REVISION OF THE BALANCE OF PAYMENTS MANUAL, FIFTH EDITION

(ANNOTATED OUTLINE)

April 2004

Statistics Department
INTERNATIONAL MONETARY FUND

Table of Contents

Chapter 12. Capital Account

Chapter 13. Uses of Balance of Payments and International Investment Position Data

Tables

Note for Reviewers

As new economic developments occur and needs in economic analysis change, international guidance for macroeconomic statistics also needs to evolve. The update of the fifth edition of the IMF's *Balance of Payments Manual* (*BPM5*) is being conducted in parallel with the review of the *System of National Accounts 1993*. The intention is to maintain the harmonization between balance of payments statistics and national accounts.

The Annotated Outline is designed to provide a framework for discussions on the updating of *BPM5*. It has benefited from the comments on a draft version made by members of the IMF Committee on Balance of Payments Statistics and international organizations. Versions in Arabic, Chinese, French, Russian, and Spanish will be released later as they become available.

The Annotated Outline is intended to note issues that have been identified in balance of payments and international investment position statistics and to point to possible solutions. It is being circulated to give compilers and users an opportunity to provide views on the content, structure, and detailed proposals. Their comments and suggestions are invited and will play an important part in the development of the revised manual, which—when drafted—will also be circulated for review and comment.

To assist reviewers, questions about key issues are included in the Annotated Outline. Reviewers are encouraged (but not required) to answer these specific questions, and comments certainly need not be limited to responses to these questions. It would be helpful for the review process, if the particular paragraph(s) of the Annotated Outline that comments refer to would be cited in comments.

Because the manual is designed to be a comprehensive theoretical framework, it deals with items that may be important for some countries but minor or impractical for some other countries. After the manual's expected completion in 2008, it is planned to revise the *Balance of Payments Compilation Guide*. Practical and compilation issues will be addressed in the compilation guide rather than in the manual.

Input on the Annotated Outline and content of the manual from interested parties is welcomed. Comments may be sent by July 15, 2004 by e-mail (bpm5update@imf.org), telephone (1 202 623-7930), fax (1 202 623-6033), or mail to:

Mr. Neil Patterson
Assistant Director
Balance of Payments and External Debt Division I
Statistics Department
International Monetary Fund
700 19th Street, NW
Washington, DC 20431, USA

The update is being conducted through the IMF Committee on Balance of Payments Statistics and the technical expert groups it has created. Nonetheless, to ensure as wide a consultation as possible, proposals, discussion papers, and draft versions of the manual will be made available for public comment, primarily through the IMF website: http://www.imf.org/external/np/sta/bop/bopman5.htm

April 2004
Washington, D.C.

Chapter 1. Introduction

1.1 The introduction to this newest revision to the *Balance of Payments Manual* will announce the scope of the revised manual, the need for the revision, the changes in structure (changes in chapters 2-13 and appendices), guidance on use of the manual, updating of the manual, and metadata and dissemination standards. Also, each section of a chapter will conclude with a summary question in italics for discussion.

A. Title and Scope of Manual

1.2 Before this section addresses the scope of the manual, comments are provided here for discussion on options for a title. Specifically, it is proposed to use in this manual the expression “international accounts” or “external accounts” to cover the balance of payments and international investment position together with a reconciliation between them. Such a term is needed to avoid the lengthy “balance of payments and international investment position” and to emphasize that together they provide an integrated view, rather than two separate areas of data. The terminology “international accounts” was adopted in *BPM5* (see footnote 2 to para. 13 and para. 461) but was not used systematically.

1.3 Thus, the proposed options for the title for this manual are:

- *International Accounts Statistics Manual 200X*: Balance of Payments and International Investment Position Statistics* (*IASM 200X** for short);

- *External Accounts Statistics Manual 200X*: Balance of Payments and International Investment Position Statistics (EASM 200X** for short); or

- *Balance of Payments and International Investment Position Statistics 200X* (*BOPIIPSM 200X** for short).

  (* where 200X is the year of publication, probably 2008 or 2009)

The options for new titles are designed to emphasize that international accounts have evolved to cover transactions, rather than payments, and that they have fully integrated position statements. Nevertheless, it is considered desirable to maintain “balance of payments” in a subtitle to highlight the link to the previous manuals and to commonly used terminology. The adoption of the year of issue, rather than the number of edition, is in accord with practice for other recent statistical manuals (e.g., the *1993 SNA*, *ESA 95*, *GFSM 2001*).

[Question: What title should be proposed for the new manual?]

1.4 This introductory chapter will go on to note that the development of international statistical standards seeks to provide a mix of detailed principles on identified issues and general concepts that can be applied to new situations. In response to changes in economic situations and user interests, and accumulation of experience by compilers, revised manuals are required from time to time.

1.5 The main objectives of the revised manual will be as stated in *BPM5*, para. 2, viz.:

(a) to provide and explain concepts, definitions, classifications, and conventions; and

(b) to facilitate the systematic collection, organization, and comparison of balance of payments and international investment position statistics.

In addition, the following objectives will also be stated:

(c) to promote consistency and show the links of balance of payments and international investment position statistics with other macroeconomic statistics and international accounting standards;

(d) to introduce various statistics on international transactions and positions that are extensions of the core framework but related to it, including references to specialized manuals on services, reserve assets, external debt, and portfolio investment; and

(e) to provide a brief introduction to uses of international accounts data.

[Question: Should these objectives be amended? Should others be added?]

1.6 The manual is not intended to address compilation issues. This section of the introduction will note that the *Balance of Payments Compilation Guide* is a separate companion volume to this manual that will deal with compilation issues. A new edition of the *Compilation Guide* will be prepared after this manual is completed. (The title of the *Compilation Guide* would be revised in line with any changes to the title of this manual.) This manual will sometimes refer to compilation issues when they may be relevant to a decision about adoption of a concept.

1.7 It is also planned to produce an updated edition of the *Balance of Payments Textbook*, which is intended to provide more explanation and examples of the concepts in the revised manual, in a way targeted for training courses.

B. Need for a Revised Manual

1.8 It will be proposed that the overall structure of the international accounts will be essentially unchanged from that of *BPM5*. In contrast, when *BPM5* was introduced, the structure of accounts was changed significantly, owing to the elaboration of the international investment position and greater harmonization of concepts with other statistics. However, there have been developments in economic circumstances and economic policy. Specifically the factors that led to the decision to produce a new edition of the manual are the needs to:

(a) take into account financial innovations that engender new types of financial assets and liabilities and increase growth in financial services;

(b) clarify selected areas (e.g., scope of direct investment, services, the borderline between use of an asset and sale of an asset);

(c) increase emphasis on the international investment position and show it fully interlinked with transactions and other flows;

(d) demonstrate the integration between international accounts statistics and other macroeconomic statistics, taking into account changes made as part of the review of the *System of National Accounts 1993* (*1993 SNA*) and the publication of the *Monetary and Financial Statistics Manual 2000* (*MFSM*);

(e) take account of developments in international accounting standards;

(f) give more details on the underlying economic concepts and their associated links with the equivalent parts of the updated *1993 SNA;*

(g) take into account specialized manuals, emphasizing the consistency of basic concepts of the *Manual on Statistics on International Trade in Services*, *External Debt Statistics: Guide for Compilers and Users* (*"the Debt Guide")*, *Coordinated Portfolio Investment Survey Guide* (*CPISG2*), *International Reserves and Foreign Currency Liquidity: Guidelines for a Data Template* (the "*Reserves Template*"), *Compilation Guide on Financial Soundness Indicators*, and *OECD Benchmark Definition of Foreign Direct Investment (Benchmark Definition of FDI)*;

(h) introduce the idea of satellite accounts to allow alternative presentations that use the same underlying principles but with (i) additional detail, and/or (ii) some alternative concepts, including nonfinancial variables (such as numbers of visitors or migrants) so that this manual can be used as a starting point for other types of analysis, and so maintain a consistent base;

(i) give background information on standards for data dissemination and frameworks for data quality assessment; and

(j) deal with the special issues surrounding economic and currency unions.

[Questions: (i) Are these objectives suitable? (ii) Are there any other objectives or examples that should be mentioned?]

1.9 This section will go on to note that changes in the treatment of financial derivatives and direct investment that were introduced as amendments to *BPM5* in 2000 and 2002 are incorporated in this edition.

1.10 This section will note the role of the IMF and the IMF Committee on Balance of Payments Statistics (BOPCOM) in development of the manual. It will explain that BOPCOM comprises national statistical experts and Fund staff, as well as staff of other international agencies. It has guided the production of the new manual by discussing relevant issues, reviewing problems, and providing clarifications.

1.11 This section will outline the process of its production, including extensive consultation with BOPCOM, expert groups, national compilers, and other users.

1.12 This chapter will briefly outline the history of the *Balance of Payments Manual*, noting editions released by the Fund in 1948, 1950, 1961, 1977, and 1993. It will make some general comments on evolution (e.g., shift from partial to full accrual, exchange orientation to general economic analysis, including international investment positions, harmonization with other datasets). It will highlight the importance of these manuals to the work of the Fund and economic analysis generally. (If long, the historical material could be shown as an appendix.)

C. Structure of the Manual

1.13 This section will state that the manual contains:

(a) introductory chapters on concepts that underlie the whole of the international accounts (Chapters 2-5);

(b) chapters that deal with a specific account, each account designed to show a separate economic process or phenomenon (Chapters 6-12);

(c) uses of international accounts statistics (Chapter 13); and

(d) appendices providing more detail on specific issues (including changes between *BPM5* and this manual, comparison with the *SNA*, and the listing of standard components).

1.14 This section will explain that the structure is designed to emphasize the general principles on which the accounts are based and the reason for the arrangement of the accounts. The structure of chapters is broadly similar to *BPM5*, with the following main differences:

(a) Classifications that are used in several accounts (including institutional sectors, financial instruments, functional categories, currency, and maturity) will be discussed in the introductory chapters, rather than under a particular account or an appendix. For example, it is considered beneficial to deal with functional categories together to highlight the borderline issues. In addition, it is recognized that the functional categories are classifications that apply across income, international investment position, other changes, and financial transactions.

(b) To emphasize the role of the accounts and how each account represents a single economic process or phenomenon, each account will have its own chapter (Chapters 6-12).[1] In *BPM5*, some accounts were split over several chapters, and some chapters covered two accounts. To reflect the increasing orientation toward information on international investment position and to reflect better the place of the IIP in the system, the stocks, transactions, and other changes in financial assets and liabilities will appear before the other accounts. The proposed order of Chapters 6-12 is shown and related to the overall structure of the statistical system in Figure 2.1 in Chapter 2 Overview. It first shows the international investment position and the flows that give rise to it, followed by the current and capital accounts. An alternative option for the order of chapters would be to follow the *1993 SNA* order, that is, with the transactions accounts (goods and services, primary income, secondary income, capital, and financial accounts), followed by other flows, followed by the international investment position.

[Comment: Since the accounts and their interrelationships are unchanged, and few people read the manual from cover-to-cover, the order is symbolic. The proposed order is designed to highlight the central role of international investment position. This emphasis is a response to economic developments and trends in economic analysis over the past decade.]

[Question: Which chapter order is preferred?]

(c) A chapter on uses of international accounts statistics will be included (Chapter 13 Uses).

1.15 This section will go on to note that the structure will inevitably involve cross-referencing and repetition, reflecting the integrated nature of the accounts. For example, aspects of a financial lease include services, interest, and loans. The general approach used

---

[1] "Account" is defined in the same way as the accounts in the *1993 SNA* and coincides with the second level of detail in the hierarchical classification used in the *BPM5* Standard Components (pp. 43–48).

will be to handle these topics under one heading to reduce repetition but provide extensive cross-referencing. For some topics that affect several accounts, it is proposed to include appendices to bring together the different aspects, e.g., insurance.

1.16 This section will note that each chapter showing specific accounts will include a simplified table, showing the account, to assist in giving an overview of the process or phenomenon that it covers and its classification. However, these tables are intended for explanatory purposes. It will be noted that the standard and other presentations will be used for statistical dissemination. These tables will include numbers based on examples, in the interest of allowing readers to check interrelationships.

1.17 A proposed list of appendixes is shown at the end of this Annotated Outline. It includes a standard presentation.

1.18 Finally, this section will note that the manual will identify standard components for reporting to the Fund to facilitate international comparisons (listed in the proposed appendices at the end of this Annotated Outline). As well, some compilers may wish to develop additional national presentations that take into account their own circumstances, for example by providing additional detail for significant components.

D. Guidance on Interpretation of the Manual

1.19 The approach of each chapter will be to:

(a) start with a statement of general economic principles—designed to assist compilers in dealing with new or other uncovered situations; and

(b) then, discuss specific cases as examples and to clear up ambiguity. (These are intended to apply general principles, not to contradict them.)

1.20 To begin, each chapter will set out concepts that serve to establish the comprehensive framework. However, it will not purport to take into account the conditions in each economy. Accordingly, while the items included are designed to constitute a comprehensive framework, they will include items that may be nonexistent or minor in particular economies. In addition, data collection for some items in the framework may be impractical if the item is small and the data collection cost is high. Conversely, compilers may identify other items of particular economic interest in their economy for which additional detail may be required by policymakers and analysts. The manual will note that comprehensive data systems should be set up to allow data to be presented as required.

1.21 Consequently, in implementing changes in the manual, compilers will be encouraged to assess the materiality and practicality of particular items in an account according to their own circumstances and further encouraged to revisit these decisions from time to time to see if circumstances have changed. It will be emphasized that such decisions necessarily rely on the professionalism of the compiler.

> *[Questions: Should anything more be said on the balance between international standards and adaptation to particular circumstances? If so what?]*

1.22 This section will go on to note that the manual distinguishes between:

(a) standard components and memorandum items that are part of the standard components; and
(b) supplementary items that are raised as options that may be considered when a particular issue is of interest to analysts and policymakers.

1.23 Data collection and other compilation procedures, including departures from standards, are not generally within the scope of a conceptual manual such as this one, because such decisions should take into account materiality and compilation issues that need to be judged in each territory. Nevertheless, in a few cases, where a problem is considered to be widespread and there is a desire that it should be handled consistently, the manual will propose alternative concepts that represent a compromise.

1.24 The intention is to reinforce harmonization with the revised version of the *1993 SNA*. It will be noted that there is no intention to differ from the revised *1993 SNA* unless specifically stated. (A list of any differences between this manual and the revised *1993 SNA* will be presented as an annex to this manual, and the datasets will be designed to be reconcilable.)

