Published	Revised (estim.)	Change
A. Central Bank	9	0	-9	10	0	-10
B. General government	104	0	-104	77	0	-77
C. Other monetary institutions	125	108	-17	228	202	-26
D. Other sectors	2 227	1 800	-427	2 953	2 699	-253
Total	2 465	1 908	-557	3 268	2 901	-366

Between 1994 and 2003, direct investment by non-residents went up by 500%, while the value of residents' foreign investment in euro terms surged by 1,500% over the same period. Based on earlier data, growth over the same period was 400% and 1,400%. Valuation of stock data that is consistent with international practice recorded a higher-than-earlier level (cumulated from settlement data) of direct investment in Hungary. The opposite goes for foreign investment by residents – in the new methodology the recorded

stock value is lower compared with earlier stocks derived from settlement data. The reason behind that is that the shift to the new questionnaire-based data often resulted in a change of currency used in accounting for investment, and thus changes in the revaluation element of changes in stocks related to exchange rate movements.

Chart 1 **Stock of FDI equity capital in Hungary**

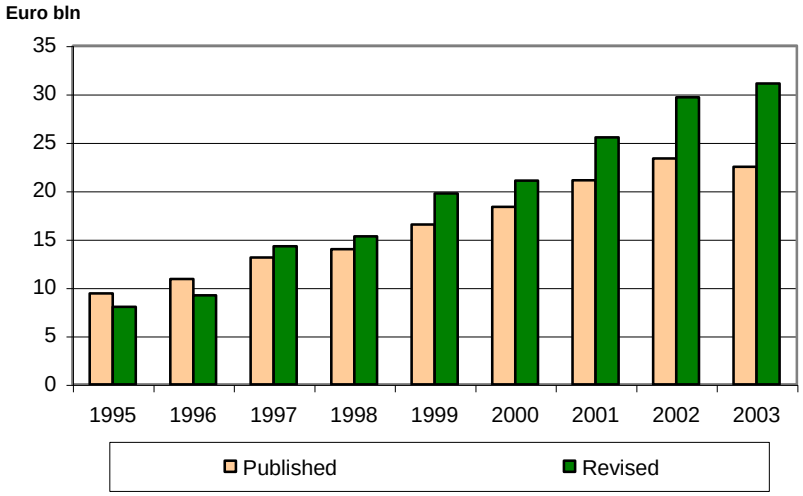
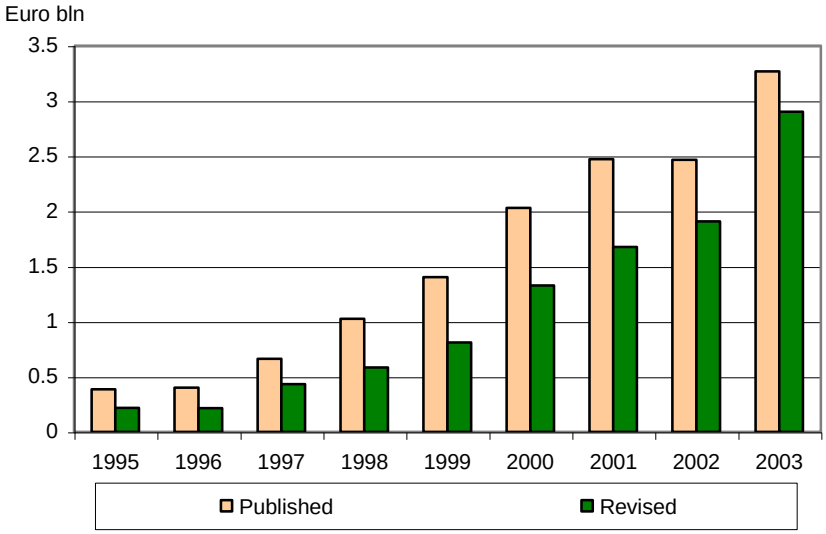


Chart 2 **Stock of FDI equity capital abroad**



1. Recording reinvested earnings in the balance of payments

As a general rule based on international methodological recommendations, the level of income accruing on direct investment in the current account depends solely on the income (which may even be negative) generated in a given year. However, this has nothing to do either with owners' decisions regarding the amounts of dividends to be paid (which only affects the distribution of income) or actual dividend payments.

Reinvested earnings are calculated as after-tax profit realised in a given year (which may be either positive or negative) less dividends declared payable for the same period. Dividends may not only be approved vis-à-vis profits earned within the given period; consequently, reinvested earnings may even be negative,[2] reflecting the fact that income repatriated from the company has been raised (lowered) by the owners at the expense of equity. (As a result of the accounting technique employed, i.e. the same sum appears with opposite arithmetic sign when accounted as dividends in one hand and as reinvested earnings on the other hand, the income balance remains unaffected by the owners' decisions concerning the distribution of earnings.)

The income category

International standards define two largely distinct approaches, depending on how corporate income is measured – income may (i) incorporate all components of profit e.g. exchange rate gains and losses, or loss related to the deduction of claims[3] or (ii) exclude such and rely solely on ordinary profits.[4] International methodologies recommend the latter approach.

However, for practical reasons the majority of EU Member States still compile statistics using the former approach, as the accounting-based information available to central banks provides no room for extrapolating the desired elements of profit. For similar reasons, the MNB has adopted the same approach.

Recording income on equity as part of direct investment in the balance of payments statistics requires the following information properly allocated in a given accounting period:

(i) the size of the after-tax profit (or loss) made by the company set up as a direct investment enterprise (ii) the timing and size of dividends declared payable by the investors (iii) the dividend tax payable and (iv) the timing of the actual dividend payment.

The responses given to questions on 'timing' help to identify the accounting period i.e. the period in which the transaction in question is to be disclosed in the balance of payments (see numerical example given in Appendix 1). Consequently:

- Direct investors' after-tax profit (or loss) must be recorded as reinvested earnings in the balance of payments of the year in which it was actually earned.[5]
- Dividends must be recorded as an income component in the period in which they are declared payable. Taken together, a clear distinction is made between profit as a benefit of the company's operation and dividend emerging as a result of the owners' decision. Dividends declared payable lower reinvested earnings for the given year in

[2] If the enterprise is loss-making, reinvested earnings are negative, regardless of owners' decision on dividends to be paid.
[3] All inclusive concept.
[4] Current operating performance concept.
[5] Such information becomes only available after the end of the financial year, i.e. with several months' delay. In the current practice the vast majority of companies in Hungary publish their balance sheet and profit and loss account at the end of May, accordingly, the deadline for returning the questionnaires has been set for the end of June. Balance of payments statistics inclusive of reinvested earnings for a given year may only be complied subsequently (in September of the year following the given year). (By contrast, earlier statistics relied on estimated data.)

the current account and the financial account. Dividend distributed yet unpaid also represents a short-term liability vis-à-vis the investor; therefore, in the financial account of the balance of payments it is accounted for under other capital within direct investment.

- After investors have distributed after-tax profits, they must pay dividend tax on the dividend declared payable. Since the tax is paid by the enterprise, general government's claim vis-à-vis the investor is replaced by the enterprise's claim vis-à-vis the investor in the financial account, as opposed to (tax) revenue recorded as current transfer.

- When dividend is paid, the actual amount transferred equals dividend declared payable net of dividend tax . Hence, both the liability (arising as a result of the distributed, but unpaid dividend) and the claim vis-à-vis the investor (i.e. dividend tax paid to the general government) becomes extinct. In other words, at the payment stage no current account component exists, the two legs of the transaction only affect the financial account.

Recording corporate after-tax profits as reinvested earnings shows how direct investment affects the current account balance through income account. However, the owners' decision concerning distribution of income (except for the indirect effect of dividend tax) and the actual payment of dividends have no effect on the current account balance, that is, they do not affect the savings and investment relationship in the national economy.

Balances complying with international recommendations may be drawn up on a yearly basis, following assessment of the questionnaires filled in using corporate balance sheet and profit and loss account data. Data reported with some delay will be replaced by (i) the adoption of balance sheets and profit and loss accounts as the closing event of the business year, or (ii) estimates for corporate profitability and the distribution of income included in statistics released prior to assessment of the information based on such statements.

