

2. Coverage of the GFS System

This chapter defines the concepts of sectors and institutional units and then uses those concepts to define the general government sector and the public sector.

A. Introduction

2.1 The government of a country consists of the public authorities and their agencies, which are entities established through political processes that exercise legislative, judicial, and executive authority within a territorial area.¹ The principal economic functions of a government are (1) to assume responsibility for the provision of goods and services to the community on a nonmarket basis, either for collective or individual consumption, and (2) to redistribute income and wealth by means of transfer payments.² An additional characteristic of government is that these activities must be financed primarily by taxation or other compulsory transfers.³ A government may, of course, also finance a portion of its activities in a specific period by borrowing or by acquiring funds from sources other than compulsory transfers, such as interest revenue, incidental sales of goods and services, or the rent of subsoil assets.

2.2 The goods and services provided to the community for collective consumption normally consist of services such as public administration, defense,

and law enforcement. By definition, collective services are always provided free. Typical goods and services provided for individual consumption are education, health, housing, recreation, and cultural services. These services may be provided for free or the government may charge a fee. The goods and services provided to the community as a whole or to individuals may be produced by the government itself or the government may purchase them from a third party.

2.3 In principle, the GFS system covers all entities that materially affect fiscal policies. Normally, fiscal policies are implemented by entities wholly devoted to the economic functions of government, such as a government ministry. In addition to those entities, however, fiscal policy may be carried out by government-owned or controlled enterprises that engage primarily in commercial activities. These enterprises, such as the central bank or national railroad, which are referred to as public corporations, are not considered part of government, but statistics should be collected on them.

2.4 Determining the coverage of the entities included in the GFS system therefore requires consideration of two questions. First, what is the statistical unit from which it is feasible and meaningful to collect statistics? Second, which of those statistical units should be included in the GFS system?

2.5 Regarding the first question, the statistical unit employed in the GFS system is the institutional unit, the same unit that is the foundation of the 1993 SNA. As explained later in this chapter, this type of unit can, in its own right, own assets, incur liabilities, and engage in economic activities and transactions with other entities. There are several reasons for choosing this unit:

- Statistics can be based on information from entities for which complete sets of accounts can be com-

¹The term “government” is used here as a collective of all entities in a country that satisfy this definition. More often, reference will be made to the various individual governments of a country. For example, a country may have one central government; several state, provincial, or regional governments; and many local governments.

²The concepts of market and nonmarket output are described in paragraphs 2.31 to 2.37. Briefly, nonmarket output consists of goods and services distributed for free or sold at very low prices.

³The requirement of financing activities by compulsory transfers is necessary to differentiate a government from a nonprofit institution, which may carry out the same functions as a government but obtains its funds from voluntary transfers, property income, or sales. The receipt of compulsory transfers may be indirect. For example, a local government may finance its activities with grants from the central government.

piled, including balance sheets. Such accounts permit the integration of flows and stocks. That is, all changes in the balance sheet during an accounting period can be traced to a transaction or other identified event recorded in the system.

- The data needed for the compilation of statistics are usually available in existing accounting records or can be made available.
- Statistics for government can be harmonized with statistics of the *1993 SNA* because the entities for which statistics are compiled are defined identically.

2.6 An alternative to compiling GFS based on institutional units is to compile statistics from all units in the economy, but include only those statistics that relate directly to fiscal operations. Not only would it be impossible to construct balance sheets and explain changes in balance sheets with such statistics, but in practice, it is unlikely to be possible to separate the fiscal operations of public corporations from their normal commercial activities. For example, it is unlikely that loans issued by a public financial corporation with an interest rate deliberately set lower than the market rate can be separated from similar loans with a market rate.

2.7 With regard to the question of the institutional units for which statistics should be compiled, two principal constructs are developed in this manual. First, the general government sector is defined. It consists of all institutional units primarily engaged in nonmarket operations. Second, the public sector is defined to capture the impact on fiscal policy of the activities of public corporations. It includes all units of the general government sector plus all public corporations. In addition, a number of subsectors of the general government and public sectors are defined because of their likely analytic usefulness.

2.8 The remainder of this chapter first defines the concepts of sectors and institutional units in general. It then applies these concepts to the general government sector and the public sector. Finally, the other sectors mentioned in this manual and the concept of residency are described.

B. Sectors and institutional units⁴

I. Definition of a sector

2.9 The total economy of a country can be divided into *sectors*, with each sector consisting of a number of *institutional units*—defined in the following section—that are resident in the economy. This manual follows the *1993 SNA* by initially dividing the total economy into five mutually exclusive sectors. The units⁵ in each sector have similar objectives and these objectives are, in turn, different from those of units in other sectors. The five sectors are as follows:

- The *nonfinancial corporations sector*, which consists of entities created for the purpose of producing goods and nonfinancial services for the market;
- The *financial corporations sector*, which consists of entities engaged in providing financial services for the market;
- The *general government sector*, which consists of entities that fulfill the functions of government as their primary activity;
- The *nonprofit institutions serving households sector*, which consists of all resident nonprofit institutions, except those controlled and mainly financed by government, that provide nonmarket goods or services to households; and
- The *households sector*, which consists of small groups of persons who share the same living accommodation, pool some or all of their income and wealth, and consume certain types of goods and services collectively.