1.25 Finally, a note along the lines of *BPM5* para. 13 footnote 2, will be included concerning the purpose of the definitions and classifications of this manual in relation to the Fund's Articles of Agreement.

E. Updating the Manual

1.26 This section will note that the Fund and the IMF Committee on Balance of Payments Statistics (BOPCOM) have developed procedures for updating the manual, as stated in BOPCOM-01/33 paras. 10–15, and these procedures will be used on an ongoing basis. The procedures will be listed in an appendix. It will note that it is proposed that changes be made readily available to compilers and users, for example, by special supplements and by placing documents on the Fund website. Possible arrangements could be set out, such as a dedicated section of the Fund website for updates, maintaining an electronic version of the manual that incorporates revisions.

F. Metadata and Data Dissemination Standards

1.27 This section will note that one of the most important statistical developments since 1993 has been the increased emphasis on publication of metadata (that is, information about data). The manual mainly deals with conceptual standards, but it will emphasize that preparation of metadata is essential to statistical compilation. Some examples will be given of issues that metadata should cover. Compilers will be urged to note explicitly cases when international standards have not been followed. An appendix outlining the main features of the Special Data Dissemination Standard (SDDS), General Data Dissemination System (GDDS), Data Quality Assessment Framework (DQAF), and a listing of the latest summary methodology prompt points will be proposed; however, it will be noted that they are likely to be subject to updating. (This topic could be dealt with in a box, as in Box 4.1 of the *Debt Guide*.)

> *[Questions: (i) Would it be helpful if guidance were provided on the compilation of metadata (e.g., along the lines of the prompt points used for preparation of summary methodologies in the context of the SDDS)? (ii) If so, should this be dealt with in this manual or in a companion document that could be placed on the web and updated more frequently?]*

References

BPM5 ch 1

1993 SNA ch 1

GFSM 2001 ch 1

MFSM ch 1

IMF, *Updating BPM5: A Proposal on How to Proceed* (BOPCOM-01/33)

Changes from *BPM5*

Change proposed:

Revised title (three options given) (para.1.3).

The manual will be restructured, so that international investment position is given greater prominence and the classification issues are dealt with in preliminary chapters rather than in the course of several chapter dealing with the financial account (para. 1.14).

A distinction between memorandum and supplementary items will be introduced (para. 1.22).

Introducing the link to data dissemination standards and data quality assessments (para. 1.27).

Glossary

1993 System of National Accounts (*1993 SNA*)
Balance of payments statistics (in contrast to "balance of payments," which can mean the monetary authorities' reserves management function, as in "for balance of payments needs" in the *BPM5* definition of reserves)
Data Quality Assessment Framework (DQAF)
General Data Dissemination System (GDDS)
IMF Committee on Balance of Payments Statistics (BOPCOM)
International accounts
Materiality
Memorandum items
Metadata
Satellite accounts
Special Data Dissemination Standard (SDDS)
Standard presentation
Supplementary items

Chapter 2. Overview of International Accounts

A. General Principles

2.1 This chapter's first section will briefly state the purpose of international accounts and their relationship to other datasets. The scope of international accounts will be explained, as per *BPM5* paras.13–14, as well as the terms "balance of payments" and "international investment position" but highlighting their integration. The international accounts will be defined as a framework for the analysis of an economy's international economic relationships. The importance of the international accounts will be briefly explained, such as relevance to assessing international economic performance, exchange rate policy, reserves management, external vulnerability, and monetary policy. (There will be a detailed study of uses of international accounts in Chapter 13.) In addition, since international accounts are embedded in the *1993 SNA*, international economic relations can be linked to other economic datasets so as to examine interrelationships.

2.2 While the concepts and structure of the international accounts are embedded in the *1993 SNA*, the focus on particular aspects in this manual means that they have some presentational and classificatory differences from the *1993 SNA*. In particular, emphasis is given to the functional classification (direct investment, reserves, etc.). Also, the manual deals with some issues specific to or highlighted in international accounts, such as special purpose vehicles created in other jurisdictions and mobile production. Furthermore, international accounts often use different data sources.

B. Structure of the International Accounts

2.3 This section will show the sequence of accounts to give an overview, emphasizing the different economic processes and phenomena shown in each part of the accounts, and highlighting the linkages between the different accounts. Only the major aggregates will be shown in this chapter; more detailed components will appear in the relevant chapters; a full listing of standard components will appear as an appendix. An introduction to the analytic framework will be given, dealing with the kinds of material on the overview of the accounting structure in *BPM5* paras. 34–56 and on the analytic framework in *GFSM 2001* Chapter 4 and *MFSM* Chapter VIII.

2.4 The manual will give two introductory presentations of the structure of the international accounts, showing the basic concepts common to the *SNA* and international accounts:

(a) Setting out a sample table of the major aggregates of international accounts (along the lines of *GFSM 2001* pp. 38, 46 and *1993 SNA* Tables 2.3 or 2.8; with the same structure as Standard Components tables in *BPM5,* but shorter so as to give an overview on one page or a two-page spread. The use of a numerical example, as in the *1993 SNA*, is planned in order to help to clarify concepts, inter-relationships, and identification of netting, zero cells, etc. A comprehensive presentation with all the standard components will be included as an appendix.)

(b) Broad overview of the sequence of national accounts with a view to showing the connection to the international accounts (along the lines of *GFSM 2001* pp. 36-37; *MFSM* Box 8.1, or *BPM5* pages 14-19). This will highlight different economic processes or phenomena shown in each of the flow accounts:

- production of goods and services;
- income (primary distribution of income);
- current transfers (distribution of secondary income);
- accumulation of nonproduced nonfinancial assets;
- accumulation of financial assets and liabilities; and
- other changes (revaluation, reclassification, write-offs, etc.);

which lead to:

- position statements of assets and liabilities.

This structure is also the basis of the *1993 SNA*, so its use underlies the harmonization of international accounts and other statistics.

2.5 This section will also point out the possibility of doing alternative presentations, for example, an analytic presentation (to be shown in Chapter 13 Uses) of the basic items, rearranged to emphasize international liquidity aspects of the balance of payments.

2.6 The following table shows the accounts, their balancing items, their linkages, and the corresponding chapter of the manual.

Figure 2.1 —Overview of Accounts, their Balancing Items, and Corresponding Chapters of the Manual

Balance of Payments

Transactions

I
Goods and Services Account

Balance on goods and services

(Chapter 9)

II
Primary Distribution of Income Account

Balance on primary income account
Balance on goods, services, and primary income (I+II)

(Chapter 10)

III
Secondary Distribution of Income Account

Balance on secondary income account
Current account balance (I+II+III)

(Chapter 11)

IV
Capital Account

Balance on capital account
Net lending/borrowing (I+II+III+IV)

(Chapter 12)

Stocks	**Net change from transactions**	**Net change from other flows**	**Stocks**
Opening International Investment Position	Financial Account	Other Changes in Financial Assets and Liabilities	Closing International Investment Position
Net IIP	*Net lending/borrowing*	*Net other changes*	*Net IIP*
(Chapter 6)	(Chapter 7)	(Chapter 8)	(Chapter 6)

2.7 These accounts will be defined briefly and linked to the subsequent specific chapters on each. Possible groupings of accounts will be noted:

- the accounts in Chapters 6-8 make up the international investment position and associated reconciliation of opening and closing values;
- the accounts in Chapters 9-11 make up the current account;
- the accounts in Chapters 7 and 9-12 make up the balance payments; and
- the accounts in Chapters 7, 8, and 12 make up the accumulation accounts.

(Note: The order of chapters was discussed and a question asked in Chapter 1 Introduction.)

2.8 This section will point out that the balance of payments uses a double-entry system, where two simultaneous entries of equal value are recorded for transactions, from the resident's viewpoint. This accounting system will be contrasted with the *1993 SNA* that also covers the entries for the counterpart unit involved in the flows (quadruple-entry system). It will also be noted that international accounts do not cover the production or use of income, because these are domestic processes that do not involve nonresidents. International accounts data have the same scope as the *1993 SNA* rest of the world sector, that is, transactions and positions between residents and nonresidents, but from the opposite perspective. The reason is the *1993 SNA* rest of world sector is expressed from the point of view of the nonresident units while the international accounts are expressed from the point of view of the resident units.

2.9 The section will go on to discuss the components of the current account and the meaning of the current account as a whole (as in *BPM5* Chapter IX);

2.10 The text will explain in more detail the relationships between the following:

(a) the closing balance sheet and the opening balance sheet, financial transactions, and other flows;

(b) the current, capital, and financial accounts (i.e., the balance of payments), showing transactions;

(c) the balance on the current and capital accounts and the balance on the financial account;

(d) the financial account of the international accounts and domestic financial accounts;

(e) the international investment position and national balance sheets;

(f) financial assets and liabilities and their corresponding income (the link between each financial instrument and its corresponding income is shown in Chapter 5

Classifications). The other changes in financial assets and liabilities account shows the nonincome aspects of the return on financial assets and liabilities; and

(g) current, capital, and financial account balances and saving and net lending in national accounts data.

2.11 This section will emphasize (as in *BPT* Chapter III) that each account is designed to show an economic process, function, or phenomenon that has economic meaning in its own right. Also, the account describes that process or phenomenon—the account is not just used to derive a balancing item.

C. Net Errors and Omissions

2.12 The causes and presentation of net errors and omissions will be discussed.

2.13 It will be stated that net errors and omissions are caused by imperfect source data, collection, and processing and are a usual feature of international accounts and other statistics. It will be stated that they should be dealt with transparently by dissemination to users.

2.14 It will be stated that the size and trends of net errors and omissions may help identify data problems and should be investigated in the light of an assessment of coverage, reporting problems, etc. In particular, they should not be included indistinguishably in other items. It will be noted that while net errors and omissions can help point to errors, it is an incomplete measure because errors in opposite directions are netted out. It will be noted that patterns in net errors and omissions provide useful information, for example, a consistent sign indicates a bias in one or more components, while a volatile pattern may suggest possible timing problems. While it is not possible to give guidelines on an acceptable size of net errors and omissions, it should be assessed by compilers in relation to other items, such as GDP, positions data, and gross flows (where possible).

2.15 This section will recommend that a net errors and omissions item be shown explicitly. Alternatives include placing net errors and omissions at the end of the financial account (to stress that the item has not been observed but derived residually), between the capital account and the financial account (to make it more evident that errors may occur in any part of the balance of payments and that it is equal to the difference between sum of the current and capital accounts and the financial account), or before the presentation of reserve assets in the financial account (as in the “analytic” presentation).

[Question: Should a particular place be specified? If so, which location is preferred?]

D. Time Series

2.16 The section will go on to note that while the bulk of the manual will deal with borderline and classification issues, with presentations focusing on relationships between series, some of the manual will deal with time series analysis. The need to support time series analysis has implications for good practice in compilation of international accounts, such as:

(a) consistency over time in concepts and compilation to avoid "breaks" and "steps" caused by compilers;

(b) location of revisions, depending on whether these are changes to source data, statistical technique, or concept;

(c) predictability and transparency of revisions; and

(d) consistency of available annual, quarterly, and monthly data.

2.17 It will be noted that the tables included in the manual have been designed to highlight classifications and interrelationships, whereas tabulations for users have been designed generally to show time series.

2.18 Seasonal adjustment of monthly and quarterly data will be mentioned as a potentially useful presentation of time series data for both analysis and compilation. It will be noted that the financial account, international investment position, and other items are often not suitable for seasonal adjustment, because of the high degree of irregularity.

2.19 The *Quarterly National Accounts Manual* will be referred to as a source of further information on time series insofar as many of the issues associated with monthly and quarterly international accounts statistics overlap.

2.20 An important aspect of assisting in the interpretation of time series is the pattern of revisions. Some articles on revision practices and studies could be cited.

E. Satellite Accounts and Other Alternative Presentations

2.21 While this manual will show a standard presentation, the manual will recognize the fact that no single framework can meet all the different analytical interests. Thus, this section will introduce the satellite accounts approach, as introduced in the *1993 SNA* paras. 2.245–249 to deal with this situation. For example, satellite accounts use the basic framework as a starting point but with concepts and definitions that differ from existing accounts; add detail or other information about a particular aspect of the economy to that in existing accounts; and rearrange information differently, to meet particular needs. Such presentations would be based on the circumstances in each economy and not be part of international requirements. Use of the basic framework for the satellite data increases the ability to relate the topic to other aspects of the economy and maintaining international comparability. The extensions to the basic framework allow other analytical needs to be met. The *Debt Guide*, the *Reserves Template*, and *CPISG2* are important examples of the satellite approach of expanded data linked to core international accounts principles.

2.22 Illustrations of possible other satellite accounts and other alternative presentations include the following:

(a) Additional related information. For example:

i. The *Debt Guide* uses the basic international accounts framework but supplemented by other data, e.g., forward payments schedules.

ii. The *Reserves Template* adds supplementary information such as contingencies and forward foreign currency commitments.

iii. Resident-to-resident transactions and positions that are connected to the international accounts could be shown, e.g., local sales, value added, employment, and assets of direct investment enterprises.

iv. Ownership-based version of the current account, as in Foreign Affiliates Trade Statistics, could be shown.

v. A presentation of exceptional financing included in *BPM5* deals with management of balance of payments crises by separating exceptional financing items from various parts of the accounts.

vi. Monetary presentation of the balance of payments could be made.

vii. Individual functional categories, for example, direct investment positions, financial transactions, as well as goods, services, and income flows between related entities could be presented together.

viii. Activities of particular importance in an economy (for example, oil, shipping, real estate ownership, tourism, students, and patients) can have data on the goods, services, income, and financial entries brought together. It may also be useful to link these to domestic activities.

ix. It could be useful to analyze the operations of special purpose entities. It may also be helpful to show them separately so that they can be excluded from other entities.

(b) It would be possible to show alternative valuations—for example, both nominal and market values (see the *Debt Guide* in the case of debt securities), or alternative measures of interest on debt securities.

(c) Alternative approaches to residence:

i. Nonpermanent workers. A satellite presentation could bring together aspects of services, compensation of employees, workers' remittances, and migrants' transfers that are affected by nonpermanent workers. Individuals with different durations of presence in the economy could be shown (discussed further in Chapter 4 Economic Territory, Units, Institutional Sectors, and Residence).

ii. Ultimate beneficial owner/ultimate destination (discussed further in Chapter 4 Economic Territory, Units, Institutional Sectors, and Residence) or round tripping (discussed in Chapter 5 Classifications).

(d) Other alternative concepts, for example involving interest, maturity, currency of denomination, and for selected partners.