International practice

Recording reinvested earnings in the balance of payments is a standard requirement in international statistical methodology. The table below shows that in the overwhelming majority of OECD countries, including EU and EMU Member States, the current practice of recording reinvested earnings is consistent with the principles of international methodology.

Distribution of countries in terms of accounting for reinvested earnings

	Reinvested earnings are recorded on		Recorded
	inward FDI	outward FDI	when they are earned
EMU-12			
yes	11	11	9
no	1	1	2
EU-15			
yes	14	14	11
no	1	1	3
OECD-30			
yes	28	27	23
no	2	3	6

Source: SIMSDI, Survey Results – OECD Countries
BOPSY 2003

BOPSY = Balance of Payments Statistics Yearbook (IMF)
SIMSDI = Survey of Implementation of Methodological Standards for Direct Investment (OECD, IMF)
http://www.imf.org/external/pubs/ft/fdis/2003/fdistat.pdf

2. The accounting system to be introduced from 2004

In agreement with the CSO, in 1999 the Magyar Nemzeti Bank introduced a questionnaire-based survey to monitor direct investment by resident and non-resident enterprises. The Bank's intention with the survey was to record reinvested earnings consistent with international statistical methodology. An additional goal was to make available data related to direct investment transactions by non-residents in Hungary and by Hungarian residents abroad on the basis of corporate balance sheets, instead of data aggregated on the basis of transactions. This is the precondition for producing not only direct investment flows for the purposes of statistical analysis, but also to produce stock data in a breakdown by country and sector, and also to be able to record cross-participation[6] consistent with international statistical methodology.[7]

> The quarterly questionnaires provide an opportunity (i) to monitor FDI transactions which do not entail cash movement, (ii) to collect more detailed data than settlements data and (iii) to check banks' settlements used to compile balance of payments statistics. The annual questionnaires on stock data, in turn, serve to collect data in full harmony with enterprises' annual balance sheets and profit and loss accounts, for example, to accurately record the capital stock and to determine the amount of reinvested earnings. As the annual questionnaires are important for recording reinvested earnings and producing

[6] Cross-participation is a situation in which an economic agent, into which the original investment was made, obtains a lasting interest in an investor. If the amount of this investment reaches or exceeds 10%, then it is recorded as direct investment in the statistical data, according to the direction of the transaction (direct investment in Hungary or abroad). Direct investment has been shown the Hungarian balance of payments statistics in the past. However, if cross-participation does not reach 10%, then the transaction and the stock of direct investment both are recorded on the rows according to the direction of the original investment transaction, as a claim on the principal investor (actually, the amount of original direct capital investment is reduced by the amount of cross-participation). Such transactions have been recorded under portfolio investment in the past.

[7] The questionnaire-based survey only covered enterprises; and the corporate tax returns also only include data on the sector. In the balance of payments, real estate holdings continue to be derived from cumulated settlement data.

stock data, in the following we discuss the relevant aspects.

Based on the responses to the corporate questionnaires, the MNB will release data consistent with international recommendations on Hungary's balance of payments and the related statistics on the country's international investment position on 31 March 2004, at the time of releasing the annual data for 2003. The Bank has produced Hungary's balance of payments and international investment position containing the stock and flow data for direct investment in accordance with the new methodology in a comparable format back to 1995. As, based on the corporate questionnaires on direct investment, data are only available from 1999, the Bank has estimated the relevant data for the period preceding 1999. The Bank has used enterprises' data from the APEH's corporate tax return database as well as publicly available information on enterprises quoted on the stock exchange to produce data for direct investment by non-residents in Hungary in the period 1995–1998. For this period,in the absence of other meaningful information, the Bank continues to rely on settlements data produce stock data on direct investment by Hungarian residents abroad.

3.1. Steps of processing questionnaires on direct investment capital

Creating and maintaining registers; defining samples

It is a fundamental issue from the perspective of the entire survey to create and maintain the proper corporate register. From the perspective of direct investment, the most important criterion of determining the range of entities to be monitored[8] is foreign ownership of at least 10% or more of the equity capital.

In choosing the sample within the population, the Bank has included those enterprises in the annual register of foreign direct investment transactions by non-resident investors in Hungary up to 2001, in the registered capital of which the holdings by non-residents amounted to at least HUF 100 million. From 2002, the criterion for choosing the sample has been investors' equity, instead of registered capital, and the minimum amount of direct holdings has been raised to HUF 300 million. The basis for compiling the register has been the list produced on the basis of corporate tax returns for the year preceding the reference year. The Bank has supplemented this list with the list of enterprises that are not included in the register but have been identified on the basis of bank settlements data used to compile the balance of payments. Each year, some 1800–2000 enterprises are entered into the register.

The Bank monitors the full rage of enterprises quoted on the stock exchange, irrespective of minimum holding criteria. Except building societies, the Bank does not request credit institutions to provide data, as any required information may be extracted from other reports provided to the Bank.

The underlying list of applications for direct investment abroad, subject to reporting for the period prior to 2001, has served as a basis for compiling the register of residents direct

[8] Off-shore firms are not taken into account in recording reinvested earnings; their transactions in direct investment capital is shown on a net basis in the balance of payments and their stock data are generated by cumulating such transactions. The CSO follows a similar approach in compiling the national accounts and other data on direct investment.

investors abroad. The Bank is continuously supplementing this list with enterprises, meeting the minimum holding criteria, which have been identified on the basis of bank settlements data used to compile the balance of payments. As a consequence of foreign exchange liberalisation, from 2001 the basic source of maintaining the register has been banks' transactions . Those enterprises have been entered into the register, in which the amount of total direct investment reached at least HUF 10 million. In respect of direct investment by residents abroad, credit institutions are also required to report, as the Bank has no data available from other sources on reinvested earnings and equity capital of their foreign subsidiaries. Capital invested by enterprises within the value limit accounts for almost the entire stock of FDI capital abroad.

Comparing questionnaire data with other data sources

From January 2002, the database corporate tax returns, making it possible to identify firms, has also been available for the Bank's Statistics Department for statistical analysis. Also from that time, there has been an opportunity to compare data reported for resident direct investment capital in the Bank's questionnaires and corporate tax returns. Erroneous reports can be eliminated by comparing data provided by enterprises reporting their direct investment capital and included in the database for corporate tax returns. The Bank has not been able to use external, additional information to check its own calculations of direct investment abroad.

Producing whole-economy data using the questionnaires

The Bank only requests the most important ones of the 20,000–25,000 enterprises operating in Hungary with foreign equity participation. The questionnaires are sent out to approximately 1,800–2,000 enterprises annually.

In projecting data for the total economy, the Bank uses the questionnaires on direct investment capital as a starting point. To this the data on enterprises in which, according to the tax return database, the equity capital holdings by non-residents reach 10% but no investment capital questionnaire is available for the firms in question (or the Bank has not requested to provide data, or the firm has not returned the questionnaire) and is not included in the lists of deleted enterprises.[9] The sum of these two data sets gives the amount of shareholders' equity, after tax profits and dividends accounted for the non-resident investor.[10]

The corporate tax returns only provide information on the size of non-resident equity capital holdings on an aggregate basis, rather than by investor. Consequently, in the case of enterprises for which the Bank does not have a direct investment questionnaire, and it cannot segregate direct investment from portfolio investment within non-residents' direct equity holdings reaching at least 10%, such data may contain portfolio investment data as well.[11]