2.10 For analytic purposes each of these sectors may be divided into subsectors, and the subsectors can be combined in different ways to form other sectors. For example, the general government sector can be divided into central, state, and local government subsectors, and the nonfinancial corporations sector can be divided into public nonfinancial corporations and other nonfinancial corporations.

⁴The definitions and descriptions of sectors and institutional units are intended to be fully consistent with the equivalent definitions and descriptions in Chapter IV of the *1993 SNA*.

⁵Hereafter, “unit” will often be used as a short form for “institutional unit.”

2. Definition of an institutional unit

2.11 An *institutional unit* is an economic entity that is capable, in its own right, of owning assets, incurring liabilities, and engaging in economic activities and in transactions with other entities. Some important features of institutional units follow:

- The ability of an institutional unit to own goods or assets in its own right means that it is also able to exchange the ownership of goods or assets in transactions with other institutional units.
- An institutional unit is able to take economic decisions and engage in economic activities for which it is itself held directly responsible and accountable at law.
- An institutional unit is able to incur liabilities on its own behalf, to take on other obligations or future commitments, and to enter into contracts.
- Either a complete set of accounts, including a balance sheet of assets, liabilities, and net worth, exists for an institutional unit, or it would be possible and meaningful, from both an economic and legal viewpoint, to compile a complete set of accounts if they were to be required.

2.12 There are two main types of entities that may qualify as institutional units: (1) persons or groups of persons in the form of households and (2) legal or social entities whose existence is recognized by law or society independently of the persons or other entities that may own or control them.

2.13 The four types of legal or social entities recognized in the *1993 SNA* and this manual as institutional units are corporations, quasi-corporations, nonprofit institutions, and government units.

2.14 *Corporations* are legal entities that are created for the purpose of producing goods or services for the market. They may be a source of profit or other financial gain to their owners. A corporation is collectively owned by shareholders who have the authority to appoint directors responsible for its general management. Institutional units owned or controlled by governments that qualify as corporations in the sense used here are known as public corporations. All corporations are members of the nonfinancial corporations sector or the financial corporations sector, depending on the nature of their primary activity.

2.15 The key to classifying a unit as a corporation is not its legal status but rather the characteristics of producing goods and services for the market and being a source of profit or other financial gain to the owners. Some nonprofit institutions and government units have the legal status of a corporation but are not considered corporations for the purposes of economic statistics because they do not produce for the market. Other nonprofit institutions are legal corporations that produce for the market but are not a source of financial gain to their owners. Conversely, some entities with different legal titles, such as joint-stock company, are considered corporations for economic statistics.

2.16 *Quasi-corporations* are entities that are not incorporated or otherwise legally established, but which function as if they were corporations, as defined in the previous two paragraphs. Quasi-corporations are also treated in the same way as corporations in the GFS system, which means that they are institutional units separate from the units to which they legally belong. They are classified as members of either the nonfinancial corporations sector or the financial corporations sector depending on the nature of their primary activity.

2.17 The concept of a quasi-corporation is intended to separate from their owners those unincorporated enterprises that are engaged in commercial activities and are sufficiently self-contained and independent that they behave in the same way as corporations. To be a quasi-corporation, there must be a complete set of accounts for the enterprise or it must be possible to construct such accounts, including any flows of income and capital between the quasi-corporation and its owner. A government printing office and an agency producing cultural services for sale to the public are examples of possible public quasi-corporations.

2.18 In order for a public quasi-corporation to exist, the government must allow the management of the enterprise considerable discretion with respect to the management of the production process and with the use of its funds. The quasi-corporation must be able to maintain its own working capital and be able to finance some or all of its capital formation, either from its own resources or by borrowing. The ability to distinguish flows of income and capital between a quasi-corporation and the government unit that owns it implies that the operating and financing activities of the quasi-corporation are not fully integrated with the parent's corresponding activities, despite the fact that the quasi-corporation is not a separate legal entity.

2.19 Nonprofit institutions (NPIs) are legal or social entities created for the purpose of producing or distributing goods and services, but they cannot be a source of income, profit, or other financial gain for the institutional units that established, control, or finance them. An NPI may engage in market or non-market production. If it engages in market production, such as a hospital that charges market prices or a university that charges tuition, then the NPI must either retain any surplus earned from its productive activities to support its future operations or distribute it to institutional units other than the units that established, control, or finance it. These market NPIs are, like corporations and quasi-corporations, members of either the nonfinancial corporations sector or the financial corporations sector. Other NPIs are members of either the nonprofit institutions serving households sector or the general government sector, depending on which units control and mainly finance the NPI.