2.23 It will be emphasized that satellite accounts and other alternative presentations are not mandatory or intended to replace standard presentations. It will be recognized that it is burdensome to maintain parallel systems, so the capacity to implement such presentations is constrained. Rather, this chapter would provide a brief survey of developments of interest to users and compilers.

OVERVIEW OF INTERNATIONAL ACCOUNTS

References

BPM5:
Overview of accounting structure paras. 34–56
Presentation paras. 139–145, 149–181, 461–477
Net errors and omissions paras. 146–148

BPT Chapter III

1993 SNA:
Overview Chapter II
Satellite Accounts Chapter XXI

Quarterly National Accounts Manual paras. 1.13-1.23, Chapter XI

MMFS paras. 411-437

GFSM 2001 Ch 4, Appendix III

Changes from *BPM5*

(a) *Changes proposed:*

Time series issues will be discussed explicitly (paras. 2.17–2.20).

Explicit recognition will be given to the satellite account approach (para. 2.21).

(b) *Changes raised as an option:*

There could be an explicit treatment for net errors and omissions (para 2.15).

Glossary

Capital transfers
Current account
Current transfers
Financial transactions
Goods and services
Income, primary and secondary, disposable
Net errors and omissions
Nominal value (contrasted with book and face values)
Production
Satellite account
Time series
Seasonal adjustment

Chapter 3. Accounting Principles

A. Flows and Stocks

3.1 The flows and stocks section will state that data recorded in the international accounts are either flows or stocks. It will describe flows and stocks, show that they are integrated (all changes in stocks between two points in time are fully explained by the flows), and determine the scope of flows and stocks recorded in the international accounts as those involving a resident and a nonresident.

3.2 The section will define flows, distinguish a flow from entries, and distinguish between two types of flows: (i) transactions and (ii) other flows. It will define a transaction as an interaction between two units by mutual agreement or an action within a unit that is analytically useful to treat as a transaction. It will note that mutual agreement means that there was prior knowledge and consent by the units, but it does not mean that both units entered into the transaction voluntarily (for example, taxes in the *GFSM 2001* para. 3.5). It will state that illegal activities are to be treated in the same way as legal activities. The section will systematically describe and give examples of various types of transactions, namely: (i) exchanges and transfers; and (ii) monetary and nonmonetary transactions. It will discuss rearrangements of transactions through rerouting and partitioning to reflect the underlying economic relationship. Examples will be given of rerouting (for example, benefits in-kind for compensation of employees) and partitioning (for example, financial leases, interest/financial intermediation services indirectly measured). The manual will define imputation of transactions. The rationale for making imputations in the international accounts will be spelled out and the various imputations will be specified.

3.3 The section will define and describe two types of other flows (other changes in volume of assets and revaluations or holding gains and losses). It will state that changes in financial claims and liabilities arising from the change in residence of individuals/households will be treated as other changes in volume of assets.

> *[Question: Should changes in financial claims and liabilities owing to the change in residence of individuals be treated as other changes in volume of assets? These flows are results of a change in the classification of the owner's residence status, and hence, they do not constitute transactions. This change will eliminate "migrants' transfers" in the capital account and have no impact on balance sheets. It will have implications for goods and capital, financial, and other changes in financial assets and liabilities accounts.]*

3.4 This section will define stocks, with a reference to the asset boundary, recorded in the external balance sheet, which covers financial assets and liabilities.

B. Accounting System

3.5 The accounting system section will explain the double-entry system used to record flows in the international accounts. Its relationship to business accounting and the quadruple-entry system in the national accounts will be discussed. The importance of conceptual symmetry as well as symmetric reporting by partner economies will be emphasized.

3.6 This section will describe the conventions and terminologies for recording flows in the international accounts. In the current and capital accounts, a credit denotes receivables from exports, incomes, transfers and disposals of nonproduced nonfinancial assets. A debit is used to record payables for imports, incomes, transfers, and acquisitions of nonproduced nonfinancial assets. In the case of the flows in financial instruments, changes in assets and changes in liabilities will be used. These are general terms that apply to both the financial account and other changes in financial assets and liabilities account.

3.7 The use of the terms of *changes in assets* and *changes in liabilities* in the financial account and other changes in financial assets and liabilities accounts will be a change from *BPM5*, which used debit and credit. The proposed terms will bring the financial account into line with the IIP, which in *BPM5* used a different sign convention from the financial account. It will bring consistency with the *1993 SNA* presentation. It will also simplify the interpretation of data; positive or negative changes indicate an increase or decrease, respectively, irrespective of whether the changes refer to assets or liabilities, whereas the increase/decrease under the credit/debit notion depends on whether it refers to assets or liabilities. Furthermore, the new terms are more consistent with the nature of each financial account flow, that is, they reflect better the net value of changes due to all credit and debit entries during an accounting period. The proposed notions are also used in other macroeconomic statistics.

> *[Question: Should the notions of changes in assets and changes in liabilities be adopted in the financial account and other changes in financial assets and liabilities account?]*

3.8 While the debit and credit presentation will not be emphasized for the financial account transactions, it will be noted that it is important to recognize and maintain the accounting identities, for example, a credit is always conceptually matched with a corresponding debit, increase in an asset, or reduction in a liability.

C. Time of Recording

3.9 The section will state that the accrual accounting principle determines the time of recording flows in the international accounts. The time of recording with accrual accounting will be defined, as in *1993 SNA* para. 3.94, that is, economic flows are recorded at the time economic value is created, transformed, exchanged, transferred, or extinguished. It will be contrasted with other time-of-recording principles, such as due-for-payment and cash bases. The importance of the guideline for the time of recording will be linked to the double-entry system and the symmetry of recording by partner economies.

3.10 In describing the accrual principle for assets that are owned by institutional units, the manual will elaborate on the concept "change of ownership." The *1993 SNA* often seems to imply legal ownership (paras. 3.97 and 3.100), but in some instances it relies on the concept of economic ownership when legal ownership remains unchanged (para. 6.118). *BPM5* mentions that the change [in ownership] may be legal, or physical, or economic (para. 111), but it notes cases where no change in legal ownership occurs as exceptions to the change of ownership principle (para. 119). The new manual will propose that "change of economic ownership" would be the proper term for determining the time of recording for transactions in goods, nonproduced nonfinancial assets, and financial assets. In general, a change in legal ownership also involves a change in economic ownership. In some cases, a change of "economic ownership" takes place even though the "legal ownership" remains unchanged (for example, financial leases and transactions between an enterprise and its foreign branches). In other cases, such as for repurchase agreements involving the provision for cash of securities, the risks and rewards attached to the asset remain with the original holder. The proposed new terminology avoids the need for exceptions to the principle that arose in *BPM5*.

> [*Question: Is the proposed use of "change of economic ownership" appropriate? If accepted, a definition of "economic ownership" needs to be added along the lines described in the 1993 SNA (paras. 6.118,10.44, 11.31, 14.58). These paragraphs state that a change in ownership from an economic point of view means that all risk, rewards, and rights and responsibilities of ownership in practice are transferred.]*

3.11 Application of the accrual principle for time of recording to various flows will be discussed. More specific description of the principle will be detailed in relevant chapters, and cross-references to them will be given in this section.

(a) Goods. The change of economic ownership for determining the time of recording goods will be explained. The manual will explain the treatment and timing of recording for financial leases and transactions between an enterprise and its foreign branches. The issues of ownership and recording for merchanting and goods for processing will be discussed. The section will discuss approximations to the change of economic ownership using the time at which transactors record entries in their books. Within the context of change of economic ownership, it will also discuss the timing when goods enter or leave the economic territory of a country. Guidelines of the *International Merchandise Trade Statistics: Concepts and Definitions* concerning the time of recording will be discussed. It will be noted that the time at which goods cross the border can be taken only as an approximation to the time when the change of economic ownership occurs. The section will also explain that a customs-based collection system usually provides a choice of dates at which transactions may be recorded (for example, lodgment of customs declaration, customs clearance of goods). The manual will explain which of these various timings provides a good approximation to the principle of change in economic ownership (references will be made to Chapter 9, Goods and Services, where specific issues will be described).

(b) Services. The recording at the time services are rendered will be described. It will note that services are provided over a period.

(c) Primary incomes. The timing for compensation of employees and interest (accrual basis), dividends (when declared payable), and reinvested earnings of direct investment enterprises (when earned) will be covered. Examples of interest accruing continuously will be given.

(d) Transfers. The timing for recording taxes and other compulsory transfers will be as explained in the *GFSM 2001* para. 3.55, that is, the time at which the activities, transactions, or other events occur that create the government's claim to the taxes or other payments. The change of economic ownership of the resources that are counterpart entries to transfers will be stated as generally determining the timing for transfers.

(e) Nonproduced nonfinancial assets. The recording of transactions in nonproduced nonfinancial assets at the time economic ownership changes will be stated. In the case of financial lease contracts, it will be noted that these involve change in economic ownership.

(f) Financial instruments in general. The change of economic ownership principle for recording transactions in financial instruments will be stated. The recording of financial claims where the counterpart entry to the transaction is in the nonfinancial accounts (such as trade credit) will be dealt with. It will be noted that as interest accrues, the commensurate interest payable/receivable is recorded as part of the associated financial asset/liability. Accordingly, it will be noted that interest is not "paid" in an accrual system—all payments represent a reduction in the outstanding principal. Where counterparties to financial transactions record the transactions on different dates will be discussed.

(g) Invocation of debt guarantees and calling on of collateral. Debt liabilities can be guaranteed by a third party. No treatment of debt guarantees is given in the *1993 SNA* and *BPM5*. Debt guarantees are not treated as financial instruments until the guarantee is invoked.

Invocation of debt guarantees raises issues on how to treat flows between the original debtor and creditor and between the original debtor and the guarantor (the new debtor). A similar issue is how to treat flows between a debtor and creditor when collateral is called by the creditor.

When a debt guarantee is activated, it will create a new liability. The guarantor now becomes the new debtor and the arrear of the original debtor is extinguished as though repaid (*Debt Guide* para. 2.30). Activation of a guarantee can be considered as acquisition of equity by the guarantor or a capital transfer to the defaulting party (*GFSM 2001* para. 9.33). Alternatively, a financial claim by the guarantor on the original debtor may be considered. Where the original debtor-enterprise is liquidated, capital transfers as well as other volume changes may seem to be possible treatments.

[Question: Is the treatment of invocation of a loan guarantee suitable?]

[Questions: How should flows between the original debtor and creditor and between the original debtor and guarantor be treated when a guarantee is activated? How should flows between a debtor and creditor be treated when collateral is called by the creditor?]

(h) The time of recording of repayments of debts. Arrears will be defined and discussed (along the lines of the *Debt Guide* paras. 3.36–37). The manual will discuss two bases for time of recording repayments of debts, namely, the due-for-payment basis and the accrual basis. The due-for-payment basis is followed in *BPM5* (paras. 123 and 528), *GFSM 2001* (para. 9.19), and *Debt Guide* (para. 2.29). When a debt liability goes into arrears, the due-for-payment basis records transactions as if the repayment of debt liability had been made and then replaced by a new short-term liability. The imputation of transactions gives the impression that the debtor has the ability to repay and borrow. According to the accrual basis, repayments of debts are recorded when they are extinguished (such as when they are paid, or rescheduled, or forgiven by the creditor). Under this approach arrears will continue to be shown in the same instrument.[1] This approach will also avoid complicated and artificial imputations because no transactions will need to be recorded. This treatment is in line, in principle, with the *1993 SNA* (paras. 3.94 and 11.101) and *MFSM* (paras. 179, 225, 238). In order to identify items in arrears in the IIP, either a separate subheading can be added for each instrument having arrears or arrears can be shown as memorandum items.

[Questions: Which time of recording principle is appropriate for recording repayments of debts? (1) the due-for-payment basis (involving imputation of transactions that the liability had been repaid and then replaced by a new short-term debt (representing the arrears)); or (2) the accrual basis (involving no imputation of transactions but continuing to show arrears in the same instrument until the liability

[1] Under the accrual basis, the manual would state that if, when a liability goes into arrears, there is a change of instrument classification, this reclassification will be shown as other changes due to reclassification of instruments.

is extinguished), but either requiring arrears to be shown in the IIP as a subgroup under relevant instrument or to be shown as memorandum or supplementary items?

Do we need subheadings or memorandum items on all arrears or selected arrears or just on arrears for exceptional financing items? Data on arrears on exceptional financing would be needed if an analytic presentation, as published in the IMF's International Financial Statistics, were to be derived on exactly the same basis as at present?]

(i) The time of recording for other changes in the volume of assets, revaluations, and stocks will be considered.

3.12 This section will discuss issues of time zone differences in international transactions, recognize intrinsic uncertainties, and identify some data sources, which often only approximate the required basis. It will encourage timing adjustments where there are major divergences from the required basis (customs-based merchandise trade statistics, ITRS data, interest). The section will follow the treatments and presentation in *BPM5* Chapter VI.

D. Valuation

3.13 This section will describe the general principles for valuation of flows and stocks. It will state that market prices are the basis for valuation in the international accounts. Market prices will be defined and linked to transaction prices. A discussion of how market prices relate to other valuation concepts used in business accounting will be given. In this context, explanations will be given of such notions as book values, amortized values, face value, nominal values, historic cost, and fair values—highlighting where statisticians take a different approach to accountants and why. It will describe cases where nominal values may be of analytical interest (see the *Debt Guide*, para. 16.13). It will explain that actual exchange values in most cases will satisfy the market price concept. Transactions that involve dumping and discounting will be stated to be at market prices. It will define transaction prices for goods and services as inclusive of appropriate taxes and subsidies. It will also explain that the valuation of financial instruments should be exclusive of any commissions, fees, and taxes. This is because both debtors and creditors should record the same amount for the same financial instrument. The manual will note that the valuation of financial instruments, which excludes commission costs, differs from the valuation of nonfinancial assets, which includes any costs of ownership transfer. Many topics are discussed in further detail under individual components in the following chapters. The general principles will be stated in this chapter.

3.14 Cases when actual exchange values do not represent market prices will be discussed, and the desirability for adjustment will be emphasized. The discussion will cover transfer prices between affiliated enterprises, manipulative agreements with third parties, concessional prices, and concessional interest rates (implicit transfer). A question on concessional interest is raised in Chapter 11, Secondary Distribution of Income Account. Although adjustment should be made when actual exchange values do not represent market prices, it will be recognized that this may not be practical in many cases. The consequences of price adjustment will be explained, for example, if prices of goods are adjusted, associated financial account transactions may also need to be adjusted.