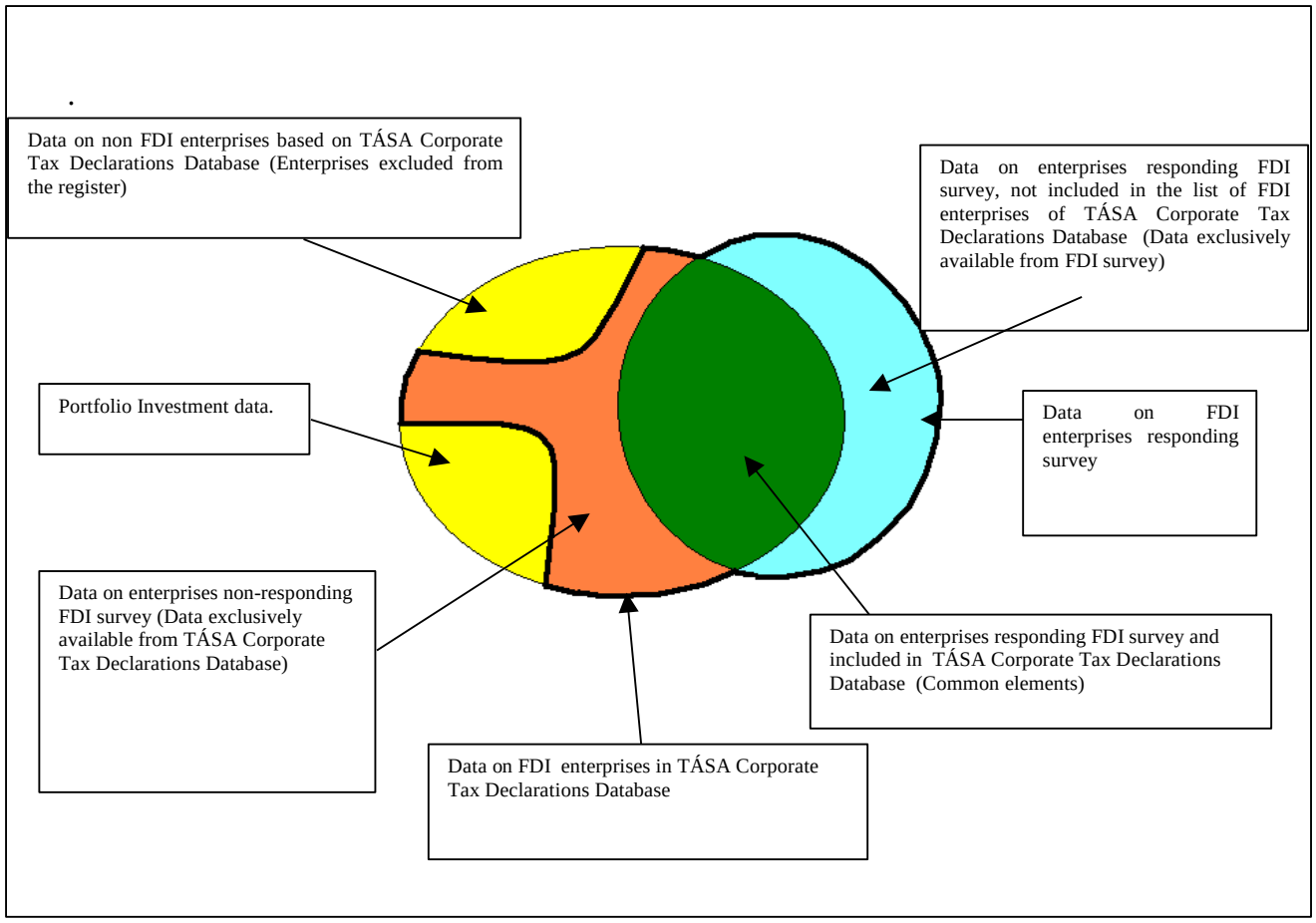
[9] The list of deleted companies contains those firms that, based on substantiated information, did not have a direct investor required to meeting the criterion of including in the sample at the end of the reference period, as a result of a transaction conducted in the reference period.

[10] If deleted enterprises are included in the tax return database, then such enterprises are not taken into account in defining the stock of direct investment (equity, after-tax profit and dividends).

[11] In the case of direct investment in equity, the statistical methodology distinguishes between obtaining a

The relationship among corporate tax returns, questionnaires on direct equity holdings and direct investment is plotted on Chart 3. (Direct investment is indicated by a thick line in the Chart.)

Chart 3



The amount of direct investment capital stock, derived from the corporate questionnaire), is supplemented 8%–9% by data on enterprises in the corporate tax return database, in which equity holdings reach at least 10%. (Only corporate tax return)

Changes in the structure and content of the balance of payments and international investment position

Recording reinvested earnings will change the structure in which the balance of payments

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lasting interest and a financial investment transaction. As a rule of thumb, a 10% ownership represents the division line between the two categories of investment in international practice. Transactions by and stocks of enterprises reaching this threshold are recorded as direct investment in the balance of payments, while those under 10% are recorded as portfolio investment. From the perspective of recording reinvested earnings, the two investment categories are treated differently in statistical methodology: unlike in the case of portfolio investment, reinvested earnings are only recorded on direct investment.

has been published so far and the contents of data.

In the current account, reinvested earnings will be recorded under a new row within direct investment income. In contrast with the financial account, where direct investment in Hungary and abroad is recorded in separate rows, according to the direction of direct investment flows, reinvested earnings will not be detailed according to direction. However, the accounting treatment will clearly show whether the income items in question are related to direct investment in Hungary or abroad. The reason for this is that all transactions in income related to direct investment in Hungary have to be recorded as debit entries, while those in income related to direct investment abroad are have to be recorded as credit entries. (Appendix 1 provides a numerical example of recording investment income according to the old and the new accounting approach.) Although distributed income has so far been recorded on a separate row, the contents of data recorded here will change with the shift to accounting for data on an accrual basis. In the future, income declared payable by direct investors as dividends will be recorded under reinvested earnings, in contrast with the current practice, whereby only actual dividend payments are recorded.

In the financial account, new rows will be introduced for direct investment transactions in both directions to record reinvested earnings. These rows will show the other leg of items recorded as income, in accordance with the principle of double-entry bookkeeping. By contrast, reinvested earnings will not be recorded separately within equity capital in the stocks of assets and liabilities in international investment position. The supplemented international investment position data will be included on the rows with changed headings under direct investment.

In calculating the stock of direct investment capital, we will shift from cumulating turnover data to record data on shareholders' equity as stated in the financial statements of the reporting enterprises, which also include undistributed and reinvested earnings.

In determining the end-of-year stock of shares and other equity and the other components of volume changes, the Bank has separated direct investment in quoted and unquoted enterprises for all observed sectors. In the former case, the Bank takes account of the value of direct investment on the basis of market value, while in the latter, it uses book values.

Equity capital as stated in the financial statements does not include dividends declared payable by owners at the time of accepting the management's report. However, in the balance of payments statistics, the stocks of reinvested earnings and, consequently, direct investment capital are only reduced by the same dividend in the following year. For this reason, the balance of payments statistics record direct investment enterprises' equity accounted for by foreign owners, increased by the amount of dividend decided, as end-of-year stock (adjusted shareholders' equity).

As for the outward direct investment by Hungarian residents, part of reporting firms could not provide data on the equity capital of the non resident direct investment enterprise. In such cases, the Bank has recorded as stocks the values as stated in the resident (reporting) enterprises' books. In calculating the whole-economy stock, the Bank has added to the results of the practically fully covered questionnaire-based survey for non-financial

enterprises and credit institutions the data for sectors not covered by the survey.

The method of producing data on foreign direct investment capital for the period 1995–2003

Methodology used between 1995–1998

In order to prevent the shift to accounting in accordance with international statistical methodology from causing a break in the time series, the Bank, in co-operation with the CSO, has produced, based on available information, comparable data going back to 1995.

The corporate tax return database has served as a source of after-tax profits accounted for by non-residents to estimate shareholders' equity and dividends as well as reinvested earnings accounted for by non-residents, required to calculate the stocks of direct investment capital.

The Bank has only been able to identify, on the basis of corporate tax return data, the enterprises that are owned more than 10% by non-residents; the same information is not available by direct investors. Consequently, the data on dividends and after-tax profits of enterprises owned by non-residents in excess of 10% also include portfolio investment data, in addition to direct investment data. The Bank has estimated the amounts of equity capital, dividends and after-tax profits, recorded under portfolio investment, be segregating quoted and unquoted firms, on the assumption that it is mainly quoted firms that engage in portfolio investment transactions. In the case of quoted companies representing a significant share form the perspective of the capital stock, the Bank has estimated the approximate amount of direct investment by segregating the various types of investors.