2.20 Government units are institutional units that carry out the functions of government as their primary activity. That is, they have legislative, judicial, or executive authority over other institutional units within a given area; they assume responsibility for the provision of goods and services to the community as a whole or to individual households on a nonmarket basis; they make transfer payments to redistribute income and wealth; and they finance their activities, directly or indirectly, mainly by means of taxes and other compulsory transfers from units in other sectors. All government units are members of the general government sector.

2.21 A social security fund is a particular kind of government unit that is devoted to the operation of one or more social security schemes, which are defined in the annex to this chapter. A social security fund must satisfy the general requirements of an institutional unit. That is, it must be separately organized from the other activities of government units, hold its assets and liabilities separately, and engage in financial transactions on its own account.

3. Application of the definition of an institutional unit to government

2.22 Depending on the complexity of a government's organization, the identification of government units may be difficult. Most of the ministries, departments, agencies, boards, commissions, judicial authorities, legislative bodies, and other entities that

make up a government are not institutional units because they generally do not have the authority to own assets, incur liabilities, or engage in transactions in their own right. In general, all entities funded by appropriations made in accordance with a budget controlled by the legislature must be amalgamated into a single institutional unit.

2.23 A government unit is not limited in its geographic location. For example, the individual ministries or departments of a particular government may be deliberately dispersed throughout the area of the government's jurisdiction. They remain, nevertheless, part of the same institutional unit. Similarly, a given ministry or department may maintain branch offices or agencies in many different locations to meet local needs. These offices and agencies are part of the same institutional unit.

2.24 There may, however, be government entities with a separate legal identity and substantial autonomy, including discretion over the volume and composition of their expenditures and a direct source of revenue, such as earmarked taxes. Such entities are often established to carry out specific functions, such as road construction or the nonmarket production of health or education services. These entities should be treated as separate government units if they maintain full sets of accounts, own goods or assets in their own right, engage in nonmarket activities for which they are held accountable at law, and are able to incur liabilities and enter into contracts.

2.25 Many governments allocate substantial volumes of resources to social protection through the provision of social benefits, which are payments in cash or in kind to protect the entire population or specific segments of it against certain social risks. A social risk is an event or circumstance that may adversely affect the welfare of the households concerned either by imposing additional demands on their resources or by reducing their incomes. Examples of social benefits are the provision of medical services, unemployment compensation, and social security pensions. Because of the large scale of social protection programs in many countries and the different organizational possibilities of such programs, an annex to this chapter describes the different types of programs and their effects on statistics of the general government sector.

2.26 When a government comprises two or more institutional units, there normally is one unit that con-

trols the other units. The controlling unit most likely includes the legislature, head of state, and judiciary. In contrast to corporations, one government unit controls another government unit by appointing its managers and/or determining the laws and regulations that provide its finance rather than through equity ownership. No government unit owns another government unit, and government units do not issue equity securities.

2.27 Public corporations, in contrast to government units, are potential sources of financial gain to the government units that own or control them. In some cases, the corporation issues equity securities so that the financial gain or loss is clearly allocated to the owner or owners. In other cases, no equity securities are issued, but it is clear that a specific government unit controls the corporation's activities and is financially responsible for it. In those cases, the responsible government unit is assumed to own implicitly issued equity securities.

C. The general government sector and its subsectors

I. The general government sector

2.28 The general government sector consists of all government units and all nonmarket NPIs that are controlled and mainly financed by government units.⁶ Hereafter the term *general government unit* will be used to refer to units of the general government sector.⁷

2.29 Nonmarket NPIs that are both controlled and mainly financed by government units are legally non-government entities, but they are considered to be carrying out government policies and effectively are part of government. Governments may choose to use nonprofit institutions rather than government agencies to carry out certain government policies because NPIs may be seen as detached, objective, and not subject to political pressures. For example, research

and development and the setting and maintenance of standards in fields such as health, safety, the environment, and education are areas in which NPIs may be more effective than government agencies.

2.30 A government unit controls a nonmarket NPI when it has the ability to determine the general policy or program of the NPI. A government unit can determine the general policy or program by having the right to appoint the officers managing the NPI or through financial means. The amount of control provided by the supply of finance depends on the timing and restrictions attached to the funds as well as the amount of financing. It is necessary, therefore, to apply judgment based on the individual facts and circumstances of each case. An NPI is mainly financed by a government unit when the main portion of the NPI's operating funds is provided by a government unit.⁸

2.31 The general government sector does not include public corporations or quasi-corporations. When a unit sells some or all of its output, it can be difficult to decide whether to classify the unit as either a government unit or a public corporation or to decide whether a public quasi-corporation exists. In general, the decision is based on whether the unit sells its output at market prices. Any unit that sells all or almost all of its output at market prices is a corporation or quasi-corporation and all other units are government units. With public units, however, market prices are not always easy to identify. The concept of economically significant prices underlies the determination of prices as market or nonmarket and, therefore, the classification of units.