> *[Questions: (i) To what extent should the adjustments be encouraged? (ii) Would it be appropriate to acknowledge difficulties in practice and recommend that all important cases be covered?]*

3.15 Similarly, this section will discuss partitioning of a single exchange of value as viewed by transactors into two or more transactions (e.g., price may include commission for currency conversion, financial leasing, and FISIM).

3.16 It will be stated that the manual follows in general the principle of market prices for the valuation of both flows and stocks. When markets prices are not observable, valuation according to market-price-equivalents provides approximation to market prices. Market prices of similar items when such prices exist will provide a good basis for applying the principle of market prices. It will be noted that for some positions in financial assets and liabilities, it may be necessary to estimate fair values that, in effect, approximate market prices. The present value method can also be used as approximation to market prices. Methods for estimating fair values will be described as in *MFSM* paras. 219–224. The manual will refer to fair value accounting for financial assets as proposed in the *International Accounting Standard 39* (*IAS 39*).

3.17 Cases where market prices are not available or pose specific problems will be discussed. The following cases will be covered:

(a) For loans other than traded loans, the manual will provide guidelines in their valuation taking into account any developments in international accounting standards.

- The current valuation principle is nominal value (including accrued interest) as defined in *MFSM* para. 206 (uses the term “book value”), *BPM5* para. 471, and *Debt Guide* para. 2.32 and Appendix III.
- Another possible valuation principle is “fair value.” Proposed amendments to *IAS 39* would considerably broaden the application of fair values. It is not yet certain whether application of fair value in *IAS 39* will cover nontraded loans and deposits. It will be noted that future developments in business accounting toward fair value principles may result in the availability of alternative valuation bases to nominal values in the case of nontraded instruments and that subsequent developments in IAS should be considered by statisticians. Depending on developments in IAS, fair value could be adopted as a valuation basis (i) in all cases, or (ii) for creditors only, or (iii) as a supplementary or memorandum item.
- If nominal valuation is adopted, the manual will clarify the treatment of bad debt and provisions for them. The manual will note that nominal values do not

take into account any provision for bad debts. Because of their analytical usefulness, bad debt provisions and/or expected loan losses should be recorded for the creditor as a memorandum item, as per *MFSM* para. 207. The manual will also clarify issues concerning write-off or write-down as in *1993 SNA* para. 11.23 and *MFSM* para. 194.

[Questions: (i) Should either nominal value or fair value be adopted, and should the valuation not adopted be considered as a memorandum item or a supplementary item?(ii) If fair value is adopted, should it be used for both creditors and debtors or only for creditors? Or (iii) should a decision be postponed until developments in international accounting standards are clear?]

(b) This section will explain the valuation of barter transactions, transfers in kind, and reinvested earnings.

(c) This section will discuss valuation principles for equity where observable market prices are unavailable. Market price equivalent or other fair values will be used. For branches, net equity will be defined to be equal to the sum of all assets, including intangible assets as well as financial, and nonfinancial tangible assets, less debts. The *Benchmark Definition of FDI* (para. 22) did not include nonproduced assets and did not mention intangible assets.

[Question: Is the measurement of net equity of branches appropriate?]

(d) For securities, in general, this section will note that, when securities are quoted on markets with a buy-sell spread, the midpoint should be used to value the instrument. (The spread is an implicit service charge to the dealer, paid by buyers and sellers. Mid-prices are recognized in *BPM5* para.132, with reference to foreign exchange, but not discussed more generally.)

(e) For loans that are traded but not sufficiently to be reclassified as securities, it will be noted that transactions will be valued at market prices. For positions, if nominal values (including accrued interest) are used for both debtor and creditor, an entry is needed for other price changes in the other changes in financial assets and liabilities account. (This follows the Bank of Japan paper (BOPCOM-00/15). *BPM5* para. 471 took the market value for the creditor and the nominal value for the debtor, with supplementary data on the alternative valuation in both cases. It is not clear whether the *BPM5* principle was intended to be limited to discounted loans of heavily indebted countries, or to traded loans generally; or whether it applied only to the transactor or to all creditors of the same loan or class of loan). A reference will be given to the definition of tradability in Chapter 5 Classifications to clarify when loans become securities.

[Question: Which treatment is suitable—(i) nominal values for both creditor and debtors, or (ii) market/fair value for both, or (iii) as in BPM5?]

(f) Deposits and accounts payable/receivable give rise to the same issues of nominal and fair values. If nominal value is adopted, the manual will note that deposits at banks and other depository corporations in liquidation will be based on their nominal value until they are written off. However, if significant, these deposits should be shown separately as a memorandum item. The same treatment will be applicable for any other cases of impaired deposits (i.e., where the depository corporation is not in liquidation but is insolvent). The manual will discuss fair value accounting for assets as proposed in the *IAS 39*.

[Questions: (i) Should either nominal value or fair value be adopted, and should the valuation not adopted be considered as a memorandum item or a supplementary item?(ii) If fair value is adopted, should it be used for both creditors and debtors or only for creditors? Or (iii) should a decision be postponed until developments in international accounting standards are clear?]

3.18 This section will describe general principles for conversion of flows and stocks expressed in other currencies to the currency used to compile data. Actual exchange rates for transactions and the rates on the date that balance sheets are prepared for stocks will be stated as the principal basis for currency conversion. The use of daily average or average rate for the shortest period will be discussed. The use of midpoint rate for currency conversion will be stated. It will be noted that the difference between the midpoint rate and the actual rate is treated as charges for financial services. The manual will discuss the principles regarding the conversion of derived measures including certain imputed flows (for example, reinvested earnings of direct investment enterprises). These derived measures and flows relate to a period rather than a particular time. The treatment of multiple official exchange rates will be explained along the lines of the *1993 SNA* (chapter XIX, Annex A). The treatment of parallel rates (black markets) will be discussed along the lines of the *1993 SNA* paras. 14.83–84.

3.19 The need for a unit of currency for compiling the international accounts will be determined. The reasons for compiling international accounts in the national currency (or in another currency in addition to national currency) and the possible usefulness of such data will be discussed. Reference will be made to links to the domestic economy (national currency), international liquidity management (international unit), special issues for high inflation and multiple exchange rates (international unit), global totals, and international comparisons (international unit). It will note that different currencies of denomination are different phenomena.

E. Aggregation and Netting

3.20 The meaning of aggregation and aggregates will be discussed along the lines of the *GFSM 2001* para. 3.81. Gross and netting in the context of international accounts will be spelled out. Aggregations or combinations in which all elementary items are included with their full values are called gross recording. This section will state that gross recording is to be followed in current and capital accounts. It will note that gross recording is also applicable to income on reverse investment where the direct investment enterprise owns less than 10 percent of its direct investor (further described in Chapter 10 Primary Distribution of Income Account). The treatment of returned goods or refunds will be clarified.

> *[Question: Is the proposed treatment of income on reverse investment where direct investment enterprise owns less than 10 percent suitable?]*

3.21 This section will describe the netting principle for transactions in financial instruments (as in *1993 SNA* para 2.84). It will explain that netting means combinations that show net changes (increases less reductions) in a particular asset category on the same side of the balance sheet. The section will recommend netting within the given category of standard components as in *BPM5* para. 324. It will state that other flows (other changes in the volume of assets and revaluations) are also recorded on a net basis. It will state that netting financial assets (changes in financial assets) against liabilities (changes in liabilities) is especially to be avoided. As gross values in some cases are of analytical interest, this section will note the usefulness for such data as supplementary items.

3.22 The section will note that in some cases a clear distinction between assets and liabilities may not be feasible (such as some financial derivatives where transactions occur in both directions). In such cases, it may not be feasible to apply the netting principle, which requires separate presentation of transactions in assets and transactions in liabilities. The section will note that presenting net changes of transactions in both assets and liabilities for such financial instruments may be acceptable.

> *[Question: Which recording basis is preferred for financial derivatives where transactions occur in both directions and it may not be feasible to distinguish between assets and liabilities—(i) net changes separately for transactions in assets and in liabilities) or (ii) net changes of all transactions in both assets and liabilities? Or should both be allowed?]*

> *[Question: Are there other instruments for which transactions in assets may not be clearly distinguished from transactions in liabilities?]*

3.23 Finally, the section will state that stocks of financial assets/liabilities are recorded on a gross basis. It will note that stocks of the same type of a financial instrument held both as a financial asset and a liability are to be presented gross, so that assets are recorded under assets and liabilities are recorded under liabilities.

F. Symmetry of Reporting

3.24 The importance of symmetry of reporting by counterparties will be emphasized. The consistency of reporting by both parties/economies involved in a transaction or position will be explained for time of recording, valuation, and definitions and classifications. Their importance for bilateral comparisons, global imbalances, and regional and global aggregates will be noted. Cases where parties may take different perspectives will be noted.

G. Derived Measures

3.25 This section will define and discuss derived measures in the international accounts. These measures are economic constructs derived as a balancing item from two or more aggregates. For example, current account balance, net lending/borrowing, net international investment position, etc. are important derived measures in the international accounts. A list of all derived measures in the standard presentation of the international accounts will be presented in this section.

ACCOUNTING PRINCIPLES

References

BPM5 chapters 5, 6, and 7;

1993 SNA chapter 3;

BPT paragraphs 9-65;

IMTS chapter I;

GFSM chapter 3.

Changes from *BPM5*

(a) *Changes proposed*:

Treat "migrants transfers" as an "other change," rather than as a transaction (para. 3.3).

Use "changes in assets" and "changes in liabilities," instead of "debits" and "credits" in financial account and other changes in financial assets and liabilities account (para. 3.7).

Debt guarantees are not treated as financial instruments until the guarantee is invoked, in which case, the creation of the new liability will be treated as a financial account transaction (the guarantor becomes the new debtor and the arrear of the original debtor is extinguished as though repaid) (para 3.11(g)).

Net equity of branches to be equal to the sum of all assets, including intangible assets as well as financial, and nonfinancial tangible assets, less debts (para. 3.17(c)).

All capital account transactions are proposed to be recorded on a gross basis (para. 3.20).

Income flows arising from reverse investment where the direct investment enterprise owns less than 10 percent of its direct investor are also to be recorded on a gross basis in consistency with gross recording of current account transactions (para. 3.20).

Balancing items will be dealt with more explicitly (para. 3.25).

(b) *Changes raised as an option*:

Use the term "change of economic ownership" rather than just change of ownership or legal ownership (para. 3.10).

How should flows between the original debtor and creditor and between the original debtor and guarantor be treated when guarantee is activated? Several possibilities depending on circumstances could be acquisition of equity by the guarantor, or a capital transfer to the defaulting party, or a financial claim by the guarantor on the original debtor, or other volume changes (para. 3.11(g)).

Which time of recording principle for repayments of debts is appropriate: (1) the due-for-payment basis (involving imputation of transactions that the liability had been repaid and then replaced by a new short-term debt (representing the arrears); or (2) the accrual basis (involving no imputation of transactions but continuing to show in the arrears in the same instrument until the liability is extinguished), but either requiring arrears to be shown in the IIP as a subgroup under relevant instrument or to be shown as memorandum or supplementary items (para. 3.11(h)).

Encourage the use of adjustments of actual exchange values when they do not represent market prices (para. 3.14).

Possibility of adopting fair values for nontraded loans and deposits either for both creditors and debtors or for creditors only. If nominal valuation is adopted, possibility for memorandum or supplementary items on data according to fair values. Similar issues for loans traded but not sufficiently to become securities (para. 3.17(a)).

Whether traded loans (not sufficiently to be reclassified as securities) should be valued at (i) nominal values for both creditor and debtors, or (ii) market/fair value for both, or (iii) as in *BPM5* (para. 3.17(c)).

Whether recording on the basis of (i) netting principle (i.e., separately for transactions on assets and liabilities) or (ii) net changes in both assets and liabilities is preferred for financial derivatives where transactions occur in both directions and it may not be feasible to distinguish between assets and liabilities? Or should both be allowed (para. 3.22)?

Glossary

Accrual basis of recording
Aggregates
Arrears
Balancing items
Book values
Cash basis of recording
Collateral
Debit/credit
Derived measures
Double-entry bookkeeping
Due for payment
Exceptional financing
Exchanges
Fair values

Flows
Gross recording
Guarantee
Historic cost
Net acquisition of financial assets
Net incurrence of liabilities
Netting
Nominal values
Multiple official exchange rates
Other changes in volume of assets
Revaluation
Stocks
Time of recording
Transactions
Valuation

Chapter 4. Economic Territory, Units, Institutional Sectors, and Residence

A. General Principles

4.1 This introductory section to this chapter will explain how an economic territory consists of institutional units and how the concept of residence is used to classify an institutional unit to an economic territory. As background, the section will note that increasing international economic openness means that some institutional units have connections to more than one economy. This chapter will introduce the concept of a predominant center of economic interest as the way to show the link between the economy and the institutional unit. This concept is designed to ensure that each unit is a resident of one and only one economy (or, in a few exceptional cases that will be set out in this chapter, a single real-world unit is split into separate institutional units that are residents of different economies).

B. Economic Territory

4.2 An economic territory will be defined by reference to an area under the effective economic control of a government, as in *BPM5* para. 59. This principle will be elaborated to cover embassies abroad, territories, and special zones such as free-trade zones and offshore financial centers. It will be noted that an implication of the definition is that embassies, foreign military bases, peacekeeping operations, and international organizations are not residents of the territory where they are physically located.

4.3 An economic territory consists of all the institutional units (defined below) that are resident (defined below) in that territory. It will be emphasized that a territory covers all entities subject to its laws, even where the government provides exemption from particular ones (such as taxation or banking regulations). The chapter will elaborate on which dimensions of the application of the laws of a territory should be specified as relevant to determining whether an entity is subject to the laws of the territory, for example, that the unit is subject to laws that apply only to some part of its operations (such as fund-raising or trade) and is not potentially subject to laws more generally.

[Question: Is this approach suitable?]

4.4 The possible inclusion of disputed zones or zones under rebel control will be discussed. In such cases, it is proposed that compilers decide on including or excluding the zone, basing its treatment on their own circumstances, and that they should state which treatment they adopted in metadata. It will be recognized that compilers will need to consider political and practical issues, as well as methodological aspects, in deciding about the scope of the economic territory.

[Question: Is this proposal suitable?]

4.5 A single government may wish to treat differently the areas under its control, usually because they are subject to different laws, such as a free-trade zone or an "offshore" financial center or have some degree of self-government. For economies with a particular interest in special territories or zones, the manual will propose that an economy show these territories or zones separately from the rest of the economy, but that they also prepare a consolidation, to produce a national total. It will emphasize that the requirement for international purposes is for national totals to cover all units under the government's effective control and that all units be a part of one and only one economic territory. A proposed presentation for consolidating different economic areas under a single government will be illustrated in the manual.