There is no alternative data source on outward investment by residents available which could be used to produce data for earlier period with the same data content as that of the questionnaire. Consequently, the Bank has made the assumption for the period in question that direct investment enterprises abroad has fully distributed their annual after-tax profits (with no reinvested earnings remaining), and dividends declared payable by the owners have been paid out in full. This means that, in the balance of payments, the Bank has recorded the same dividends declared payable as those recorded for the given year, which, in the Bank assumption, is equal to earnings recorded as after-tax profit for the previous year. Stock data, cumulated from balance of payments credits and debits, have been recorded as direct investment for the period 1995–1998.

Calculation method from 1999

Questionnaire data are available from 1999. The deadline for submitting responses to the questionnaire on direct investment capital for the reference year is 30 June of the year following the reference year. Consequently, the Bank reports estimates of (i) the after-tax profit component of reinvested earnings and, until the annual questionnaires, submitted in the reference year and filled in on the basis of operations in the previous year are processed, of (ii) dividends decided for the reference year. The Bank also estimates the amount of dividend tax for the reference year, projecting the average percentage share of dividend tax for previous years into the future. In September of the year following the

reference year, the Bank replaces the estimates of after-tax profit recorded in the balance of payments of the reference year and dividends declared payable in the year following the reference year with preliminary actual data derived as a result of the processed questionnaires.

Asset and liability data for the end of the reference year are also estimates. These are derived by taking account of all elements causing a change in stocks that have become available for the Bank, starting from the closing stock of actual data for the end of the previous year. Accordingly, the Bank records the effects of transactions, reinvested earnings and exchange rate gains/losses (exchange rate changes affecting enterprises that keep their records in foreign currency, and price changes affecting quoted companies) causing changes in stocks which have become available for the Bank. The closing stock derived using this approach is the estimate of closing stock for the end of the reference year.

Method of estimating reinvested earnings of direct investment enterprises

The Bank has calculated all types of income related to direct investment by non-residents in Hungary and by residents abroad in 2003 and 2004 as the averages of the indicators as a proportion of GDP for the previous three years (2000–2002). In calculating the absolute amounts, the Bank's official forecast of GDP has served as a basis. The quarterly data can be produced from the annual data, using the seasonal factors of GDP.

The method used in forecasting has been based on the following:

- It can be seen based on past data that the after-tax profits as a proportion of GDP of enterprises partly or wholly in foreign ownership have been broadly stable. This means that this category of enterprise is less exposed to various economic shocks. One explanation for this is that these enterprises are more active in hedging their foreign exchange risks, and that their propensity to take on risks is much lower. In addition, a major part of these enterprises enjoy reliefs from taxation; consequently, they are not exposed to income shocks resulting from changes in taxes. Finally, they are less exposed to fluctuations in fiscal transfers.
- The Bank has no information available on any future changes in ownership structures.
- Dividends declared payable are only partly dependent on after-tax profits – dividends mainly reflect owners' decision and so they cannot be related to other variables.
- Although, in the absence of meaningful information, the Bank has not been able to identify similar relationships between the various categories of income in the case of direct investment abroad, for practical reasons it has followed the simple and transparent procedure discussed above.
- In recording after-tax profits as reinvested earnings from the estimated annual data, the Bank has produced quarterly data on direct investment by non-residents in Hungary consistent with the seasonal pattern in GDP. The monthly data within

each quarter, in turn, have been produced by even distribution. The data are produced separately for credit institutions and other sectors, according to the rules of sector classification. In addition, quoted and unquoted companies are treated differently . Annual dividends are distributed over the first five months of the year, using the ratios as follows: 5%–5% of the annual data for January and February; 10% for March; 20% for April and 60% for May. Dividend taxes are recorded in the same breakdown as in the case of dividends declared payable.

- In respect of enterprises having shifted from the calendar year to business year accounting from 2001, the business data for the business year ended during the reporting year are recorded under the reporting year. In 2001, the registered capital and shareholders' equity of enterprises shifting from the calendar year to the business year accounting made up some 3% of the total stock of direct investment capital.[12]

3. Effect of recording reinvested earnings on Hungarian statistical data

- Only distributed dividends has so far been recorded as direct investment income on equity. Developments in distributed income over time and its amount and, accordingly, its effect on the current account balance has so far been the result of owners' decisions, governed by other considerations, rather than by development sin corporate profitability determined by economic processes.
- Except for 1995, recording reinvested earnings has resulted in higher current account deficits in each year. However, this change is only of technical nature, as the increase in current account deficit is financed automatically, and so it does not lead to additional external financing requirement.
- Recording after-tax profits accounted for by investor also includes accounting for any loss accounted for by investor. Losses in the reference year are recorded as a negative reinvested earnings credit (investment by residents abroad) and a debit (investment by non-residents in Hungary), which is financed by reinvested earnings from direct investment in the financial account. (Accordingly, in the balance sheet of the stock of external financial assets and liabilities the amount of reinvested earnings with a negative sign reduces the amount of direct investment capital.)
- After-tax profits for the reference year, do not constitute an upper limit for distributed dividends decided by owners. Parts of direct investment capital, contributed in earlier years in the form of reinvested earnings, can also be distributed as dividends even in a single year. The stock of reinvested earnings alone does not show the upper limit to the possible amount of distributed dividends, as this figure derives as the balance of losses and not yet distributed profits for earlier periods. This is explained by the fact that only enterprises generating profits may distribute any dividend. (On the whole-economy level, dividends may also be distributed if the aggregated profits of direct investment enterprises are negative, but there is at least one enterpris which has earned positive income.)

[12] The data on the tax returns of enterprises adopting the business year instead of the calendar year in accounting have not been available available for 2002; however, the equity capital of those firms as a proportion of direct investment capital which only filled in a questionnaire does not reach 5%–6%.

- The amount of dividends declared payable by direct investors in a given year may be different from income actually distributed. The time of profit transfer is mainly influenced by the firm's liquidity position and other economic considerations. This transfer is only recorded in the financial account.
- Except in the first two years, the amount of reinvested earnings has been fairly stable, fluctuating in a relatively narrow band as a proportion of GDP, being 2%–3% of it. As discussed earlier, the higher current account deficit caused by accounting for reinvested earnings derives from the particular method of statistical recording; and it is always financed automatically, and it does not require additional financing.