2.32 *Economically significant prices* are prices that have a significant influence on the amounts the producers are willing to supply and on the amounts purchasers wish to buy. This definition can be implemented, however, only with a great deal of judgment after considering all of the facts and circumstances. Although no precise guidelines can be provided, it is clear that an economically significant price does not have to be so high that all costs of production are covered. At the other extreme, a price that is not economically significant is one that is not quantitatively significant from the point of view of either supply or demand. Such prices are likely to be charged in order to raise some revenue or achieve some reduction in the excess demand that may occur when services are

⁶Only resident government units and NPIs are included in the general government sector, but it can be assumed that all government units and NPIs controlled by government are residents. The concept of residency is described in paragraphs 2.70 to 2.77.

⁷The term "general government unit" will generally be used in this manual, but in most cases the text is equally applicable to public corporations. In some cases, reference will be made to public corporations or public sector units for clarity. Otherwise an extension to the public sector can be assumed.

⁸In agreement with footnote 4, the assignment of NPIs to sectors should be identical to the assignment used in the national accounts.

provided completely free, but they are not intended to eliminate such excess demand. The price merely deters those units whose demands are the least pressing without greatly reducing the total level of demand.

2.33 *Market output* consists of goods and services that are sold at economically significant prices, otherwise disposed of on the market, or intended for sale or disposal on the market. *Nonmarket output* consists of goods and services that are supplied free or at prices that are not economically significant to other institutional units or the community as a whole.

2.34 A *market producer* is a unit that markets its entire output. In this context, market output includes output in the form of own-account fixed capital formation. A *nonmarket producer* is a unit that mainly supplies goods or services free or at prices that are not economically significant to households or the community as a whole. These producers may also have some sales of market output as a secondary activity.

2.35 Thus, when classifying units that sell some or all of their output, two questions must be considered. First, if a unit sells most or all of its output, are the prices economically significant? If they all are, then the unit is a public corporation. If none of the prices is economically significant, then the unit is a general government unit. Second, if only some of the prices are economically significant or if the unit sells only some of its output, is it possible to identify a quasi-corporation within the unit? If it is possible, then the organizational components that sell their output at economically significant prices and have a complete set of accounts are treated as a quasi-corporation. The remaining components would form a general government unit. If it is not possible to form a quasi-corporation, then the components selling their output for economically significant prices remain an integral part of the general government unit and their sales are part of the unit's revenue.

2.36 If a general government unit sells some of its output for economically significant prices, then one or more *market establishments* may exist. An establishment is an enterprise⁹ or a part of an enterprise situated in a single location at which only a single productive activity is carried out, or where the principal productive activity accounts for most of the value added. In practice, an establishment is usually identified with an individual workplace at which a particular kind of

productive activity is carried out. An institutional unit may be composed of one or more establishments.

2.37 A market establishment within a general government unit is an establishment that sells or otherwise disposes of all or most of its output at prices that are economically significant.¹⁰ All other establishments are nonmarket establishments. A nonmarket producer, such as a general government unit, will have mostly nonmarket establishments, but it may have one or more market establishments. For example, a municipal swimming pool that charges entrance fees or a government publishing office that sells its publications might be a market establishment. The definition of a market establishment implies that complete accounting records about its production activities are available, including the value of its output and the cost of producing that output. It will not, however, have a complete balance sheet or be able to engage in financial transactions in its own name. If it had those qualities it would be treated as a quasi-corporation. The sales of market establishments are identified in Chapter 5 as a specific category of revenue. Sales by nonmarket establishments, whether at economically significant prices or not, are classified as a different category of revenue, incidental sales of goods and services.

2.38 There are two exceptions to these general rules about the classification of units. First, if the unit is an internal service organization that sells its output mainly to other government units, such as a transportation pool, a supply depot, or a munitions factory, then it is treated as an ancillary unit and its activities are consolidated with the other activities of the government unit that controls it. Second, in some cases a unit that appears to be a financial corporation is in fact a general government unit. Most typically, a government may establish a central borrowing authority that borrows on the market and then lends only to general government units, generally on commercial terms. Such organizations merely facilitate government borrowing and should be classified as general government units.¹¹

2.39 An additional consequence of compiling statistics based on institutional units is that a part of the monetary authority may be included in the general government sector. Normally, the central bank is a

⁹An enterprise is an institutional unit engaged in production.

¹⁰A market establishment is the closest equivalent in this manual to the concept of a departmental enterprise in the *1986 GFS Manual*.