4.6 The treatment of changes in sovereignty over a particular area will be discussed. The chapter will explain that an exchange of a geographical/physical area by mutual agreement (defined as in *GFSM 2001* para. 3.5) from one government to another or an exchange under a decision of a court satisfies the definition of a transaction. Accordingly, the chapter will indicate that such a transfer will be treated as an acquisition of land in the capital account, along with associated buildings and equipment in the goods and services account. If the exchange is paid for, the offsetting entry will be a financial account entry for the agreed amount. If there is no payment, the offsetting entry is a capital transfer. If there is a mutual exchange of land or buildings, the manual will recommend that both entries in the exchange will be shown in the accounts on a gross basis (viz., capital account in the case of land; construction services in the goods and services account, in the case of buildings).

4.7 If the change in the status of a particular area is not by mutual agreement (defined as in *GFSM 2001* para. 3.5), then it would not qualify as a transaction: it would be treated as other changes in volumes.

4.8 Treatment of cases of joint sovereignty will be discussed:

(a) If economic administration of a zone is effectively with only one government, the zone could be considered as in the economic territory of that government.

(b) If the zone is jointly administered, then the applicable laws will differ from other territory of any of the individual governments, so the joint zone is potentially a territory in its own right. However, if the zone is relatively small or data are confidential, it may be better to split the institutional units in the zone among the primary territories:

- If there is a strong connection to just one of the primary territories, particular enterprises in the zone or the whole zone could be allocated to that territory.

- If there are connections to both territories, then particular enterprises in the zone or the whole zone may be split in a similar way to enterprises that operate in two or more territories, as discussed under residence later in this chapter.

The statistical compilers of each territory should consult to adopt consistent methods with no gaps or overlaps.

[Question: Are these proposals suitable?]

4.9 The chapter will indicate that instances of a single territory splitting, or two or more territories combining, are not transactions between two parties, because these instances involve the creation or elimination of parties (and are, therefore, distinguishable from two parties exchanging a particular area, which was discussed earlier). Accordingly, the chapter will note that there is a reclassification, which should be shown as other changes in assets account. (The proposals were explained in more detail in BOPCOM-02/59.) (In any case, like other large, lumpy items, it is desirable that they be shown separately in national presentations of the data, so that users can understand the event and exclude it if they wish.)

4.10 The words “territory,” “economy,” and “economic territory” are used interchangeably in international accounts literature to represent an area for which international accounts are compiled. It will be mentioned that “economic territory” is generally a country but may also be applied to other territories, such as dependencies or crown territories. The concept of economic territory can also generally be applied to a group of countries (e.g., for an economic or monetary union) or parts of countries (e.g., for states, provinces, local governments, or regions). In the case of groups of countries, there is a need to consolidate transactions and positions between different countries within the group. These issues are discussed in more detail in an appendix. For parts of an economy, such as provinces or states, it will be noted that the issue is specialized, that there may be difficulty in separating the operations of entities operating in more than one area, and that these issues are outside the scope of the manual.

C. Units

4.11 The chapter will introduce the principles relating to units for statistical purposes, using the general principles in the *1993 SNA* Chapter IV (at length), *MFSM* paras. 62–79, and *GFSM 2001* paras. 2.11–2.21 (both more briefly). While the principles for units are the same in all the macroeconomic datasets, it is useful to briefly outline them in this manual. Following *1993 SNA* para. 2.19, institutional units will be stated in terms of ability to own assets, incur liabilities, and undertake a full range of transactions. It will be noted specifically that institutional units relate to the point of financial decision-making, so they include some arrangements that may not be legal entities in their own right, such as unincorporated joint ventures, branches, and partnerships. Also, some entities that are separate legal entities are combined as not having a separate economic status, such as ancillary companies. While institutional units for statistical purposes use legal units as a starting point, as noted below, some combinations and splits are made to improve their usefulness for economic analysis.

4.12 The "enterprise" is defined in *1993 SNA* para. 5.1 as an institutional unit that undertakes production, and so is useful in international statistics. (Note that some institutional units that do not engage in production but hold financial assets—such as holding companies, mutual funds, and some SPEs—are referred to as enterprises in the *1993 SNA*, *BPM5*, and *MFSM*, despite *1993 SNA* para. 5.1.) Enterprises will be contrasted with enterprise groups and establishments (the latter also called local kind of activity units). Enterprises will be stated to include corporations and quasicorporations, that is, unincorporated structures such as branches. In addition, government entities, households, nonprofit institutions serving households, and international organizations are institutional units.

4.13 The principles for institutional units take into account the desirability of having institutional units that are only resident of a single territory. In a few cases where a single entity has strong links to two or more economies, the entity will be split into separate units. Those cases include branches, multiterritory enterprises, other legal structures, preparatory expenses, and ownership of land, as discussed below. Also, legal entities will not be combined across territories. Entities may normally be combined with owners because they have no separate decision-making, such as ancillary companies and some trusts. But in cases in which they are located in a different territory to that of their owners, they will be treated as separate institutional units.

1. Branches and other quasicorporations

4.14 When a single legal entity has sufficiently substantial operations in two or more territories, unincorporated branches will be recognized as separate institutional units in territories outside that of the legal entity. The rationale for this treatment will be given that the parts of the legal entity should be separate for statistical purposes, because each of the parts has its strong connection with a different economic territory. The requirements for a branch to be recognized as a separate unit will be that the operation:

(a) has undertaken or has an intention to undertake production on a significant scale for at least one year;

(b) has its own separate income statement and statement of assets and liabilities; and

(c) acts in its own right rather than as an agent.

(It will be noted that although "branch" is used more generally in common usage for incorporated subsidiaries, the international accounts term is limited to unincorporated branches recognized as a separate entity for statistical purposes.)

4.15 These requirements for identifying a branch as a separate entity are similar to *BPM5* para. 78, except that the requirement for significant physical presence given in *BPM5* will be limited to activities that require physical presence. (As an illustration, some financial services can be undertaken with little or no physical presence.) In addition, the unit's being subject to income tax laws will be mentioned as strong evidence of the existence of a branch, but will not be a requirement, as was the case in *BPM5*.

[Question: Are these principles for the identification of branches suitable?]

4.16 A branch is a type of direct investment enterprise (see Chapter 5 Classifications). A branch is one form of "quasicorporation," in the terminology of the *1993 SNA*, that is, it is an unincorporated enterprise that functions as if it were a corporation.

4.17 A quasicorporation can also be identified for an unincorporated partnership, such as a joint venture.

4.18 The application of the principles on branches to construction projects will be discussed and illustrated by specific situations, such as long-term projects and site offices. The same principles will be applied for both capital formation and repairs (in contrast to *ESA9*5 page 18 footnote 4, where a notional institutional unit is imputed in all cases where the output is gross fixed capital formation.)

4.19 Branches will be contrasted with agents, as in *BPM5* para. 83.

2. Multiterritory enterprises

4.20 In some cases, it is not possible to separately identify a branch because a single entity is officially authorized to be run as a seamless operation across several economic territories. The *BPM5*-preferred treatment (para. 82) of prorating the operations of the company to the individual territories will be adopted. *BPM5* proposed equity contributions as the basis for prorating. In addition, it will be proposed that other factors, such as fixed assets by location, may be considered if equity shares are unrepresentative of the operations. It will be noted that the situation applies beyond operators of mobile equipment, for example, to a range of cross-border activities including hydroelectricity schemes on border rivers, pipelines, bridges, tunnels, and undersea cables. The same issue arises for a *societas europaea*—a company created under one European Union member state and able to operate in any member state. The manual will note that the treatment will mean that each transaction by these enterprises needs to be split into resident and nonresident components. (The same solution is proposed as an option above in cases of zones of joint sovereignty.)

4.21 Compilers in each of the territories involved in such arrangements will be encouraged to cooperate to develop consistent data and avoid gaps. In view of the complexity of splitting of units, which results in each transaction of the enterprise also being split, an example could be included as an appendix to this chapter. Alternatively, although this suggestion raises some conceptual issues, the example could be included in the revised version of the *Balance* *of Payments Compilation Guide*. For other territories that have transactions or positions with the multiterritory enterprise, the implications of splitting will be noted.

3. Other legal structures

4.22 The following types of legal structures have varying degrees of legal status and only partially separate identities from their owners, so their status as units needs to be discussed:

(a) Unincorporated entities used to undertake production. Whether branches, trusts, partnerships, or unincorporated joint venture structures, these will be treated as separate institutional units from their owners if they are in a separate territory from at least one of their own owners and qualify as entities, using the guidelines for identifying branches discussed above.

[Question: Are the proposed treatments for unincorporated entities suitable?]

(b) Holding corporations. Defined in *MFSM* para. 70 as enterprises whose principal activities are holding and directing subsidiaries, these are separate institutional units. These entities are direct investors when the holding corporation is in one territory and the subsidiaries are in another.

[Question: Is the proposed treatment for holding corporations suitable?]

(c) Ancillary companies. The *1993 SNA* (para. 4.40) defines ancillary companies as those whose activities are limited to providing services to its parent, such as sales, management, or financial services. While the *1993 SNA* paras. 4.43–44 state that ancillary companies are not treated as separate units, consistent with *MFSM* para. 71, it will be stated that an ancillary enterprise is treated as a separate institutional unit if it is located in a different territory from that of the parent corporation. If an ancillary company is identified, it is likely that it provides goods or services to affiliated enterprises, so compilers may need to pay attention to identifying any such flows (as in *MSITS* 3.135). In the case where an ancillary company serves a number of related companies—at least one of which is in the same territory—it would still be treated as a separate entity.

[Question: Is the proposed treatment for ancillary companies suitable?]

(d) Special purpose entities/vehicles. When used to issue debt securities on behalf of a parent company, they are separate entities if they are resident in a different territory to that of their owners.

[Question: Is the proposed treatment for special purpose vehicles used for fund-raising suitable?]

(e) Entities for holding and managing wealth. These may have varying titles and legal structures, for examples, international business companies (IBCs), shell companies, shelf companies, brass plate companies, special purpose entities/vehicles, estates, other trusts, and partnerships. (See BOPCOM-02/60.) These structures have a common economic function of holding wealth rather than undertaking production. While they always hold assets, some of these entities also have liabilities, such as for geared investment. They will be treated as separate entities from their owners if they are established in a different territory from the residence of at least one of their owners. The possibility of these being shown as a separate subsector is raised below.

[Question: Is the proposed treatment of wealth management entities suitable?]

(f) Nominees. These are a legal device for holding assets for confidentiality or convenience reasons. Assets held by a nominee are treated as being owned by the beneficial owner, rather than by the nominee or as an imputed unit (see *CPISG2* para. 3.20). (It can be recognized that there are practical problems in recording assets as belonging to the nominee as an institutional unit or to the beneficial owner.)

[Question: Is the proposed treatment for assets held by nominees suitable?]

4. Preparatory expenses prior to the creation of a legal entity

4.23 As decided by BOPCOM in 2001 (see paper 01/20B), a resident notional enterprise will be identified if it undertakes preparatory expenses associated with an institutional unit to be created in the future, even though it may precede the legal creation of the unit. Examples will be given, such as paying for mining rights licenses, and legal costs. (Notional institutional units are called quasicorporations in the *1993 SNA*.)

5. Ownership of land and associated buildings by nonresidents

4.24 As in *BPM5* para. 64, where immovable assets (such as land and associated buildings) are owned by nonresidents (see Section E ahead), a resident notional enterprise (quasicorporation) will be identified as the owner. The rationale for this treatment is that it avoids the immovable asset being owned by an institutional unit that is resident in a territory other than that in which the immovable asset is located. It will be stated that the same treatment will be applied to long-term leases of immovable assets on the basis that long-term leases approximate ownership.

[Question: Is the proposed treatment for long-term leases of land suitable? If so, what is the definition of "long-term"? Is it one year, as in other cases or something longer?]

4.25 The manual will elaborate further that unless the activities undertaken on the land are sufficient to qualify as a branch, then the income of the imputed unit will be confined to what is generated from the provision of rent or rentals to the owner. It will be noted that the notional unit is almost always a direct investment enterprise.

4.26 It will be stated that notional units will not automatically be imputed for other nonproduced nonfinancial assets (such as patents, mining rights, or broadcasting spectrum) owned by nonresidents. Nevertheless, it will be stated that it will normally be expected that the owner of these rights would have sufficient operations to constitute a resident unit or have the intention to establish a resident unit. (Also discussed in BOPCOM-02/59. Note that *BPM4* also required units to be imputed for ownership of leases, copyrights, patents, etc.)

> *[Question: Is the proposed treatment for other nonfinancial nonproduced assets suitable?]*

D. Institutional Sectors

4.27 This section will introduce the principles relating to groupings of institutional units for statistical purposes, based on the principles in the *1993 SNA* Chapter IV (at length) and *MFSM* paras. 80–115 and *GFSM 2001* paras. 2.9–2.10 (both more briefly). While the principles are the same in different economic datasets, it is considered useful to briefly outline them in this manual.

4.28 The *1993 SNA*/*MFSM* institutional classification will be taken as the basis, following the ECB proposal (in BOPCOM-02/64) to bring the sectoral classification into line with the *1993 SNA*. Table 4.1 shows two alternative presentations for the institutional sector classification.

Table 4.1A. Institutional Sector Classification Option based on *1993 SNA*/*MFSM*

Financial corporations Central bank*1 Other depository corporations Other financial corporations Insurance corporations and pension funds *Mutual funds, unit trusts, and other collective investment schemes* Other financial corporations, except insurance corporations and pension funds, *and mutual funds etc.* Financial auxiliaries *Holding companies* *Entities for holding and managing wealth*
Nonfinancial corporations
General government
Households
Nonprofit institutions serving households*2
Supplementary sectors for counterpart data: *International organizations* *International financial organizations* *Other international organizations*

Possible additional institutional sector classifications shown in italics; see discussion below.

(This classification is from *MFSM* Box 3.1, without the more detailed breakdowns of nonfinancial corporations and general government. For reconciliation with government finance statistics, there may be interest in providing additional detail for the general government sector. International organizations are not resident sectors but are relevant if data on the sector of the nonresident counterpart are prepared.)

Table 4.1B. Institutional Sector Classification Option based on the *1993 SNA/MFSM* classification, rearranged to be compatible with the *BPM5* classification

General government
Central bank[*1]
Other depository corporations

Other sectors
  Other financial corporations
    Insurance corporations and pension funds
    Other financial corporations, except insurance corporations and pension funds
    Financial auxiliaries
  Nonfinancial corporations
  Households
  Nonprofit institutions serving households[*2]

Additional sectors for counterpart data:
  International organizations
    International financial organizations
    Other international organizations

(This classification uses the same items as Table 4.1A, rearranged to be more compatible with the *BPM5* headings, and would allow the less detailed breakdown to be continued where the full classification was not being adopted.)