Chart 4 **Current account balance/ GDP**

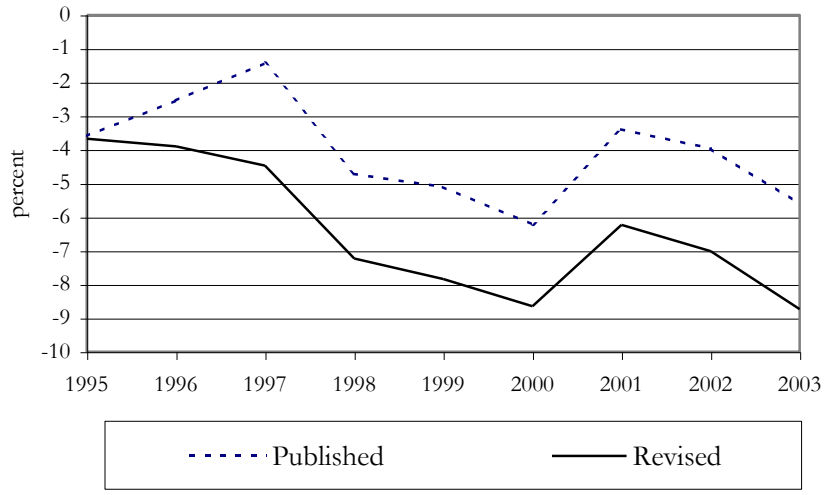


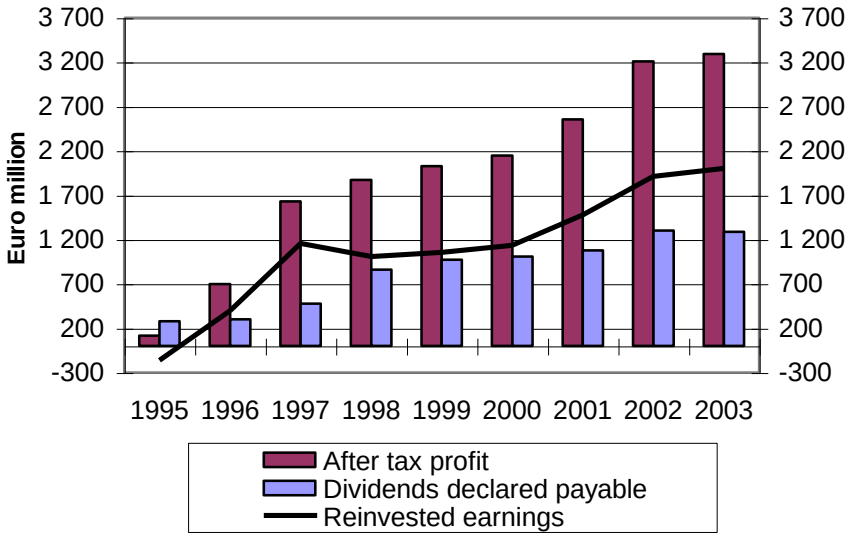
Table 3 **Current account balance/ GDP (percent)**

	1995	1996	1997	1998	1999	2000	2001	2002	2003
Published	-3,6	-2,5	-1,4	-4,7	-5,1	-6,2	-3,4	-4,0	-5,6
Revised	-3,7	-3,9	-4,5	-7,2	-7,8	-8,6	-6,2	-7,0	-8,7

As a consequence of the new accounting method, the stated current account deficit was higher each years, except in 1995. This is explained by the fact that (i) direct investment by non-residents in Hungary is substantially higher than that by Hungarian residents abroad and (ii) income accruing to owners (after-tax profits) is higher than the amount of dividends actually distributed. Recording income consistent with the international methodology highlights the fact that actual foreign direct investment in Hungary exceeds direct investment in equity capital, given that it may also be contributed as earnings which accrue to direct investors but retained in their resident enterprises as undistributed profits, based on their decision. Increasing reinvested earnings of direct investment enterprises reflect foreign investors' positive attitude towards the Hungarian economy, as they continuously retain a part of their earnings in their resident enterprises, in addition to the original equity capital investment.

Throughout the entire period from 1995 to 2002, non-residents retained some EUR 7,4 billion into their Hungarian enterprises from their earnings.

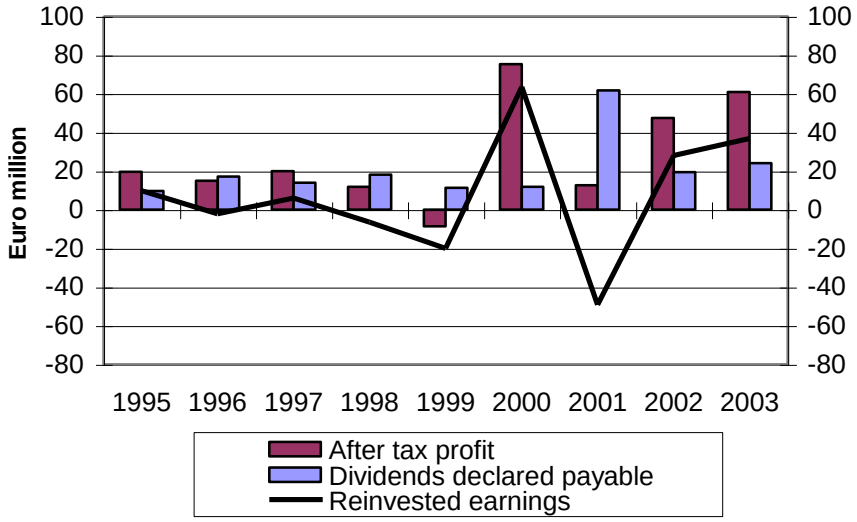
Chart 5 **Income on FDI equity capital in Hungary by components**



After-tax profits of non-residents' Hungarian direct investment enterprises have been rising more strongly than dividend declared payable by their owners. In the period between 2000–20023, reinvested earnings grew at an increasing rate.

Earnings of Hungarian residents' from their direct investment enterprises show a more varied picture. In 1999, even after-tax profits were negative. In 1998 and 2001, in turn, reinvested earnings were negative, as a result of the higher amount of dividends declared payable than the amount of after-tax profit. In the period under rewiev, resident investors retained some EUR 30 million from their earnings in their non resident direct investment enterprises.

Chart 6 **Income on FDI equity capital abroad by components**



At the whole-economy level, the stocks of direct investment in both directions are altered with the recording of reinvested earnings.

The stock of non-residents' direct investment in Hungary, as calculated according to the new method, is increasingly higher throughout the review period relative to the data published earlier. Under the new method, the amount of non-residents' direct investment equity capital in Hungary was nearly EUR 30 billion at the end-2002. (Calculated using the old method, the stock of direct investment equity capital was by EUR 6,3 billion lower. The effect of prices changes also contributed to the increase in stock in certain years, in addition to the effect of recording reinvestment earnings. In large part that includes the changes in prices of shares of quoted companies. (Price movements affected changes in stocks particularly strongly in 1997, 1999 and 2000.)

Due to the shift to the data derived from the questionnaire-based survey, the currency of recording direct investment changed in many cases. This contributed significantly to the decrease in the stock of direct investment abroad, calculated under the old method. Earlier, the Bank recorded direct investment transactions in the currency in which they actually occurred, instead of the currency in which the enterprise established abroad kept its books.[13]

Compiling stock data on the basis of the corporate questionnaires also makes it possible to break down the stock of direct investment by country and sector. (In charts other capital is excluded.)

[13] If , for example, a firm invested USD in Romania, then the original investment was recorded in US dollars and a currency gain was recorded in forints. By contrast, if the investment capital stock had been recorded in the Romanian currency, it would have fallen in forint terms.