¹¹If the unit mainly lends to public corporations, then it would be classified as a financial corporation.

separate institutional unit classified as a public corporation. In some countries, however, the central government may include units that engage in financial transactions that in other countries would be performed by central banks. In particular, government units may be responsible for the issue of currency, the maintenance of international reserves, the operation of exchange stabilization funds, or transactions with the IMF. When the units in question remain financially integrated with the government and under the direct control and supervision of the government, then they cannot be treated as separate institutional units and any monetary authority functions carried out by the government are recorded in the general government sector.

2. Subsectors of the general government sector

2.40 It is often necessary or desirable for analytic reasons to disaggregate the statistics of the general government sector. Two primary methods of constructing subsectors are presented. The difference between them is the result of alternative possible treatments of social security funds.

2.41 Depending on the administrative and legal arrangements, there may be more than one level of government within a country, and statistics should be compiled for each level. In the GFS system, provision is made for three levels of government: central; state, provincial, or regional; and local. Not all countries will have all three levels; some may have only a central government or a central government and one lower level. Other countries may have more than three levels. In that case, the various units should all be classified as one of the three levels suggested here. In addition to levels of government, the existence of social security funds and their role in fiscal policy may require that statistics for all social security funds be compiled as a separate subsector of the general government sector.

2.42 Classification problems may arise when government operations are carried out by a general government unit jointly responsible to two levels of government. This classification decision may be especially difficult if the agency has its own source of funding, such as earmarked taxes. Similarly, an NPI might be controlled and mainly financed by two or more government units at different levels of government. For example, a state government unit might have the right to appoint the majority of officers managing an NPI but the finance might be provided mainly by the central government.

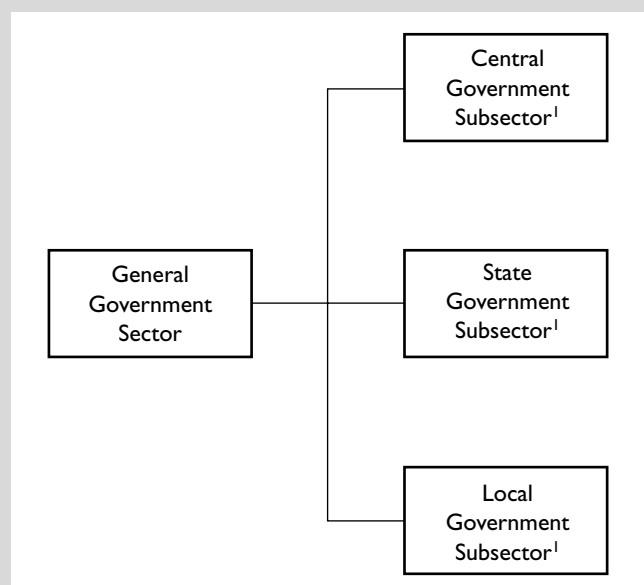
General government units subject to dual control should be classified to the level of government that predominates in financing or controlling its operations, but no precise rules can be formulated that cover all possible arrangements.

2.43 The requirements to classify general government units according to their level of government and whether they are a social security fund can be accommodated in two alternative sets of subsectors. First, all social security funds could be classified according to the level of government that operates them and combined with other general government units at that level. Thus, the subsectors would be central, state, and local government, assuming that all three levels of government exist (Figure 2.1). Second, all social security funds could be combined into a separate subsector and all other general government units could be classified according to their level. In that case, the central, state, and local government subsectors would consist of all government units other than social security funds.

2.44 The alternative methods of subsectoring are designed to accommodate different analytic needs. The decision as to which method is more appropriate in a given country depends on how well organized and important social security funds are and on the extent to which they are managed independently of the government units with which they are associated. If the management of social security funds is so closely integrated with the short- or medium-term requirements of the government's general economic policy that contributions and benefits are deliberately adjusted in the interests of overall economic policy, it becomes difficult, at a conceptual level, to draw any clear distinction between the management of social security and the other economic functions of government. In other countries, social security funds may exist in only a very rudimentary form. In either of these circumstances it is difficult to justify treating social security funds as a separate subsector on a par with central, state, and local government.

2.45 In addition to subsectors based on the level of government and the existence of social security funds, it may be possible to create subsectors at each level of government based on whether the units are financed by the legislative budgets of that level of government or by extrabudgetary sources. It is often analytically desirable to classify these types of units separately because of their differing sources of finance and different types of public oversight of their operations.

Figure 2.1: The General Government Sector and Its Subsectors



¹Includes social security funds. Alternatively, social security funds can be combined into a separate subsector.

2.46 In addition to the classification of units by level of government and by social security funds, some classifications of transactions are based on the other party to the transaction. In those instances, one grouping of units is “other general government units,” which consists of all general government units other than the units for which the statistics are being compiled. For example, when statistics for the central government subsector are compiled, this grouping would include all general government units other than central government units.