[*1] In cases where certain central banking functions are performed wholly or partly outside the central bank, consistent with *MFSM* para. 403, it will be suggested that, if parts of general government undertake central bank functions, consideration be given to compiling accounts for "monetary authorities" that combine the central bank functions or that the monetary authorities' activities outside the central bank be shown as a memorandum item accompanying central bank data.

[*2] May be combined with households.

[Questions: (i) Is the enhancement of compatibility with the SNA/MFSM suitable? Which option is preferred? (ii) Is the MFSM approach to the selective use of a monetary authorities sector suitable?]

4.29 A possibility is to use the *1993 SNA* classification for compilation but to use a lesser degree of detail in the standard components. Such a proposal would allow generally insignificant components to be omitted from the standard presentation, while allowing other presentations to be prepared as needed and reconciliation with other datasets to be achieved.

For example, it will be recognized that, in practice, households and nonprofit institutions serving households are often combined.

4.30 In the discussion of institutional sector classifications, cases of particular importance to international transactions will be noted. These cases will include:

(a) branches and other cases where institutional units for statistical purposes are identified but are not legal entities (called "quasicorporations" in the *1993 SNA*). These entities are included in either the financial or nonfinancial corporations sector, according to their own function (usually, but not necessarily the same as the parent entity);

(b) clearing houses (such as stock exchanges, option exchanges, and repurchase agreement settlement institutions). It is proposed to classify these as "other financial institutions" if they take positions in the instruments they handle; otherwise, as "financial auxiliaries";

(c) international financial organizations (such as the IMF, World Bank, Bank for International Settlements, and regional development banks). It will be stated that within the international organizations category, it is useful to classify entities as either financial or nonfinancial entities;

(d) occupying authorities and international organizations that act as the administrators of a territory. When another government acts as occupying authority of another territory, it will be treated as part of parent government and nonresident in the territory that it administers. Administrations by international organizations will be classified as international organizations and nonresident of the territory they administer;

(e) holding companies, which belong to the preponderant sector of the group of companies of which the holding company is part (including nonresident members of the group, determined by relative size; otherwise, if that is not practical, by number of subsidiaries). The *1993 SNA* para. 4.100 suggests both the subsidiaries of the holding company and the group as a whole as criteria. However, it will be noted that holding companies can themselves be subsidiaries or associates and that a company group structure can include more than one holding company. In such a case, the preponderant sector of the group as a whole may differ from that of the subsidiaries of the particular holding company, making the *1993 SNA* self-contradictory, so it has been proposed to adopt the sector of the group as a whole as the criterion. Alternatively, a convention could be adopted to classify holding companies as other financial intermediaries or financial auxiliaries either in all cases or in those located in a different territory to other members of the group;

[Questions: Would it be preferable to treat all holding companies as financial intermediaries? Or only those in different territories from the other members of the group? Or should the sector be determined from other members of the group?]

(f) entities that solely hold assets and/or liabilities without undertaking production (such as some special purpose entities and trusts). In the absence of a more specific heading, these entities could be classified as “other financial intermediaries or financial auxiliaries” (in the next paragraph, the possibility of having a specific category for these entities is raised);

(g) entities that raise funds on behalf of their owners on financial markets. These will be classified as “other financial intermediaries” (see *MFSM* para. 72); and

(h) ancillary companies, which will be classified according to the predominant sector of the company or companies served.

The manual will give other difficult cases, if solutions are available, for example, “bad banks.”

[Questions: (i) Are there other special cases that should be discussed? (ii) Are the proposed solutions appropriate?]

4.31 Possible additions to the institutional sector classification are:

(a) mutual funds, unit trusts, and other collective investment schemes (other than life insurance and pension schemes, already shown separately). In light of their (growing) importance, there is interest in showing separately mutual funds from other financial corporations. Mutual funds, etc. would be defined as including unit trusts and other legal structures that carried out the function of being a collective investment vehicle. Whether hedge funds and vehicles limited to a small number of investors are included in this category would need to be determined. One possibility would be to define mutual funds, etc. in terms of the regulatory boundary. Note that in Chapter 5, Classifications, it is also proposed to show equity in mutual funds, etc. as a separate financial instrument;

[Question: Should mutual funds and related entities be shown as a separate subsector?]

(b) Entities for holding and managing wealth. These entities hold financial assets or valuables, sometimes partly financed by debt, but do not produce goods or services or act as financial intermediaries. Their objective is usually to hold private wealth, often using the legal structures of trusts, international business companies, or other private companies. As noted in the previous paragraph, the function carried out by the entity does not fit well with the function of any of the possible institutional sectors (namely, financial intermediation, being an auxiliary supporting financial intermediation, or production of nonfinancial goods or services for the market). Besides the adoption of a convention, such as to treat them as financial auxiliaries, another possibility would be to add an institutional sector category; and

[Question: Should asset-holding entities be recognized as a separate sector or subsector?]

(c) Holding companies. An alternative to allocating these based on the sector of related entities would be to treat them all as a subsector of financial intermediaries.

[Question: Should holding companies be recognized as a separate sector or subsector?]

4.32 While the institutional sector classification is mainly applied to resident units, as in *BPM5*, another possibility is compiling supplementary data on the sector of the nonresident counterpart. For example, in an economy that received international aid, there may be interest in separating data on general government from private sources.

E. Residence

1. General principles

4.33 The concept underlying residence will be stated, that is, for each institutional unit, the territory will be identified with which the unit has the strongest link, in other words, its "predominant center of economic interest." Each unit should be a resident of one and only one territory. Because some units have connections with two or more territories, there is a need to choose between alternative criteria for economic interest, and there may be different perceptions about which criterion is applicable. Physical presence for a year or more is the main criterion, but other criteria apply, for example, in the cases of governments, international organizations, and units without physical presence. (It will be noted that some corporate entities with substantial connections to more than one economy may have been split, as described in Section C above.)

[Comment: The addition of the word "predominant" to the term "center of economic interest" is not intended to be a substantial change. Rather, it is a presentational change to recognize and emphasize that some units have economic interest in more than one territory, so that there may be more than one potential "center of economic interest." In such cases, the principle is to identify the territory to which the unit has the stronger or strongest connection.]

2. Residence of households

4.34 It will be noted that the household sector includes unincorporated entities that are resident in the same territory as the households that own them and that do not satisfy the criteria to be a quasicorporation, as in *1993 SNA* para. 4.49. This chapter will state that the principle of predominant center of economic interest is also applied to determine the residence of households. The chapter will make clear the relationship between individuals and households. A household is defined so that all members have the same economy of residence. Thus the residence of individuals needs to be established before a household can be identified. It will be noted that, as a result of that definition, there is a reconciliation of the apparent incompatibility between the use of households as a unit for international accounts statistics and the use of data on international movements that are undertaken by individuals.

4.35 It is proposed that the definition of the residence of households and individuals for international accounts should be consistent or reconcilable with international standards in migration, tourism, and services statistics, to the extent practical. Accordingly, proposals in this chapter may need to be amended in the light of ongoing discussions with experts and agencies in those fields. Any remaining differences in the residence concept with these other statistics will be explained in this chapter.

4.36 The starting point of discussion will be identification of the predominant center of economic interest, which will be contrasted with other links to a territory, such as citizenship, migration status, and income tax status. Subject to developments in international standards noted in the previous paragraph, to assist compilers on applying the concept of predominant center of interest, this chapter will propose a guideline of actual or intended residence for a year or more.

4.37 The chapter will explain that the guideline of one-year or more will have the advantage of straightforward practical implementation and ensuring international consistency. It will also explain that a convention is needed because some households have strong connections to more than one economy. The chapter will recognize that, in practice, data about individuals may be inadequate. Therefore, the residence of households will often need to be determined from general trends identified in aggregate data. Similarly, while data on intention may not be available, it could be inferred from past behavior of similar groups of people, or a convention may be needed. The classification of being a resident or not determines how the income and expenditure of the people concerned are treated in international accounts statistics.

4.38 The manual will give guidance on specific cases. The following cases are proposed as exceptions to the guideline of one year or more:

(a) diplomats and their families; and

(b) expatriate staff of foreign military bases and their families.

These exceptions are made because, although physically present in the host territory, the households are subject to the jurisdiction of their home territories.

4.39 It will be stated that the guideline of one year or more will be applied in the following cases:

(a) students;

(b) patients;

(c) ship's crew (i.e., if present on a ship for a year or more, they will have the residence of the operator of the ship as their own territory of residence);

(d) employees of international organizations and their accompanying dependents. These differ from embassy staff in their being subject, to a greater degree, to the laws of the host economy;

(e) local employees of embassies and military bases;

(f) nonpermanent workers and their accompanying family members; and

(g) refugees.

The one year or more guideline was not applied to students and patients in *BPM5*; the change is proposed for greater simplicity, for consistency with tourism, demographic, and immigration statistics, and for avoidance of anomalies for those who undertake other activities in addition to studies or heath care.

In practice, intergovernmental agreements and taxation issues may be relevant to assessing the connections of the individuals concerned. In these cases, host and source territories should be able to identify a consistent treatment (see South African Reserve Bank, 2003).

Another possible issue that could be considered, within the constraint of consistency with those other fields of statistics, is the inconsistency between the use of "a year or more" in the definition of residence but "more than a year" in the definition of long-term.

[Comment: It would look more systematic and be easier to remember if the definition were the same. However, since the criteria evolved independently in financial and demographic statistics, it might not be practical to change them.]

[Questions: (i) Is the extension of the one year or more guideline to students supported? (ii) Is the extension of the one year or more guideline to patients and ship's crew supported? (iii) Is any change needed for nonpermanent workers? (iv) Do any other cases need to be mentioned?]

4.40 In the following cases, the one year or more guideline is not conclusive, so additional guidance is needed:

(a) people who leave their original home for a year or more but reside in two or more other economies each for less than a year. In these cases, residence will be determined from the predominant location during the period;

(b) border workers. The residence will be determined from the location of the dwelling of the individual, rather than the place of work; and

(c) individuals who move back and forth between territories, so they do not stay in any one territory for a year or more, such as those who have dwellings in two or more economies and commute between them. The residence status will be determined from their predominant location during the period, that is, where the most time is spent.

4.41 In each case, in view of the conceptual and practical difficulties, this chapter will emphasize the importance of metadata that would state the treatment of the above categories of individuals. In the case of significant population movements between two territories, it will be urged that the compilers of each territory cooperate to ensure consistent definitions and measurement.

4.42 As noted above, the chapter will recognize that some individuals have close connections with two or more economies. Some common examples of such individuals are nonpermanent workers, students, patients, and their accompanying dependents. While such individuals need to be classified as residents of a single economy for international accounts purposes, it may be desirable for compilers to provide supplementary data on those who are classified as nonresidents of their economy but maintain significant links with it. Similarly, it may be desirable to have supplementary data on those who are classified as residents of the economy but maintain significant links to other economies. Possible data and presentations will be discussed in an appendix to this chapter.

4.43 A brief summary will encapsulate the implications for the international accounts of whether a household is classified as resident or nonresident of the reporting economy for different types of flows. In particular it will be noted that any changes in the criteria for residence will affect service flows (e.g., expenditure by foreign students or guest workers either being included as services exports or as out of scope of the balance of payments, depending on their residence status).

3. Residence of enterprises

4.44 The enterprise sector will be noted as including quasicorporations, that is, unincorporated entities that are separate from the owners. This relates to *1993 SNA* paras. 4.49–51, which includes unincorporated joint ventures, limited liability partnerships, and other unincorporated entities owned by nonresidents.

4.45 The residence of enterprises is based on the same general principles of identifying the predominant center of economic interest used for households and other entities. As applied to enterprises, the specific criteria as follows:

(a) First, the territory where or from which the enterprise engages in a significant amount of production over a significant period, as in *BPM5* paras. 73 and 79–83. This criterion involves physical presence. The case of enterprises that undertake production in other economies from a base in one economy will be covered, as in *BPT* paras. 104–106. Types of mobile delivery of services include transport, advice, and repairs. In these cases, this chapter will state that the residence is determined from the base of operations rather than the point of delivery (unless the activities elsewhere are sufficiently substantial and significant to amount to a branch, as defined above). For example, the operations of a ship that was on the high seas are part of the enterprise that operates the ship, and the residence of the enterprise is determined from its base or bases of operations; or

(b) Second, if the enterprise does not have a physical presence, the territory of incorporation or registration. For entities that have little or no physical presence and/or do not undertake production, location and production may not be useful criteria. As a result, the jurisdiction that allows the creation of and regulates the entity will be considered as the entity's predominant center of economic interest. (If there is no incorporation or regulation, legal domicile will be used, that is, the jurisdiction whose laws the entity is subject to.) The *Debt Guide* and *CPISG2* already adopt a residence concept based on incorporation where there is little physical presence. However, the *Benchmark Definition of FDI* (para. 69) classifies the residence of some entities according to the territory of the management office, which may sometimes differ. No exception would be made for entities owned by a general government entity of another jurisdiction. The application of these principles will be stated for unincorporated entities that have some legal recognition, including limited liability partnerships, trusts, and joint ventures. The identification of the jurisdiction of *societas europaea* will be discussed.

[Questions: (i) Is this approach to enterprises with little or no physical presence suitable? (ii) Is any further specification necessary for societas europaea*?]*

4.46 The chapter will note that many of the apparently difficult cases for determining residence are actually problems of whether there is a separate unit, as discussed above, under the section on units in this chapter.

4.47 The chapter will illustrate applying of the general principles to some of the difficult cases. It will note that enterprises that are run as a single institutional unit in two or more economies should be split up by prorating (as discussed already under Section C (2) above).

4.48 There will be a brief summary of the implications for the international accounts of whether an enterprise is treated as a resident enterprise or as a nonresident for different types of flows.

4. Residence of other institutional units

4.49 The residence of embassies, military bases, and intergovernmental organizations will be covered, using the same concepts as stated in *BPM5*. This section will note that these are simply applications of the concept of economic territory because these institutions are outside the control of the government of the territory in which they are located. It will be noted that corporations created on behalf of a government in territories other than its own follow the residence principles for corporations (i.e., the corporation is a resident of the territory in which it was created; it may also have a branch if it has operations in other territories).

[Note: This issue is currently under discussion. Question: Is the treatment of government offshore corporations suitable?]

