Untangling the effects of “special purpose entities” on global FDI
by
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The measurement of foreign direct investment (FDI) flows and stocks between home countries and host countries is muddied by the widespread use of “special purpose entities” (SPEs), including for the round-tripping of domestic investment.¹ Many national statistical bodies still do not separately track investments through SPEs and thereby risk presenting a distorted picture of global FDI. International bodies, including the OECD² and UNCTAD,³ have long identified the problem, but it persists.

This Perspective provides a Russian illustration: the US$55 billion acquisition of TNK-BP, a Russian oil producer, by Rosneft, another Russian oil company, in 2013. While the case may be singular, its magnitude made the distortive effect quite visible.

Rosneft is a Russian company that is majority owned by the Russian state. TNK-BP was a Russian oil-producing group with a top holding company in the British Virgin Islands (BVI). Before its acquisition by Rosneft, it was 50/50 owned on the one side by BP of the United Kingdom (UK) and, on the other side, by AAR, a consortium of companies registered in the BVI but ultimately owned by Russian individuals.⁴

BP’s total consideration for the sale of its TNK-BP share was US$27.4 billion, split into Rosneft shares and net cash proceeds of approximately US$12 billion.⁵ The cash proceeds were taken out of Russia, i.e., for BP this was a share swap and partial divestment. As for the AAR segment, the consideration of US$27.7 billion was paid entirely in cash by state-owned Rosneft to the BVI companies of the Russian shareholders.⁶ Seen synthetically, the combined transaction was therefore a share swap and partial divestment by a foreign investor (BP), combined with a renationalization of domestic oil production assets.⁷

Official FDI statistics, however, gave a picture that was arguably the very opposite—that of an all-around increase in global FDI. Russia’s Central Bank reported a significant outflow of Russian FDI, with stocks in the BVI jumping to US$82 billion as of December
31, 2013, making the BVI the second largest Russian outbound FDI destination behind Cyprus. The reason was that, technically, although the TNK-BP assets were located in Russia, the shares acquired by Rosneft were those of a BVI company. Russia’s Central Bank also reported a significant inflow of FDI into Russia from the UK (and not a divestment), and on that basis Russia appeared to become the world's third largest recipient of FDI inflow that year. This was presumably because BP's previous position in TNK-BP had never been reflected as British Russian-bound FDI in the first place.

The TNK-BP example illustrates the difficulties of untangling the statistical effects of SPEs in cross-border investment. International bodies recommend that national data compilers create additional series looking through SPEs to identify the ultimate origin and destination of investments. This task would be facilitated, however, if all countries hosting large numbers of SPEs produced such origin and destination data for their resident SPEs (as here the BVI). Mandatory corporate registers publicly disclosing ultimate beneficial ownership of these SPEs would also increase transparency and lead to a better understanding of global capital flows.

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1 “Special purpose entity” is used here in the wide sense of legal entities with little or no substance that are used in cross-border investment, for tax or other purposes (whether or not they are separately reported as SPEs in national statistics).


4 One of them is a Soviet-born UK citizen.


7 The main production units forming TNK-BP had been privatized in the 1990s.


10 See supra note 3, p. 71.


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