2.47 The following sections define the levels of government. These definitions apply regardless of the selected treatment of social security funds.

a. Central government

2.48 The political authority of a country’s central government extends over the entire territory of the country. The central government can impose taxes on all resident institutional units and on nonresident units engaged in economic activities within the country. The central government typically is responsible for providing collective services for the benefit of the community as a whole, such as national defense, rela-

tions with other countries, public order and safety, and the efficient operation of the social and economic system of the country. In addition, it may incur expenses on the provision of services, such as education or health, primarily for the benefit of individual households, and it may make transfers to other institutional units, including other levels of government.

2.49 The compilation of statistics for the central government is particularly important because of the special role it plays in monetary and economic analysis. It is mainly through central government finances that fiscal policy operates on inflationary or deflationary pressures within the economy. It is generally at the central government level alone that a decision-making body can formulate and carry out policies directed toward nationwide economic objectives. Other levels of government have neither national economic policies as their objective nor the central government’s access to central bank credit.

2.50 The central government subsector is a large and complex subsector in most countries. It is generally composed of a central group of departments or ministries that make up a single institutional unit plus, in many countries, other units operating under the authority of the central government with a separate legal identity and enough autonomy to form additional government units.

b. State, provincial, or regional government

2.51 A state, province, or region is the largest geographical area into which the country as a whole may be divided for political or administrative purposes. These areas may be described by other terms, such as provinces, cantons, republics, prefectures, or administrative regions. For ease of expression and consistency with the *1993 SNA*, this level of government will be referred to hereafter as the state government.

2.52 The legislative, judicial, and executive authority of a state government extends over the entire area of an individual state, which usually includes numerous localities, but does not extend over other states. In some countries, individual states and state governments may not exist. In other countries, especially those with federal constitutions, considerable powers and responsibilities may be assigned to state governments.

2.53 A state government usually has the fiscal authority to levy taxes on institutional units that are resident in or engage in economic activities in its area

of competence. To be recognized as a government unit the entity must be able to own assets, raise funds, and incur liabilities on its own account, and it must also be entitled to spend or allocate at least some of the taxes or other income that it receives according to its own policies. The entity may, however, receive transfers from the central government that are tied to certain specified purposes. A state government should also be able to appoint its own officers independently of external administrative control. If a government entity operating in a state is entirely dependent on funds from the central government, and if the central government also dictates the ways in which those funds are to be spent, then the entity should be treated as an agency of the central government.

2.54 If a state government exists, then its principal departments and ministries will constitute a single institutional unit in a manner similar to the core unit of the central government. In addition, there may be agencies operating under the authority of a state government with a separate legal identity and enough autonomy to form additional institutional units. There may also be institutional units whose authority extends over two or more states, but which are responsible to the respective state governments. Such units should also be included in the state government subsector.

c. Local government

2.55 The legislative, judicial, and executive authority of local government units is restricted to the smallest geographic areas distinguished for administrative and political purposes. The scope of a local government's authority is generally much less than that of the central or state governments, and such governments may or may not be entitled to levy taxes on institutional units or economic activities taking place in their areas. They are often heavily dependent on grants from higher levels of government, and they may also act as agents of central or state governments to some extent. To be treated as institutional units, however, they must be entitled to own assets, raise funds, and incur liabilities by borrowing on their own account. They must also have some discretion over how such funds are spent, and they should be able to appoint their own officers independently of external administrative control.

2.56 Local governments typically provide a wide range of services to local residents, some of which may be financed out of grants from higher levels of government. Statistics for local government may cover a wide variety of governmental units, such as counties, munic-

ipalities, cities, towns, townships, boroughs, school districts, and water or sanitation districts. Often local government units with different functional responsibilities have authority over the same geographic areas. For example, separate government units representing a town, a county, and a school district may have authority over the same area. In addition, two or more contiguous local governments may organize a government unit with regional authority that is accountable to the local governments. Such units should also be included in the local government subsector.

2.57 Some of the most typical functions of local governments include (1) educational establishments to which users' fees are small in relation to the main costs borne by the local government; (2) hospitals and social welfare establishments, such as kindergartens, nurseries, and welfare homes; (3) public sanitation and related entities, such as water purification systems and plants, refuse collection and disposal agencies, cemeteries, and crematoria; and (4) culture, leisure, and sports facilities, such as theaters, concerts, music halls, museums, art galleries, libraries, parks, and open spaces.

2.58 Government units serving both a state government and one or more local governments would be included with the level of government that predominates in its operations and finances. In some countries more than one level of government exists between the central government and the smallest governmental institutional units at a local level. In such cases, these intermediate levels of government are grouped together with the level of government, either state or local, with which they are most closely associated.