4.50 International organizations will be defined as organizations created by agreements between national states and/or other international organizations whose members are national states. They will be specifically excluded as residents in the economy in which they are physically located.

4.51 Consistent with that principle, it is proposed that the central bank of a currency union be treated as an international organization. In contrast, *BPM5* para. 90 required that the financial assets and liabilities of a "regional central bank" be prorated to the members. This chapter will discuss the treatment of central banks of a currency union, including whether it is appropriate to have monetary activities become transactions with nonresidents. It will also discuss how the activities undertaken by national central banks within a currency union should be treated.

[Question: What treatment should be adopted for the central banking functions in a currency union?]

4.52 The treatment of international organizations that operate military forces and act as the interim administration of a territory will be discussed, for example, based on treatments adopted for Kosovo. Two units provide supports in the post-war Kosovo. The Kosovo Force (KFOR) is under the control of NATO and its member countries. The United Nations Mission in Kosovo (UNMIK) also provides collective nonmarket services. The UNMIK's operations are predominantly controlled and financed by the United Nations and its members. (The treatment of the associated costs as being a transfer to the administered economy will be cross-referenced.)

4.53 It will be noted that the IMF collects selected data on international organizations to include in global totals. Regional intergovernmental organizations should not be included in national totals, that is, regional international organizations should be included in world totals as well as any regional totals that cover all the economies of the organization.

4.54 It will be noted that a separately constituted pension fund of an international organization is regarded as a resident of the territory in which it is located (i.e., in the same territory where the fund is administered, which would often be where the organization's headquarters is located).

4.55 Nonprofit institutions serving households will be mentioned briefly, as in *BPM5*, including the guidelines for recognizing a branch. It will be noted that nonprofit institutions serving households are not international organizations, which are defined as being created by governments.

F. Other Issues Associated with Residence

1. Assets and liabilities held by groups that include both residents and nonresidents

4.56 Some economic entities such as partnerships, bank accounts, and trusts may have owners who are residents of different territories. The manual will use a convention introduced in *MFSM* para. 318—that accounts held by emigrant workers in their economy of origin that are freely usable by family members in that economy are treated as accounts held by residents of the economy of origin. The manual will extend that convention to treat all assets and liabilities of groups that include both residents or nonresidents as being held by residents of the economy in which the account is held. However, compilers would be able to adopt other treatments, such as actual shares or prorating between residents and nonresidents if appropriate information were available and the amounts were significant. It is also important that compilers share information with their counterparts in affected economies with a view to developing consistent measures.

[Question: Is the proposed treatment suitable?]

2. Data by partner economy

4.57 This section will state that the primary presentation of international accounts is to show all nonresidents as a single group. However, data broken down into individual partner economies or groups of economies may be of analytical interest. Data may be for the balance of payments or international investment position as a whole, or for particular components such as goods, services, direct investment, or portfolio investment. In addition, such data make possible bilateral comparisons and, hence, assist in identifying data problems. Some direct investment data and the CPIS will be cited as examples. (The *BPM5* terminology "Regional Statements" will be replaced because it applies not only to "regions," but also to individual economic territories.)

[Question: (i) Should there be a standard requirement for partner data? (ii) If so, should it be in general or for any particular components?]

4.58 The guidelines will be as in *BPM5* paras. 478–498 and spelled out in more detail as in *CPISG2* in the case of portfolio investment. In general, the attribution of partner is based on the residence of counterparty to the transaction or financial position. As a result, all the residence issues discussed above are applicable (and are often more difficult to obtain information on). Among the issues that arise for compiling partner data to be discussed in the manual are:

(a) Goods. The residence of the seller/purchaser of the good is the conceptually correct partner. It will be recognized that, in practice, data are based on the territory of origin, consignment, destination, etc. which may not always be the same.

(b) Freight. The residence of the freight service provider is the correct partner. It will be recognized that, in practice, data may be based on other bases, such as the territory of source or destination of the goods carried, or the flag of the ship.

(c) Financial transactions. The debtor/creditor principle will be explained (as per *BPM5* paras. 334, 482–483, and 493–494) and recommended. (The transactor principle will be noted as a conceptually less suitable basis adopted in some cases as the result of limited data availability. It will be noted that the transactor principle is not suitable for position data.)

(d) Monetary gold and SDRs. As these have no counterparty, the manual will note the need for an “unallocated” category.

(e) Direct investment. There can be “chains” of direct investment, for example, when a direct investor X in Territory A has a fully owned subsidiary Y in Territory B, which in turn has a fully owned subsidiary Z in Territory C. The territory of ownership of the investment in Territory C will be Territory B. However, the possibility of supplementary data based on *ultimate beneficial owner* (in the example, Territory A) or *ultimate destination* (in the example, Territory C) will be discussed.

These bases, showing the underlying reality in a potentially useful way, will be of interest to some data users. Definitions of ultimate beneficial owner or destination will be given, but significant and unresolved practical difficulties will be noted and such data would not be the standard basis for reporting international accounts.

It will be noted that in the case of “round tripping” (discussed in Chapter 5, Classifications) the ultimate beneficial owner and ultimate destination are in the same territory. In such cases, each territory would include itself as a source and destination of foreign investment.

[Question: Is this recognition of the ultimate beneficial owner and/or ultimate destination suitable?]

(f) Depository receipts. Depository receipts will be explained briefly. It will be stated that they will be attributed on the basis of the issuer of the underlying security, not the issuer of the depository receipts, as in *CPISG2* Appendix 1 Note 8.

[Question: Should the CPISG2 treatment be reviewed, to be more consistent with data availability and to be consistent with other cases where legal form is adopted in preference to underlying economic reality?]

(g) Nominee accounts and custodians. Nominee accounts and custodians will be explained briefly. It will be stated that the assets should be classified on the basis of the beneficial owner.

(h) Securities. It will be noted that securities are to be classified on the basis of the residence of the issuer, not the place of issue, the residence of a guarantor, or the currency of issue.

(i) Multiterritory enterprises. The implications of splitting an enterprise (as noted in this chapter above) for other territories that have transactions or positions with the enterprise will be noted.

3. Changes in residence of institutional units

4.59 An individual or enterprise can change its economy of residence. The manual will cross-reference the discussions on the treatment of changes in residence in Chapter 3, Accounting Principles. It is proposed to treat a change of residence of households as a reclassification and, hence, such changes would be recorded as other changes in financial assets and liabilities accounts rather than as capital transfers, as occurs in *BPM5*.

APPENDIX: INDIVIDUALS AND HOUSEHOLDS WITH CONNECTIONS TO TWO OR MORE TERRITORIES

Nonpermanent workers, students, and their accompanying dependents may have strong connections with two or more economies. Thus, they are difficult to cover adequately in a balance of payments framework.

The balance of payments structure limits the treatment of households to a resident-nonresident split, but it will be recognized that, in reality, a range of degrees exists of connections to both home and host territories. Accordingly, a possible way of responding to these concerns is as follows: the manual would propose that, for territories where these issues are significant, compilers consider supplementary presentations that provide other information separately (e.g., data on the numbers, demographic characteristics, earnings, expenditure, and saving of these groups, or where nonpermanent residents are combined with nonresidents in short-term employment). Such supplementary monetary and nonmonetary data could allow users to assess the effect of different definitions on the international accounts and understand the phenomenon of international labor movement as a whole.

A possible satellite or supplementary presentation would be to bring together relevant components of services, compensation of employees, workers' remittances, migrants' transfers, financial flows, and positions. It could also include data on certain resident-to-resident transactions undertaken by groups with connections to other territories, such as expenditure by long-term guest workers.

Such a presentation would not be a standard requirement and would only be suggested for economies where the impact of people with connections to other economies was regarded as an economically significant issue.

> *[Question: Is this proposal suitable for a supplementary presentation for nonpermanent workers and their accompanying dependents?]*

A possible definition of nonpermanent residents is as follows: workers, students, patients, and their accompanying dependents who have lived or intend to live in one or more territories other than their home territory for a period from one year up to five years, with an intention to return to the home territory at the end of that time. Depending on the circumstances, intention could be identified from surveys, the type of visa issued, or past patterns of behavior by that class of people.

There may be different presentations for different classes of nonpermanent residents, for example, a territory that provides major education services may wish to show the various flows associated with types of students. (Particularly if the proposal to apply the one-year or more criterion for residence to students is accepted, it could be useful to bring together data on students above and below the one-year criterion.)

> *[Question: Is the proposed definition for nonpermanent residents suitable?]*

ECONOMIC TERRITORY, UNITS, INSTITUTIONAL SECTORS, AND RESIDENCE

References

BPM5
Residence Chapter IV
"Regional statements" Chapter XXIV
Institutional sectors Appendix II

BPT Chapter II (note: guidelines for branches appear to be less restrictive than *BPM5*)

External Debt Statistics: Guide for Compilers and Users paras. 29–37

CPISG2 paras. 3.6–3.32

Benchmark Definition of FDI, 1996

1993 SNA Chapter IV, paras.14.9–14.34 (effectively repeats *BPM5* Chapter IV)

MFSM paras. 26–35, 46–14

M. Debabrata Patra and M. Kapur, *India's Worker Remittances: A User's Lament About Balance of Payments Compilation*, BOPCOM-03/20

ECB, *Updating BPM5: Possible Expansion of the Sector Breakdown*, BOPCOM-02/64

IMF, *The Legal Structure, Economic Function, and Statistical Treatment of Trusts*, BOPCOM-01/12

IMF, *Clarification of the Recommended Treatment of Selected Foreign Direct Investment Transactions*, BOPCOM-01/20B

IMF, *Recommended Treatment of Selected Direct Investment Transactions (2002)* http://www.imf.org/external/np/sta/di/fditran.htm, based on previous BOPCOM decisions

IMF, *Residence*, BOPCOM-02/59

Hong Kong Special Administrative Region, Census and Statistics Department, *Nonpermanent Workers*, BOPCOM-03/19

R. Kozlow, *Exploring the Borderline Between Direct Investment and Other Types of Investment: The U.S. Treatment*, BOPCOM-02/35

R. Kozlow, *Investment Companies: What are they, and Where Should they be Classified in the International Economic Accounts?* BOPCOM-03/22

A. Ridgeway, *A Note on Trusts and Partnerships*, BOPCOM-02/60

South African Reserve Bank, *The Concept of Residence with Special Reference to the Treatment of Migrant Workers in the Balance of Payments of South Africa*, BOPCOM-03/18

Changes from *BPM5*

(a) *Changes proposed:*

The definition of economic territory will be refined (para. 4.3).

A discussion of the treatment of changes in sovereignty and joint sovereignty will be introduced (although not covered in *BPM5*, the proposed treatment is in accord with general principles) (paras. 4.6–4.8).

Modification of the definition of branches so that payment of income taxes will instead be taken as an indication of a branch, rather than a requirement (para. 4.15).

The *1993 SNA*/*MFSM* institutional sector classification will be adopted. The use of a "monetary authorities" sector will remain as an option, where appropriate (para. 4.28).

Change in definition of residence by qualifying "center of economic interest" with "predominant" (para. 4.33).

Stricter application of the guideline for residence of households based on presence for one year or more than in *BPM5* including application to students, patients, and ship's crew; decision to take into account harmonization with demographic, immigration, and tourism statistics (para. 4.39).

Residence of entities with little or no physical dimension to be attributed to the territory of registration or legal domicile (para. 4.45(b)). (This issue was not discussed in *BPM5*, but proposal is the same as in the *Debt Guide* and *CPISG2*.)

Treatment of central banks of currency unions not to involve prorating of assets and liabilities to members (para 4.51).

Clarification of the residence of treatment of joint accounts and discretionary trusts is covered (para. 4.56).

Adoption of preference of debtor/creditor principle over the transactor principle (para. 4.58(c)).

Clarification of the classification of the residence of issuer of depository receipts and like instruments (para. 4.58(f)).

(b) *Changes raised as an option:*

A discussion of treatment of rebel-held areas (which are not mentioned in *BPM5*) with a recommendation for transparency but no standard treatment (para. 4.4).

Treatments for unincorporated entities, holding companies, ancillary companies, special purpose entities, entities for holding wealth, and nominees are proposed (paras. 4.22, 4.30(e), 4.31(b) and (c)).

Treatment of leases of land and other nonproduced is proposed (paras. 4.24–4.26).

The possibility of showing mutual funds as a separate sector is raised (para. 4.31(a)).

The possibility of a convention or separate sector classification for asset-holding entities is raised (para. 4.31(b)).

Treatment of government offshore corporations, central banks of currency unions, and administering authorities is proposed (paras. 4.49–4.52).

Possible recognition of selected data by partner as a standard component (para. 4.57).

Supplementary information on direct investment, using ultimate beneficial owner and/or ultimate destination as the basis (para. 4.58(e)).

Provide supplementary data on nonpermanent workers, students, patients, and their accompanying dependents who have connections to both a host and home territory (Appendix).

Glossary

Ancillary company
"Bad banks"
Branch (note that common usage may also be used for incorporated subsidiaries, while international accounts usage is limited to unincorporated structures)
Brass plate company
Central bank
Custodians
Debtor/creditor principle
Depository corporations
Depository receipts
Enterprise
Estate

Financial auxiliaries
Financial corporations
General government
Holding company (should not be assumed to be at top of organizational chart; may also be a subsidiary)
Household
Institutional unit
Insurance corporations
International business company
International organization
Joint venture
Limited liability partnership
Monetary authorities
Mutual funds (It will be noted that statistical treatments will be the same for unit trusts and any other structures that undertake the same economic function)
Nominee
Nonfinancial corporations
Nonpermanent worker
Nonprofit institutions serving households
Notional unit
Offshore financial center
Partnerships
Pension funds
Predominant center of economic interest
Quasicorporation
Regional central bank (used in *BPM5*, but may need to be replaced by "central bank of a currency/monetary union")
Regional international organization (i.e., established by two or more governments)
Rent (cf. rental)
Residence
Securities
Shell company, shelf company
Special purpose entity/vehicle (SPE, SPV)
Transactor principle
Trust
Ultimate beneficial owner

Chapter 5. Classifications:
Financial Instruments, Functional Categories, Maturity, Currency, and Type of Interest Rate

5.1 An introduction to this chapter will note that classifications such as financial instruments, functional categories, maturity, currency, and type of interest rate relate to several different parts of the international accounts. It will also state the objectives of classification, namely to develop aggregates that (i) group similar items, and (ii) separate items with different characteristics and causes.