Chart 7 **Stock of FDI equity capital in Hungary by countries of investors**

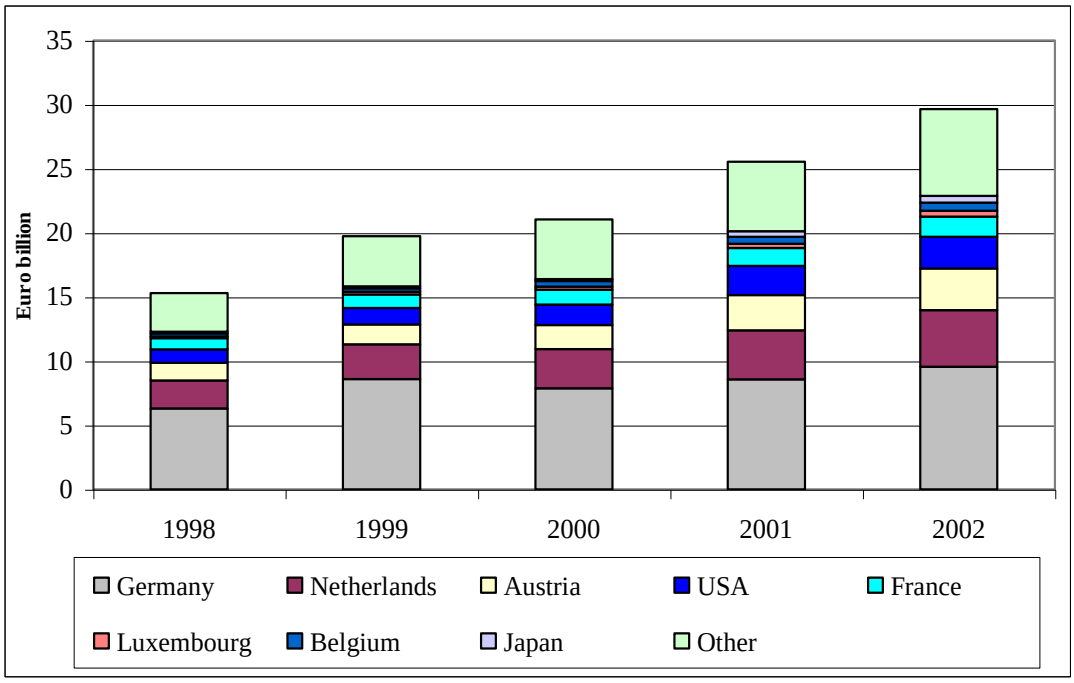
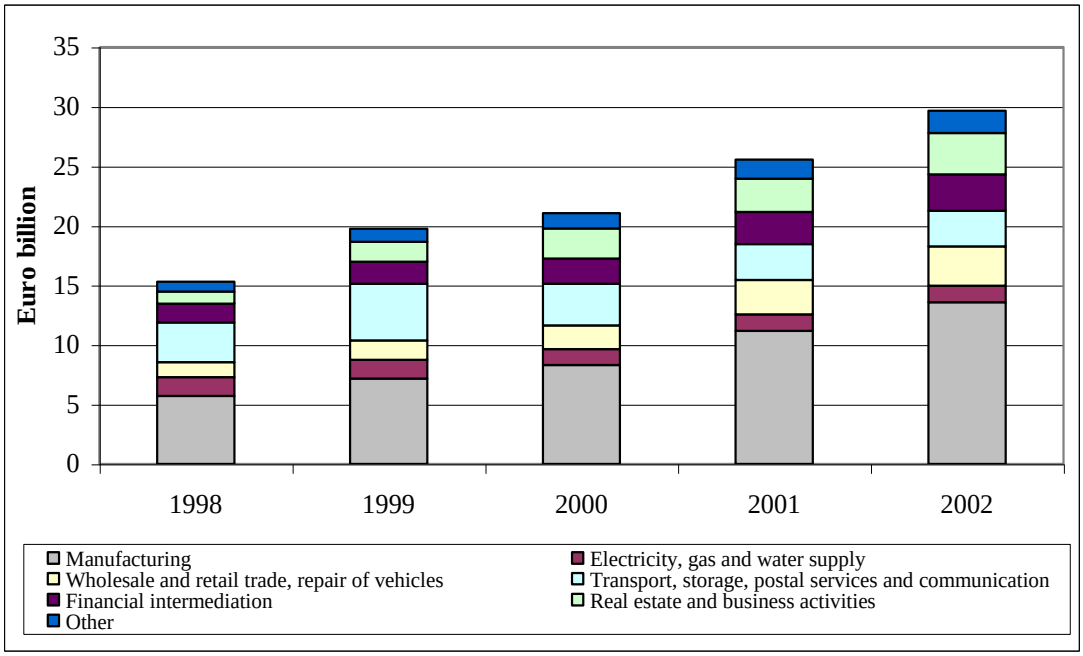


Chart 8 **Stock of FDI equity capital in Hungary by economic activity**



4. Impact of accounting for reinvested earnings on the publication and revision of data on direct investment

From 2004, accounting for reinvested earnings will be a component of the updated procedural rules, effective from 2004, for the publication and revision of balance of payments data. Owing to Hungary's accession to the EU, the process of the compilation of the balance of payments will be different from May 2004[14].

The last issue of the monthly balance of payments statistics (on April 2004) is due in June 2004. From then on, the MNB will no longer publish monthly data. Detailed balance of payments and the related stock data will be compiled and published quarterly, with a deadline of reference quarter + 90 days, in accordance with the current practice and international data reporting requirements.

In keeping with the data revision practice of the Intrastat system, balance of payments data for the previous two quarters will be revised at the time of releasing data for the reference quarter. Annual balance of payments data will be first released 9 months after the reference year. They will include final data on trade in goods and services as well as preliminary data on reinvested earnings. Annual balance of payments data will be first revised in 15 months after the end of reference period, in line with the publication of detailed statistics on direct investment (in a sectoral and country breakdown). No separate press release on balance of payments statistics will be published then. Only the changes brought about by direct investment will be recorded in the time series available on the Internet. Final data on reinvested earnings and the balance of payments including the stock of direct investment capital will be published 21 months after the reference period.

Brought about by the recording of reinvested earnings, changes in the revision policy will be first tangible in the publication due in September 2004. It will be the first time that annual balance of payments for 2003 data, to be released after 9 months following the reference period, and revised annual balance of payments data for 2002, to be released after 21 months following the reference period, have been published. The new policy of quarterly revision will be implemented for the first time in September 2004, when data on the preceding two quarters (i.e. 2003 Q4 and 2004 Q1) will be revised for the first time.

Budapest, March 31, 2004

[14] See also the press release of the MNB of January 5, 2004:
http://english.mnb.hu/dokumentumok/pressrelease0105_en.pdf

Appendix 1

The impact of the accounting for reinvested earnings in the balance of payments illustrated by aexample

Suppose that an enterprise only has foreign owners and that, in terms of its balance of payments, key data on a single year in operation in three consecutive years are as follows.

	Year 1	Year 2	Year 3
1. After-tax profit	100	0	0
2. Dividend (declared payable)	0	50	0
3. Reinvested earnings (1-2)	100	-50	0
4. Dividend tax	0	10	0
5. Dividend transferred (less dividend tax)	0	0	40

1. In keeping with the old methodology, nothing has been recorded in the balance of payments for year 1, as no dividend has been paid. In fact, foreign owners have earned 100 units, which, however, have been reinvested.

   According to the new methodology, a debit of 100 units is recorded in the current account as reinvested earnings under direct investment income on equity. The same amount, now as a credit, is recorded in the financial account as reinvested earnings under direct investment in Hungary.

   The current account deficit, which is higher than the deficit calculated under the old methodology, is thus automatically financed. As no additional financing has to be raised, international reserves are left unaffected. As a result, the country's debt does not increase either. There has been a rise of 100 units, however, in the stock of non-residents' investment in Hungary.

2. In keeping with the old methodology, no transactions have been recorded for year 2.

   Under the new methodology, the following entries have to be recorded in the current account: reinvested earnings, which is the difference between the amount of after-tax profit in year 2 and that of dividend declared payable in year 2, and dividend distributed in year 2, both as a debit under income on equity. Simultaneously with the distribution of dividend in year 2, non-resident investors incur a dividend tax liability vis-à-vis general government, which is recorded as current transfer (general government) credit. Recording suggests that the amount of dividend declared payable alone leaves the current account balance unaffected (except for the indirect effect of dividend tax). It only influences the distribution (reinvested earnings vs. dividend) of non-resident investors' earnings. Actually, only after-tax profit and dividend tax affect the balance of the current account. (If, based on its earnings in the reporting year, a company is loss making, then, supposing that everything else remains unchanged, the current account deficit will be lower when reinvested earnings are recorded, for non-residents' negative earnings will have to be recorded as debit.)

Thus, under the new methodology, the current account surplus amounts to a total of 10 units as a the balance of (i) reinvested earnings debit of -50 units, (ii) the debit of the dividend declared payable of 50 units and (iii) the credit of dividend tax of 10 units.

In the financial account a decrease in non-residents' direct investment in Hungary (reinvested earnings, debit) is recorded as an offsetting item to the reinvested earnings (correction) debit on income account.. A rise in liabilities vis-à-vis non resident investor (direct investment, other capital, credit) is recorded vis-à-vis dividends declared payable (direct investment income, debit). Because of the dividend tax liability, general government incurs other short-term claims, which are settled when resident companies pay the dividend tax payable by investors by the deadline set by the Hungarian Tax and Financial Control Authority. At that time, companies have claims vis-à-vis owners.

3. In accounting for year 3, loan liabilities [incurred as a result of the dividend declared payable, but not yet paid] and claims [arising from the payment of dividend tax] are settled when the dividend [less the amount of tax] is paid, with a simultaneous reduction in financial assets. In contrast with the way it used to be recorded in the balance of payments compiled under the old methodology, the payment of dividend is now recorded as an outright financial account entry, leaving the current account balance unaffected and, consequently, net external liabilities unchanged.

