F.2 Asymmetric Treatment of Retained Earnings

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Issue

Retained earnings are treated in Foreign Direct Investment (FDI) as if paid to shareholders (this is the so called "reinvested earnings – REI –" imputation of an income flow and an accompanying financial transaction flow).

No other area in macroeconomic statistics follows the same treatment, which causes methodological "asymmetries": retained earnings are sometimes reflected as transactions (in FDI), and others as revaluations (otherwise), arguably leading to distortions in key indicators (e.g. GNI)

What can we do to **mitigate these asymmetries**? Should we extend the RIE imputation to other areas? Which ones? Should we rather discontinue the imputation in FDI?

Why extending RIE might not be a good idea?

- ✓ RIE masks the corporate retribution policy
- ✓ Assuming RIE goes against the requirement for “mutual agreement” for flows to be considered as transactions
- ✓ Setting corporate savings to zero (which would follow from applying RIE all over) would eliminate an indicator of internal funding of corporate investment expenditure

Why extending RIE might be a good idea?

- ✓ Increases in equity prices due to retained earnings contribute to consumption decisions by households similarly as regular income does (if RIE is followed consistently all corporate income would end up in the households and government sectors)
- ✓ Households' savings might be seen as underestimated if RIE is not followed as it misses a great deal of sources of increases in net worth
- ✓ In the case of public corporations, RIE would simplify the current rules set up to avoid that governments use their corporate ownership relationships to manipulate (the temporal profile of) the deficit figures

Options

						RIE in …
		Option 5	**Option 2**			*supplemental tables/ memorandum items*
	Option 5	**Option 1 to 4**	**Option 3 and 4**		**Option 4**	*core accounts*
RIE applied to …	*none*	*FDI enterprises*	*public corporations*	*foreign portfolio investment*	*private domestic equity stakes*	

Outcome of discussion and status

- Global Consultation with split views on its inclusion in the core accounts: 27% supported the extension to Portfolio Investment and public corporations (Option 3), 18% supported no extension (Option 1), 12% supported discontinuation of RIE in FDI (Option 1), 9% supported the extension to all equity relationships
- AEG (and BOPCOM) discussion: an extension of RIE in the core accounts is seen as premature, mainly given data difficulties, but however its analytical value is recognized and **Option 2 ,extension in supplementary tables, is supported**, pending on a feasibility assessment based on testing. Option 2 was supported in the Global Consultation by 35%
- Testing:
  - Balance of Payments: testing finalized with the conclusion that there is evidence of existence of methods to estimate RIE for portfolio investment (albeit data sources are limited)
  - National accounts: testing in progress

Thank you for your attention !