Conceptual Framework of International Investment Position

1.1. Introduction

The international investment position (IIP) is a statistical statement that shows an economy's stock of external financial assets (financial claims on non-residents) and liabilities (liabilities to non-residents) at a particular point of time. The changes in stock are results of past external transactions (financial flows e.g. drawings and repayments of loans, issuance of shares) measured according to current market values (current market prices and exchange rates) and other factors (for example, allocation or cancellation of SDRs, the monetization or demonetization of gold, reclassifications, bad debt write offs and measurement errors) at a specific point of time.

The concept of flows is to be distinguished from the general perception of changes in stock positions during a period. The flows represent the net outcome of transactions. It is therefore, necessary to provide clear identification of causes, resulting in the overall changes in stocks in addition to changes due to flows over a period of time measured through balance of payments (BOP). It has also been observed that any such comparison of stocks is possible if flows are included into the reconciliation process to see what has happened to the stock on account of other changes. It is evident that stocks arrived through flows will give a different position, due to price changes, exchange rate and other changes which also affect the stock positions i.e.

Opening position +Transactions +Exchange rate changes +Price changes +other changes = Closing position

1.2. Basic Concepts

1.2.1. Residence

Residence is a particularly important attribute of an institutional unit in the IIP because the identification of transactions between residents and nonresidents underpins the system. The concept of residence used in IMF's Balance of Payments Manual sixth edition (BPM6) is not based on nationality or legal criteria, although it may be similar to concepts of residence used for exchange control, tax, and other purposes in many countries. The concept of residence is based on a sectoral transactor's center of predominant economic interest. Moreover, country boundaries recognized for political purposes may not always be appropriate for economic purposes. Therefore, it is necessary to recognize the economic territory of a country as the relevant geographical area to which the concept of residence is applied. An institutional unit is a resident unit when it has a center of economic interest in the economic territory of a country. To have some location, dwelling, place of production, or other premises on which or from which the unit engages and intends to continue engaging, either indefinitely or over a finite but long period of time, in economic activities and transactions on a significant scale. The location need not be fixed so long as it remains within the economic territory. For IIP, the concept of residence implies that only those assets and liabilities of residents that represent claims on or liabilities to nonresidents are recorded. The distinction between residents and nonresidents is closely related to the description between the compiling economy and the rest of the world. Residents of an economy are institutional units such as households, corporations, and government that have the strongest connection, expressed as center of predominant economic interest in the economy in question. For simplicity one year's stay in an economy is considered as a threshold for considering the unit to be resident.

1.2.2. Valuation

In principle, all asset and liability positions constituting a country's international investment position are measured at market prices. The market price measurement cannot always be implemented, especially if financial instruments are not traded in the market. Cash items (currency and transferable deposits) have only one value that could be assigned for any purpose. Similarly, non-marketable financial items such as loans in one form or the other are valued at the nominal values. Balance sheet (or book) value is often the only valuation available or reported for direct investment. When direct investment enterprises are listed on stock exchanges, the listed price is used as the market values of shares in those enterprises. Similarly in case of non-listed enterprises the break up values is used.

1.2.3. Time of Recording

The international investment position presents data related to a country's external financial conditions at a specific point (such as year-end). The time of recording financial items that constitute the position is governed by the principle of accrual accounting.

1.3. Classification Scheme of IIP

As the objective of classification scheme is to set various types of financial assets and liabilities into analytically useful components, therefore, the classification is based on:

- **Financial assets and liabilities**
- **Functional types of investment**

1.3.1. Financial assets and liabilities

Financial claims and obligations come from contractual relationships when one institutional unit provides funds to other. A financial claim is an asset that entitles its owner, the creditor, to receive a payment, or series of payments, from the debtor, in certain circumstances specified in the contract between them. The claim is renounced when the debtor discharges the liability, paying a sum agreed to in the contract. In addition, the creditor may receive a series of interest payments. Financial instruments such as cash and deposits, loans, advances and other credits, and securities such as bills and bonds represent financial claims. In the IIP, the external financial claims are classified as assets when the holders are residents. They are classified as liabilities when the issuers are residents.

1.3.2. Functional types of investment

In the classification, various financial instruments that make up the financial assets and liabilities are grouped according to the intent of the resident holders / issuers of the financial instruments. They are grouped according to the functional type of investment, direct investment, portfolio investment, financial derivatives, other investment, and reserve assets.

1.3.2.1. Direct investment

Direct investment reflects the objective of a resident entity in one economy obtaining a lasting interest in an enterprise resident in another economy. The resident entity is the direct investor and the enterprise is the direct investment enterprise. The lasting interest implies the existence of a long-term relationship between the direct investor and the enterprise and a significant degree of influence by the investor on the management of the enterprise. According to BPM6, a lasting interest can usually be assumed if the direct investor has ownership of a minimum of 10 percent of the ordinary shares or voting power or the equivalent in the direct investment enterprise. Direct investment comprises not only the initial transaction establishing the relationship between the investor and the enterprise but also all subsequent transactions between them and among affiliated enterprises, both incorporated and unincorporated.

1.3.2.2. Portfolio investment

The portfolio investment covers financial instruments in the form of equity and debt securities that are usually traded (or tradable) in organized markets and where the resident holders / issuers are largely driven by consideration of portfolio diversification. Debt securities are subdivided into bonds and notes and money-market instruments. The instruments are further classified by institutional resident sectors, namely, monetary authorities, general government, banks, and other sectors.

1.3.2.3. Financial derivatives

Financial derivatives are financial instruments that are linked to another specific financial instrument, indicator, or commodity and through which specific financial risks can be traded in financial markets in their own right.

1.3.2.4. Other investment

Other investment is a residual category that covers all financial instruments other than those classified as direct investment, portfolio investment, financial derivatives, or reserve assets. It is primarily classified by instrument and secondarily by sectors. The instruments include trade credits, loans, currency and deposits, and other assets and liabilities.

1.3.2.5. Reserve assets

Reserve assets are external assets that are readily available to and are under the effective control of monetary authorities for balance of payments or other purposes. These are classified as monetary gold, SDRs, reserve position in the IMF and other reserve assets. Other reserve assets are comprised of currency and deposits, securities, financial derivatives and other claims.

Main classification of IIP

Assets	**Liabilities**
1. Direct investment	**1. Direct investment**
1.1 Equity and investment fund shares	1.1 Equity and investment fund shares
1.2 Debt instruments	1.2 Debt instruments
2. Portfolio investment	**2. Portfolio investment**
2.1 Equity and investment fund shares	2.1 Equity and investment fund shares
2.2 Debt securities	2.2 Debt securities
3. Financial derivatives (other than reserves) and employee stock options	**3. Financial derivatives (other than reserves) and employee stock options**
4. Other investment	**4. Other investment**
4.1 Other equity	4.1 Other equity
4.2 Currency and deposits	4.2 Currency and deposits
4.3 Loans	4.3 Loans
4.4 Insurance, pension, and standardized guarantee schemes	4.4 Insurance, pension, and standardized guarantee schemes
4.5 Trade credit and advances	4.5 Trade credit and advances
4.6 Other accounts receivable	4.6 Other accounts receivable
	4.7 Special drawing rights (Net incurrence of liabilities)
5. Reserve assets	
5.1 Monetary gold	
5.2 Special drawing rights	
5.3 Reserve position in the fund	
5.4 Other reserve assets	

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