D. The public sector

2.59 Statistics should be compiled for the public sector as well as for the general government sector. For example, public corporations may carry out government operations at the behest of the government units that own them. Such activity can take place in a variety of forms. Most directly, a public corporation can engage in specific transactions to carry out a government operation, such as lending to particular parties at a lower-than-market interest rate or selling electric power to selected customers at reduced rates. More generally, however, a public corporation can carry out fiscal policy by employing more staff than required, purchasing extra inputs, paying above-market prices

for inputs, or selling a large share of its output for prices that are less than what the market price would be if only private producers were involved.

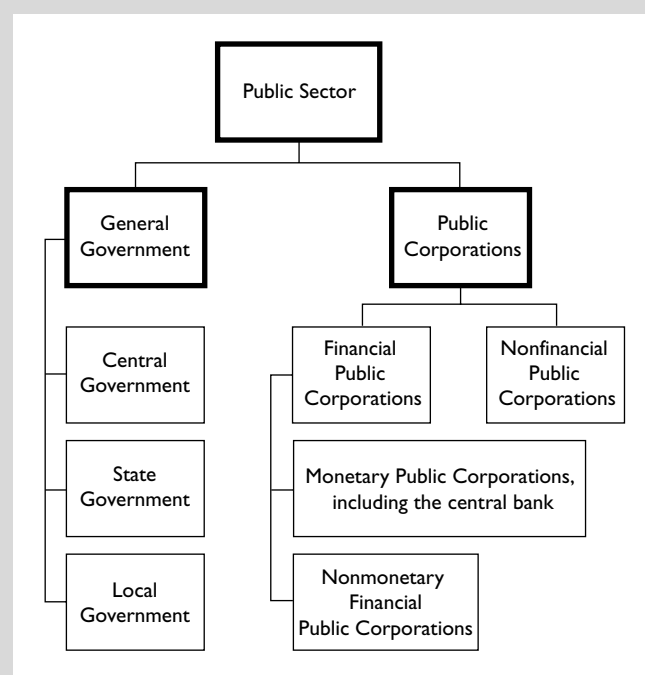
2.60 Statistics on public corporations are also likely to be necessary to compile comprehensive statistics for the general government sector. For example, changes in the net worth of public corporations are reflected in the value of the equity of those corporations owned by general government units. The accounts of public corporations will help explain the source of changes in these assets, and that information will be useful for an analysis of sustainability and other aspects of fiscal analysis.

2.61 When compiling statistics of public corporations, various groupings—or subsectors of the public sector—may be desirable for analytic purposes. Four groupings of public corporations will likely form the foundation from which other groupings can be created. These four groupings are (Figure 2.2):

- Nonfinancial public corporations—all resident nonfinancial corporations controlled by general government units.
- Nonmonetary financial public corporations—all resident financial corporations controlled by general government units except the central bank and other public depository corporations. Depository corporations are financial corporations, quasi-corporations, or market NPIs whose principal activity is financial intermediation and who have liabilities in the form of deposits or financial instruments that are close substitutes for deposits.
- Monetary public corporations other than the central bank—all resident depository corporations other than the central bank that are controlled by general government units.
- The central bank, which consists of the central bank itself, currency boards or independent currency authorities that issue national currency that is fully backed by foreign exchange reserves, and other government-affiliated agencies that are separate institutional units and primarily perform central bank activities.

2.62 Starting with the four groupings just listed and the subsectors of the general government sector, other subsectors of the public sector can be created, including:

Figure 2.2: The Public Sector



- The nonfinancial public sector—the general government sector plus nonfinancial public corporations.
- The nonmonetary public sector—nonfinancial public corporations, nonmonetary financial public corporations, and the general government sector.
- Central government public sector—the central government subsector plus public corporations controlled by the central government.

E. Sectors other than the general government and public sectors

2.63 Certain transactions in the GFS system are classified by the sector of the other party to a financial instrument. For example, in Chapter 9 the incurrence of debt liabilities by the general government sector can be classified by the sectors in the rest of the economy or in other countries providing the finance. For this purpose, a classification of sectors other than the general government or the public sector is needed. This section summarizes the definitions of the sectors used in those classifications. In some cases, the sectors are identical to those defined in the 1993 SNA. In

other cases, different groupings of institutional units are appropriate for use in the GFS system. In particular, the term “sector” is used in the 1993 SNA only in reference to resident institutional units. The aggregate of all nonresident institutional units is referred to as the rest of the world. In this manual, sector is used to refer to nonresident units in the same manner as it is used to refer to resident units.

2.64 The *financial corporations sector* consists of all corporations, quasi-corporations, and market NPIs principally engaged in financial intermediation or in auxiliary financial activities closely related to financial intermediation. In some cases, this sector is disaggregated into three subsectors: the central bank, other depository corporations, and financial corporations not elsewhere classified.

2.65 The *other depository corporations subsector* consists of all depository corporations, quasi-corporations, and market NPIs except the central bank.

