Who Owns Europe's Firms?

Globalization and Foreign Investment in Europe and Implications for Aggregate National Accounts Statistics

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Proposal

How globalized is Europe? Following the introduction of the euro, European financial markets have become more integrated and trade within Europe has doubled. It has been suggested by policy makers that such European integration is a desirable outcome of the European project. During the post-crisis period, calls for even more integration increased, such as pan-European banking union, to be able to deal with the destabilizing effects of crisis.

How much financial integration Europe has achieved so far? The measurement of financial integration in Europe has mostly focus on the convergence of interest rates and asset prices. The key reason for this measure is the difficulty in measuring the cross-border capital flows given the

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extensive network of multinational corporations within Europe and across the world. The goal of this project is to construct new measures of cross border equity flows from bottom up, that is from firm level data. We construct measures of foreign portfolio equity and foreign direct investment (FDI) for the years 1999–2012 based on unique micro data extracted from the ORBIS/AMADEUS dataset. The micro data follows firms over time and records direct and ultimate ownership, both domestic and foreign, based on mergers and acquisitions transactions regardless of the amount of capital invested by the investor. Hence a company might look like foreign owned based on the direct owner who may be a subsidiary or a financial intermediary in a different country, where based on the ultimate owner the company can be domestic. For example, a German firm may be owned by a British firm, which is recorded as the direct owner, but the British firm may be a subsidiary of a U.S. firm which is the ultimate owner, or ultimate owner can also be a German firm. If both owners own a controlling stake this can be categorized as FDI.

We aggregate our firm-level foreign ownership data by country of destination and origin of the investor by year. These aggregated numbers can be compared to FDI data from the (country-pair level) OECD International Direct Investment Database and the (country level) Balance-of-Payments (BoP) statistics. Our data improves upon the data from these "official" sources. Country-level studies of foreign investment use available measures of capital flows/stocks from aggregate BoP statistics provided by International Monetary Fund (IMF), International Financial Statistics (IFS). In such statistics any investment involving ownership stakes over 10% are classified as foreign direct investment and anything less than this amount is classified as portfolio equity investment. This practice is necessary to harmonize data provided by different country statistical offices. But it is most often the case that the statistics were aggregated at different thresholds by different country offices. Our data, being firm-level and having continuous measures of ownership shares, can be aggregated at different thresholds of ownership stakes and hence by using the same threshold for

every country, our data is more internationally comparable.

In terms of country-pair level studies, the standard data source is the OECD International Direct Investment Database, which covers all OECD countries from 2000 to 2010 in terms of bilateral FDI flows. Bilateral portfolio equity investment positions (investment less than 10% of ownership stake) are available for 40+ country-pairs from the Coordinated Portfolio Investment Surveys (CPIS) conducted by the IMF covering the last 10 years. However, the CPIS is not an annual survey and thus time variation in CPIS is rather limited. Neither the OECD nor the CPIS records direct versus ultimate ownership. And also they are both based on the concept of residence which assigns ownership of financial flows to legal entities' place of registration. However, the legal entity which is the direct owner is often be located in a tax heaven or financial center even if the ultimate owner resides somewhere else—typically in a major developed country such as the United States. Therefore, direct ownership overstates exposure to and from small financial centers and understates exposure of countries, such as the United States and the UK.

This project expands the set of measures available for analyzing investment flows and uses disaggregated data along with appropriate methods of aggregation to develop better measures of portfolio equity investment and FDI, that is multinational economic activity. In the world we are living in where availability of big data is changing the way we understand many things, we need to understand the exact patterns of foreign investment and how this will affect our standard national account systems. For our question of interest, that is measuring the extent of globalization for European countries in the aftermath of the introduction of euro this is clearly paramount. But it is also important from a broader perspective. If we use the standard residence based balance of payments data, this will distort national accounts. Based on this data a nation's external wealth can be negative if these measures show foreigners own more assets in the domestic economy then domestic residents own in other countries. Such measures will also distort the difference between

GDP and GNI, where for a nation with negative external wealth, GNI will be less than GDP. Based on our measures, these measures can revert. If France assets seem to be owned by Germans based on aggregate FDI data but if the ultimate owner of these assets are the US corporations then this should not be recorded as inward FDI within Europe. More importantly if France assets are owned directly by a US corporation which is owned ultimately by a French multinational, then external FDI liability of France becomes an external FDI asset of France. We will be calculating net external wealth and GDP-GNI difference between countries based on our measures of foreign investment and compare to what standard national accounts and balance of payments statics will give us. Our results will have important policy implications in the context of debate of global imbalances.