   Despite the difference in current account balance outcomes, changes in financial assets are identical in the balance of payments, either prepared under the new or the old method. They are equal to the amount of the dividend (net of tax) paid. Automatically financed by the corresponding financial account entries, higher current account deficit brought about by the recording of reinvested earnings warrants no additional funds. Thus, it does not affect external equilibrium (financing needs).

Recognition of transaction pairs in compliance with the principle of double-entry book-keeping

	Year1		Year2		Year3	
	CR	DR	CR	DR	CR	DR
Direct investment income						
Reinvested earnings		100		-50		
Dividends and distributed income				50		
Current transfers, Government sector			10			
Direct investment in reporting economy						
Reinvested earnings	100			50		
Other capital, Liabilities to direct investor			50			50
Other capital, Claims on direct investor				10	10	
Other investment						
ST assets, Government sector			10	10		
ST assets, Other sectors					40	

Changes in the stylised balance of payments under the old and new methodologies respectively

	Year1		Year2		Year3	
	paid basis	accrual basis	paid basis	accrual basis	paid basis	accrual basis
I. Current account	**0**	**-100**	**0**	**10**	**-40**	**0**
3.2. Direct investment income, net	0	-100	0	0	-40	0
3.2.1. Income on equity, debit	0	100	0	0	40	0
net	0	-100	0	0	-40	0
3.2.1.1. Dividends and distributed income, debit	0	0	0	50	40	0
net	0	0	0	-50	-40	0
3.2.1.2. Reinvested earnings, debit	–	100	–	-50	–	0
net	–	-100	–	50	–	0
4.1. Current transfers, General government, net	–	–	–	10	–	–
III. Financial account	–	**100**	–	**-10**	–	**-40**
8. Direct investment, net	–	100	–	-10	–	-40
8.2. In reporting economy, net	–	100	–	-10	–	-40
8.2.1. Equity capital, net	–	100	–	-50	–	0
8.2.1.1. Reinvested earnings, net	–	100	–	-50	–	0
8.2.2. Other capital, net	–	0	–	40	–	-40
8.2.2.1. Claims on direct investor, net	–	0	–	-10	–	10
8.2.2.2. Liabilities to direct investor, net	–	0	–	50	–	-50
10. Other investment, ST assets, net	0	0	0	0	40	40

The role of direct investment income on equity in selected countries

The manner in which reinvested earnings are recorded has been studied by analysing the balance of payments statistics in nine countries. Five of the nine countries selected for review, i.e. Finland, Greece, Ireland, Portugal and Spain are EU member states, Spain being the only member state where reinvested earnings are not recorded; the rest are Poland, the Czech Republic, Slovakia (also OECD members) and Slovenia acceding to the EU simultaneously with Hungary.

1. Data on equity under the heading direct investment have been available in Greece since 1998. Non-residents' capital investment accounts for 10% of GDP. The corresponding figure for residents' foreign investment is 5-6%. Accounting for a mere 0.1%-0.2% of GDP, the amount of direct investment income flows is negligible. At their highest in 1997, even then amounting to only 13%, reinvested earnings within this category of earnings carry practically no weight. Accounting for reinvested earnings did not modify the current account balance significantly in any of the years under review. The current account outcome was primarily determined by the amount of net expenditure on trade in goods relative to that of travel surplus. The trade deficit accounted for roughly 15% of GDP.

2. Data on the inward and outward direct investment have only been available in Ireland since 2001. Foreign direct investment stock was 1.5 times the GDP in 2002, which clearly shows the importance of such investment in Irish economy. As regards direct investment income, net income outflow as a proportion of GDP edged up before 1998, when it amounted to 22%. It has been broadly flat since 1999. Yet the balance of the current account was in surplus between 1995 and 1999. (It amounted to 2.3-2.8% of GDP between 1995 and 1997.) The GDP-proportionate surplus of the current account balance has been decreasing since 1998. In 2000-2002 the balance was in deficit, though it remained below 1% of GDP. The reason for this is that, prior to 1999, the adverse effects of income outflows were offset by a goods surplus, which had grown steadily before 1998, amounting to 29.4% of GDP. The value of goods exports nearly doubled during the period under review, and that of imports grew by over 1.5 times. Accounting for reinvested earnings between 1995 and 1997 reduced the current account surplus by 1.5% of GDP on average. From 1998 onwards, this ratio grew considerably higher, exceeding 11% of GDP in 2002. Earning increasingly large amounts of profit, foreign investors reinvested an equally high proportion (over 50% in 2002) of earnings in Ireland. The corresponding figure for foreign investment by the Irish had been almost 100% prior to 1999, when it fell to 80%.

3. Portugal can be characterised by vigorous growth in direct investment by residents. While the resident/non-resident foreign investment ratio was a mere 25% in 1996, it stood at 80% in 2002. The current account deficit in Portugal increased steadily from 1995 onwards, exceeding 10% in 2000, when it started to fall. Net expenditure of trade in goods is key to developments in deficit. Direct investment income added an additional 0.7-1.1% to the current account deficit from 1997, an average 0.5-0.7% of which could be attributed

to the recording of reinvested earnings, since income from and expenditure on respectively of dividend and distributed income did not depart materially. The proportion of reinvested earnings from investment in Portugal amounted to 60%-70% of all earnings between 1996 and 1999, only to fall to 40%-50% after 2000. The corresponding figures for investment abroad are roughly similar.

4. Of the countries under review, Spain has the largest stock of foreign direct investment, and is only second to Ireland in terms of direct investment by residents. Residents' direct investment capital exceeds that of non-residents' in Spain. Net direct investment income flows, which only include actual movements of cash, added 0.4% of GDP to the current account deficit between 1996 and 1999. In 2000 the proportion of deficit started to decline, with inflows and outflows having offset each other by 2002. The current account deficit and surplus primarily determine the extent to which travel income can offset the goods deficit.

5. Residents' foreign direct investment exceeds non-residents' investment in Finland as well. Nevertheless, it was not until 1997 and 1999 that, other things being equal, the balance of direct investment income flows were able to improve the current account balance, which, mainly due to the goods surplus, started to be in surplus from 1995 onwards. This means that, in the intervening years, the profitability of Finnish direct investment abroad lagged behind that of non-residents' direct investment in Finland. Accounting for reinvested earnings improved the current account balance in 1997, 1999 and 2002, when the value of recorded reinvested earnings from Finnish foreign direct investment exceeded that of non-residents' investment. Overall, the balance of recorded reinvested earnings from inward and outward investment was in the surplus in respect of the Finnish economy. The ratio of non-resident's reinvested earnings seems to have been on the decline, having fallen from 45%-65% to 20%. The corresponding figure for Finnish direct investment was 60% and 35% in 1999 and 2000 respectively.

6. In absolute terms, data on Polish foreign direct investment are similar to those on Hungary. However, considering the size of the Polish economy, it carries less weight there than in Hungary. The current account balance primarily hinges on deficit on trade in goods. Direct investment income as a proportion of GDP led to deficit on the current account to a decreasing extent from 1995. Since 1998 it has left the current account balance practically unaffected. The recording of reinvested earnings started to improved the balance of the current account balance from 1998. The reason for this is that non-residents' direct investment in Poland was loss-making. An increasingly large amount of loss has been recorded since 1998. However, there are no data on the methodology adopted, no explanation can be provided for the underlying reasons. The proportion of reinvested earnings from direct investment in Poland gradually declined in the period of profit making. It fell from nearly 100% in 1994 to 7% in 1997. By contrast, the corresponding figure for direct investment abroad was 60%-80%.