2.66 The *financial corporations not elsewhere classified subsector* consists of all nondepository financial corporations, quasi-corporations, and market NPIs.¹² It includes units that raise funds on financial markets other than by deposits and use them to acquire other kinds of financial assets, such as investment corporations, corporations engaged in financial leasing, hire purchase corporations, other corporations engaged in the provision of personal finance or consumer credit, insurance corporations, and autonomous pension funds. It also includes corporations, quasi-corporations, and market NPIs engaged primarily in activities closely related to financial intermediation, such as public exchanges and securities markets, brokers and agents, foreign exchange companies, financial guarantee corporations, insurance and pension auxiliaries, and government-affiliated units established to regulate financial institutions.

2.67 The *other nonresidents* sector is an aggregation of all nonresident nonfinancial corporations, households, and NPIs serving households with which the general government sector had transactions.

2.68 The *international organizations sector* consists of all international organizations, all of which are nonresidents. As indicated in paragraph 2.76,

supranational organizations are considered a type of international organization.

2.69 As described earlier, transactions between general government units and public corporations can have an important impact on statistics of the general government. In such cases, the financial and nonfinancial corporations sectors and subsectors can be divided into a public corporations subsector and an other corporations subsector. The latter would include all foreign-controlled corporations.

F. Residency

2.70 The concept of residency is important for determining the coverage of the GFS system and the classification of transactions. The total economy of a country consists of the set of all resident institutional units, and the general government sector consists of all resident general government units. In addition, as described in later chapters, some types of transactions and stocks of assets and liabilities of the general government sector are classified in the GFS system on the basis of the other party to a financial instrument, and one of the classification criteria is the residency of the other party.

2.71 An institutional unit is resident in a country if it has a center of economic interest in the economic territory of that country. Residency in the GFS system is not based on nationality or legal criteria, although it may be similar to the concepts of residency used for exchange control, taxes, or other purposes in many countries.

2.72 The economic territory of a country consists of the geographic territory administered by a government. The economic territory need not be identical to its physical or political borders, but it will usually correspond closely with these borders. In particular, the economic territory of a country includes the following:

- The airspace, territorial waters, and continental shelf lying in international waters over which the country enjoys exclusive rights or over which it claims to have jurisdiction in respect of the right to fish or to exploit fuels or minerals below the sea bed.
- Territorial enclaves physically located in other countries that a government owns or rents with the formal political agreement of the government of the country in which they are physically located.

¹²This subsector is the combination of three subsectors in the 1993 SNA: other financial intermediaries, except insurance corporations and pension funds; financial auxiliaries; and insurance corporations and pension funds.

These enclaves are used for embassies, consulates, military bases, scientific stations, information offices, immigration offices, and aid agencies. Conversely, the economic territory of a country does not include the territorial enclaves that are physically located within the geographical boundaries of that country that are used by foreign governments or international organizations.

- Any islands belonging to a country that are subject to exactly the same fiscal and monetary authorities as the mainland.
- Free zones and bonded warehouses or factories within the geographical boundaries of a country that are operated by offshore enterprises under customs control.

2.73 An institutional unit has a center of economic interest within a country when there exists some location—a dwelling, place of production, or other premises—within the country’s economic territory on or from which it engages, and intends to continue to engage, in economic activities and transactions on a significant scale indefinitely or over a finite but long period of time. In most cases, a long period of time may be interpreted as one year or more. The location need not be fixed so long as it remains within the economic territory.

2.74 On the basis of this definition of residency, all general government units are considered to be residents in their own country regardless of their physical location. Public corporations, however, are considered to be residents of the economies in whose territories they operate. Thus, a general government unit resident in one country can own a corporation resident in a second country. In particular, when a resident public corporation maintains a branch, office, or production site in another country in order to engage in a significant amount of production over

a long period of time, the branch, office, or site is considered to be a quasi-corporation resident in the other country.

2.75 The economic territory of an international organization consists of the territorial enclaves over which it has jurisdiction. As a result, international organizations are not considered residents of any national economy, including the country in which they are located or conduct their affairs.

2.76 Supranational authorities are international organizations that have been endowed with the authority to raise taxes or other compulsory contributions within the territories of the countries that are members of the authority. Despite the fact that supranational authorities fulfill some of the functions of government within each member country, they are not resident units of any country. Thus, transactions between the supranational authority and resident institutional units outside the general government or public sectors are not included in the GFS system of an individual country. It is possible, however, to compile statistics for supranational authorities using the GFS framework as if they constituted a separate government. In doing so, the various categories of transactions and other economic flows should be classified according to the member country that is the counter party so that analytic measures can be compiled for individual countries that include the impact of supranationals.

2.77 A regional central bank is an international financial organization that acts as a common central bank for a group of member countries. Such a bank has its headquarters in one country and usually maintains national offices in each of the member countries. Each national office acts as the central bank for that country and is treated as a resident institutional unit in that country. The headquarters, however, is an international organization.