7. The country that lends itself the most easily to comparison with Hungary is the Czech Republic. The reason for this is that not only the level of the two countries' economic development, but also the size of direct investment and the weight it carries in the two countries' respective national economies are similar. The current account deficit as a proportion of GDP grew before 1996, then it started to decline. It has been on the

increase since 1999. The main underlying reason for that prior to 2001 was developments in trade in goods. Direct investment income had hardly had an impact on the GDP-proportionate amount of the current account balance prior to 1997. Since 1998, when reinvested earnings were first recorded, deficit on direct investment income outflows as a proportion of GDP has been on the rise. It accounted for 4.6% of GDP in 2002. The proportion of reinvested earnings within direct investment income amounted to 80%. Non-resident investors reinvested 50% of their earnings during the year on which data were first published. The corresponding figure for 2002 is above 80%. Czech investors reinvested nearly 95% of their earnings abroad in 2001-2002.

8. As regards Slovakia, non-resident and resident direct investment amounted to USD 3.5 billion and 300 million respectively in 2000. The value of investment income flows is rather low. Amounting to USD 40 million, net income outflow was at its highest in 1998 and 1999, accounting for 0.1-0.2% of GDP. Net annual expenditure arising from accounting for reinvested earnings was below USD 1 million. As there are no data available on either 2001 or 2002, no information can be obtained on the effects of a pick-up in direct investment.

9. The current account balance primarily depends on developments in trade in goods in Slovenia. The volume of trade in goods reached its peak in 1999. So did the current account deficit. Prior to 2002, net expenditure on trade in goods declined gradually, hence the current account deficit, which later turned into a surplus. From 1998, outflows of direct investment income either added an average amount of 0.4% of GDP to the current account deficit or reduced the current account surplus by the same amount. The recording of reinvested earnings had a less significant impact. The proportion of reinvested earnings varies widely. In the case of Slovenian direct foreign investment, it ranged from 10 to 70%, whereas the corresponding figure for non-residents' direct investment in Slovenia is 30-60%.

Table 4 **Net reinvested earnings / GDP (percent)***

	1995	1996	1997	1998	1999	2000	2001	2002
Greece	0.0	0.0	0.0	n.a.	n.a.	n.a.	n.a.	n.a.
Ireland	-1.8	-2.0	-1.4	-4.6	-8.1	-10.0	-7.1	-11.4
Portugal	0.0	-0.6	-0.5	-0.5	-0.6	-0.4	-0.5	-0.7
Spain	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Finland	-0.4	-0.2	0.3	-3.4	0.4	-0.1	-2.4	0.2
Poland	-0.7	-0.2	0.0	0.1	0.3	0.2	0.6	0.6
Czech Republic	n.a.	n.a.	n.a.	-0.5	-1.3	-1.9	-2.5	-3.8
Slovakia	n.a.	0.0	0.0	n.a.	n.a.	n.a.	n.a.	n.a.
Slovenia	0.1	0.0	-0.1	-0.3	-0.1	-0.2	0.1	-0.3
Hungary	**0.5**	**-1.1**	**-2.8**	**-2.4**	**-2.4**	**-2.1**	**-2.6**	**-2.7**

* - = net income outflow

Source: BOPSY 1998-2003; IFS 2003, MNB

Table 5 **Current account balance/GDP (percent)**

	1995	1996	1997	1998	1999	2000	2001	2002
Greece	-2.4	-3.7	-4.0	n.a.	-5.8	-8.7	-8.0	-7.8
Ireland	2.6	2.8	2.3	1.2	0.4	-0.6	-0.7	-0.8
Portugal	-0.1	-4.8	-6.3	-7.3	-8.5	-10.4	-9.4	-7.2
Spain	0.1	0.1	0.4	-0.5	-2.3	-3.4	-2.8	-2.4
Finland	4.0	3.9	5.4	5.7	6.3	7.5	7.2	7.8
Poland	0.7	-2.3	-4.0	-4.3	-8.1	-6.1	-2.9	-2.6
Czech Republic	-2.6	-7.2	-6.8	-2.3	-2.7	-5.2	-5.7	-6.5
Slovakia	2.1	-10.2	-9.3	-9.7	-5.7	-3.5	n.a.	n.a.
Slovenia	-0.4	0.3	0.3	-0.6	-3.5	-2.9	0.2	1.7
Hungary	**-3.7**	**-3.9**	**-4.5**	**-7.2**	**-7.8**	**-8.6**	**-6.2**	**-7.0**

Source: BOPSY 1998-2003; IFS 2003,
Hungary: MNB

Table 6 **Net income on FDI equity capital/GDP (percent)**

	1995	1996	1997	1998	1999	2000	2001	2002
Greece	-0.2	-0.1	-0.1	n.a.	0.0	-0.2	-0.1	-0.2
Ireland	-11.2	-11.7	-12.7	-21.8	-21.0	-22.4	-19.8	-22.8
Portugal	-0.3	-0.7	-0.7	-0.7	-0.8	-1.1	-1.1	-1.1
Spain	-0.1	-0.3	-0.4	-0.4	-0.4	-0.3	-0.1	0.0
Finland	-0.2	-0.1	0.5	-0.2	0.5	0.5	1.2	1.0
Poland	-0.8	-0.3	-0.3	-0.1	0.0	-0.1	0.0	-0.1
Czech Republic	-0.1	-0.1	0.0	-0.8	-1.7	-2.4	-3.3	-4.6
Slovakia	n.a.	0.0	0.0	-0.2	-0.1	-0.1	n.a.	n.a.
Slovenia	0.0	0.0	-0.2	-0.4	-0.4	-0.4	-0.1	-0.5
Hungary	**-0.3**	**-1.9**	**-4.0**	**-4.4**	**-4.5**	**-4.1**	**-4.4**	**-4.5**

Source: BOPSY 1998-2003; IFS 2003,
Hungary: MNB

In international comparison, the following conclusions can be drawn in connection with Hungarian data:

- The quantifiable impact of the recording of reinvested earnings on the current account balance exceeds 1% of GDP in four countries (Ireland, the Czech Republic, Hungary and, in certain years, Finland).

- No unambiguous link can be established between the current account balance and developments in reinvested earnings as a proportion of GDP. In Ireland, despite a considerable amount of reinvested earnings, the current account deficit is low (owing to high goods surplus). In Greece, however, the case is just the opposite.

- The three tables reveal that the country which is the most easily comparable with Hungary is the Czech Republic. The reason for this is that not only the level of the two countries' economic development and the number of their population, but also the size of direct investment, the weight it carries in the two countries' respective national

economies as well as the impact of accounting for reinvested earnings are all similar.

Table 7 **Recording of reinvested earnings in OECD countries**

	Reinvested earnings are recorded on		Recorded
	inward FDI	outward FDI	when they are earned
EMU-12			
Austria	yes	yes	yes
Belgium	yes	yes	yes
Finland	yes	yes	yes
France	yes	yes	no
Greece	yes	yes	yes
Netherlands	yes	yes	yes
Ireland	yes	yes	yes
Luxembourg	yes	yes	yes
Germany	yes	yes	yes
Italy	yes	yes	no
Portugal	yes	yes	yes
Spain	no	no	–
+ EU-15			
Denmark	yes	yes	no
United Kingdom	yes	yes	yes
Sweden	yes	yes	yes
+OECD-30			
Australia	yes	yes	yes
Czech Republic	yes	yes	yes
Iceland	yes	yes	yes
Japan	yes	yes	no
Canada	yes	yes	yes
Korea	yes	yes	yes
Poland	yes	yes	yes
Hungary	yes	yes	yes
Mexico	yes	no	no
Norway	yes	yes	yes
Slovakia	yes	yes	yes
Switzerland	yes	yes	yes
Turkey	yes	no	no
New Zealand	yes	yes	yes
USA	yes	yes	yes
EMU-12			
yes	**11**	**11**	**9**
no	**1**	**1**	**2**
EU-15			
yes	**14**	**14**	**11**
no	**1**	**1**	**3**
OECD-30			
yes	**28**	**27**	**23**
no	**2**	**3**	**6**

Source: SIMSDI, Survey Results – OECD Countries
BOPSY 2003

Notes:
Denmark, Greece: although reinvested earnings data are compiled but they are not published
Korea: reinvested earnings are recorded only for resident banks' direct investment abroad