A. Financial Instruments

1. General issues

5.2 This section will briefly define financial instruments. The relationship between financial assets and other financial instruments will be explained, as per *MFSM* para. 117. Also instruments that are not financial assets will be identified (viz., contingencies, guarantees, nonfinancial contracts). It will be noted that the financial assets classification generally applies to both claims (described as assets) and obligations (described as liabilities). There are exceptions in that monetary gold and SDRs are international financial assets with no counterpart liabilities and that "accounts receivable" is an asset, while "accounts payable" is the corresponding liability.

5.3 The objectives of classification of financial instruments will be spelled out. The potential dimensions by which instruments can be classified are numerous, so the classification involves identifying the most economically crucial features. The implications of a high degree of financial innovation will be discussed—in particular, that the classification will need to define the instruments with reference to the characteristics, not just specific types of instrument, so that it is applicable to new instruments and helps deal with hybrid and other borderline cases. The importance of classification of financial assets for understanding financial markets and for consistency with other datasets, particularly monetary and financial statistics, will be highlighted. In addition, the financial asset classification will be presented as the foundation for the functional category classification, which in some cases takes into account the type of instrument.

2. Overview of classification of financial instruments

5.4 It is proposed to adopt an instrument classification that is based largely on that of the *MSFM* (see Chapter IV) and the *1993 SNA* (see p. 589). Also, see Table 5.1 ahead. The differences are (i) a rearrangement into broad category headings: equity, debt instruments, and other instruments, and (ii) some clarification of terminology. In addition, an explicit concordance is made between the assets and the corresponding income. The underlying components remain identical.

Table 5.1. Proposed Instrument Classification and Terminology for the New Manual

Type of Financial Instrument	Corresponding Type of Income
Equity Finance, covering:	
- equity securities	}dividends,
of which equity in mutual funds	}withdrawals of income from quasi-
of which equity in money market mutual funds	} corporations (distributed branch profits),
-reinvestment of earnings[1]	reinvested earnings,
- other equity (not including net equity in insurance technical reserves and pension funds)	
	other: (securities lending)?
Debt, covering:	
- debt securities	}interest
- long-term	}
- short-term	}
- loans	}
- currency and deposits	}
- accounts receivable/payable	}
- trade credit and advances	}
- other accounts receivable/payable	}
- other debt instruments	}
of which arrears[2]	
	other: (securities lending)?
Other instruments, covering:	
- monetary gold	generally none; gold lending fees
- *financial gold*[3]	*generally none; gold lending fees*
- SDRs	rate of return
- net equity in insurance technical reserves and pension funds	dividends, property income attributed to insurance policy holders
- financial derivatives and employee stock options	none
- financial derivatives	
- forwards	
- options	
- employee stock options	

Possible additional instrument classifications shown in italics.
[1] An imputed instrument for the imputed financial transaction.
[2] Possible sub-item that could be added as a component of any debt instrument on an "as relevant" basis.
[3] If included as an asset, financial gold would appear in international transactions, but not the international investment position, as there is counterpart liability which means that the positions lack an international dimension.

5.5 Definitions of debt and equity will be given, based on definitions in *1993 SNA* para 11.86–87 and the *Debt Guide* para. 2.3. Certain financial assets that have no counterpart liability do not qualify as debt or equity and so have been included under “other.” Given that equity in insurance reserves and pension funds has components of both equity and debt, it has been classified to “other” (The *BPM5*, para. 474 and the *Debt Guide* both treat it as “debt,” but defined contribution schemes have equity elements.) In addition, financial derivatives do not meet the definitions of debt or equity, so they have been classed as other.

[Question: Is the debt/equity/other split suitable?]

5.6 The *BPM5* instrument classification appears implicitly in conjunction with the functional and institutional sector classifications. It differs in order and in some details from *MFSM/1993 SNA*, as shown in the following table.

Table 5.2. Comparison of *1993 SNA*/*MFSM* and *BPM5* Instrument Classifications

1993 SNA/MFSM	*BPM5*
Monetary gold and SDRs	Two components are shown separately, not grouped.
Currency and deposits Currency Transferable deposits Other deposits	The total is not split among the three components.
Securities other than shares	Called “debt securities.” Split into: Bonds and notes Money market instruments (“Bonds and notes” and “money market instruments” were defined by maturity, rather than their qualities as instruments.)
Loans	Same.
Shares and other equity	Called “equities” or “equity securities.” (For direct investment, reinvested earnings is shown separately for transactions only.)
Insurance technical reserves Net equity of households in life insurance reserves Net equity of households in pension funds Prepayment of premiums and reserves against outstanding claims	Included with “other assets.” (The three components are not shown separately, but are included as a supplementary item for national accounts purposes.)
Financial derivatives	Same.
Other accounts receivable Trade credit and advances Other	 Called “trade credits.” Included with “other assets.”

5.7 The following more detailed comments on the proposed instrument classification should be noted:

(a) Monetary gold and SDRs will continue to be shown separately, as in the *BPM5* classification, because of their analytical importance in the international accounts.

(b) “Securities” will be defined.

(c) “Debt securities” is considered to be a clearer term than “securities other than shares,” which is used in the *1993 SNA* and the *MFSM,* so the *BPM5* term will be maintained.

(d) The generic term “equity finance” will be used, as opposed to “shares and other equity,” which is used in the *1993 SNA* and the *MFSM*. “Equity finance” is considered to be a clearer term and it is also shorter. It will be used instead of “equity capital,” to avoid confusion with the term “capital” in the capital account.

(e) “Equity in mutual funds” would be proposed as a supplementary or memorandum item under equity. It would include equity in mutual funds, unit trusts, and other collective investment schemes, other than life insurance and pension funds to be identified separately from “equity finance” in view of their importance. Within such collective investment schemes, there could be separate components for the type of investment, namely (a) money market (see next point); (b) real estate; (c) stocks; and (d) mixed, as supplementary information, where this information is felt to be analytically important.

[Questions: (i) Should more detail on collective investment schemes be included? (ii) If so, how much detail? (iii) Should they be standard or supplementary items?]

(f) Money market mutual funds (MMMFs) and other pooled investments that are included in broad money (as discussed in *MFSM* para. 100) may be shown as a supplementary category. In light of the treatment in the *MFSM* of such holdings as “deposits” and recognizing their money-like properties, the manual will recommend that, where significant, they need to be identified separately for reconciliation with monetary and financial statistics. (However, it will be recognized that this is not usually a concern in international accounts data.)

(g) As agreed by the Advisory Expert Group on National Accounts in its February 2004 meeting, the manual will recommend an instrument category “financial derivatives and employee stock options” with the subcategories of (i) financial derivatives and (ii) employee stock options. Although employee stock options share some characteristics with financial derivatives, they do not fully meet the definition of financial derivatives.

[Question: Is the proposed treatment of employee stock options suitable?]

(h) A more detailed breakdown of financial derivatives by their instrument types will be mentioned as possible supplementary items, viz., (i) forwards, and (ii) options (as in the *Debt Guide* Table 7.11). Financial derivatives could also be classified by risk categories: (i) foreign exchange; (ii) interest rate; (iii) equities; (iv) commodities; and (v) other; on a supplementary basis.

[Questions: (i) Is an additional split of financial derivatives desirable? (ii) If so, how much detail? (iii) If so, as standard or supplementary items?]

(i) If arrears on debt and/or nonperforming loans are of economic interest, compilers should consider either or both as an optional “of which” component for relevant position items.

- Arrears are shown separately in *Debt Guide* Table 4.1. Arrears will be defined as in the *Debt Guide* para. 3.36. (Cases of arrears need not be limited to Exceptional Financing. The desirability of identification of arrears is not limited by whether or not going into arrears is treated as an imputed transaction or not, as discussed in Chapter 3 Accounting Principles. However, if a transaction is imputed, all arrears are classified as short-term; if a transaction is not imputed, they will be classified according to the original instrument.)
- Nonperforming loans are a related but not identical concept, often defined by payment being overdue by more than a specified time.

[Questions: (i) Is this proposal suitable? (ii) Should data be limited to liability positions data, or should the possibility be opened for asset positions? (iii) Should arrears, nonperforming loans, both, or a mixture be adopted? (iv) How should the category be defined?]

(j) Financial gold could be considered for reclassification as a financial asset, rather than a good, because of its role in financial markets. As a result, international transactions would be recorded in the financial account, rather than as goods, and would be netted, rather than gross. However, the positions would not be included in the international investment position because they lack the international element that arises for monetary gold included in reserve assets.

[Question: Should financial gold be treated as a financial asset?]

(k) Trade-related credit. Trade credit is limited to credit extended by suppliers, so the *Debt Guide* paras. 6.9–11 introduce a wider concept of trade-related credit that includes trade credit, trade-related bills, and credit by third parties to finance trade. Trade-related bills and credit by third parties to finance trade could be identified as a separate component of loans as supplementary information where they are considered statistically significant and analytically useful.

[Question: Should an optional category for trade-related credit be created?]

(l) Reinvestment of earnings. This imputed instrument is used for the financial account entry that corresponds to the imputed income item for reinvested earnings. (Further discussion appears in Chapter 7, Financial Account, and Chapter 10, Primary Distribution of Income Account.)

[Question: Are the proposals in this paragraph, other than those for which there are specific questions, suitable?]

The rationale for the classification will be stated, for example, the role of currency and deposits in monetary analysis, and the residual claim nature of equity interests. It will be noted that financial innovation has resulted in new types of instruments.

3. Discussion of the classification of particular instruments

5.8 After introducing the main types of financial assets, this chapter will go on to discuss the application of the general classification to particular situations. This discussion will largely follow Chapter IV of *MFSM* (paras. 116–181) because the content and level of description is considered appropriate for this manual. However, it should be elaborated and updated to account for any subsequent developments in particular cases:

(a) Repurchase agreements, securities lending, and gold swaps will be defined and illustrated. The instrument classification will be highlighted by identification of security and loan aspects. An example will be given. (See *MFSM* paras. 142–148 and BOPCOM-01/16.)

(b) The borderline between monetary gold and other gold will be discussed, and the process of monetization and demonetization of gold will be explained. (In addition, if financial gold were to be recognized as a financial instrument, the borderline with nonfinancial gold would also be discussed.)

(c) Gold loans, gold swaps, and gold deposits will be defined. Possible treatments are as the gold staying on the books of the gold provider, in conjunction with a loan or deposit. (See *MFSM* paras. 154–164, *Debt Guide* paras. 3.31 and 3.34, and *GFSM 2001* para. 7.115.)

(d) Employee stock options will be classified as a subcategory under a new instrument category "financial derivatives and employee stock options," the other subcategory being financial derivatives.

(e) Inclusion of financial leases as loans will be noted. (It is proposed that financial leases will be noted under Chapter 5 Classifications, Chapter 6 International Investment Position, Chapter 7 Financial Account, and Chapter 10 Primary Income, with a full exposition in an appendix to the manual.)

(f) Loans that have been traded will be classified as securities under certain conditions, as stated in the *Debt Guide* para. 3.29. It will be noted that many loans are traded but not sufficiently to become securities.

(g) Depository receipts are classified in the same way as the underlying security, as noted in Chapter 4 Economic Territory, Units, Institutional Sectors, and Residence.

(h) Ownership of mutual funds, unit trusts, and other pooled investments will be regarded as equity, regardless of what kind of assets the fund holds. In contrast, because the assets of an asset-backed security remain owned by the issuer, the security is a debt instrument.

[Comment: This treatment is adopted because the investors in mutual funds, etc. have ownership rights, and otherwise these entities would have no owners. The treatment is unchanged from BPM5 para. 388.]

(i) Convertible bonds will be classified as debt securities until the option to convert them is exercised, at which time they will be classified as the new instrument.

(j) Islamic instruments will be discussed, with a reference to Appendix 2 of *MFSM* as a source for further information.

(k) Trade credit and advances that are sold to another party (e.g., discounting of an importer's bill) will be treated as ceasing to be trade credit and advances and will be classified as a loan or some other instrument, depending on its nature.

(l) Financial reinsurance will be explained and will be treated as a loan.

(m) Activation of guarantees. Chapter 3 Accounting Principles will state the recommended treatment in instances when a debt guarantee is invoked. It will state that, once the guarantee has been invoked, the debt of the primary debtor is assumed to have been repaid and then assumed by the guarantor, as its own debt. However, Chapter 3 Accounting Principles notes that guarantees are not recognized as liabilities until invoked.

[Questions: (i) Are these treatments suitable? (ii) Are there other particular issues?]

4. Other issues associated with the instrument classification

5.9 There will be an outline of the classification of specialized government-to-government instruments, such as capital subscriptions to international nonmonetary organizations including development finance institutions, and payments agreement balances, as discussed in *BPM5*, para. 432.

B. Functional Categories

5.10 The five current functional categories will be highlighted as the major classification for each of financial transactions, positions, and income (with the exception that financial derivatives do not give rise to income). It will be noted that the classification combines functions and instruments to give a useful breakdown of investment flows and levels. The proposed category and instrument breakdown is shown in the following table. Table 5.3 shows a combined classification by functional category, major instruments, and maturity.

Table 5.3. Proposed Functional Category and Instrument Breakdown

Assets	*Liabilities*
Direct investment	**Direct investment**
Abroad	In reporting economy
Equity finance	Equity finance
of *which* Reinvestment of earnings[1]	of *which* Reinvestment of earnings[1]
Debt	Debt
(Other instruments if applicable)	*(Other instruments if applicable)*
In reporting economy (claims on direct investors)[2]	Abroad (liabilities to direct investment enterprises)[2]
Equity finance	Equity finance
Debt	Debt
(Other instruments if applicable)	*(Other instruments if applicable)*
Portfolio investment	**Portfolio investment**
Equity securities	Equity securities
Debt securities	Debt securities
Long-term	Long-term
Short-term	Short-term
Financial derivatives and employee stock options	**Financial derivatives and employee stock options**
Financial derivatives	Financial derivatives
Forwards	Forwards
Options	Options
Employee stock options	Employee stock options
Other investment	**Other investment**
Equity finance[3]	Equity finance[3]
Debt	Debt
Loans	Loans
Currency and deposits	Currency and deposits
Accounts receivable	Accounts payable
Trade credit and advances	Trade credit and advances
Other accounts receivable	Other accounts payable
Other debt instruments	Other debt instruments
Other instruments	Other instruments
Net equity in insurance companies technical reserves and pension funds	Net equity in insurance companies technical reserves and pension funds
Reserve assets	
Monetary gold	
SDRs	
Foreign exchange	
Currency and deposits	
Securities	
Equity securities	
Debt securities	
Other claims	

The instrument breakdown is discussed in the section of this chapter on financial instruments.

[1] Reinvestment of earnings is an imputed financial transaction, rather than a different type of claim, and so is not relevant for the IIP or Other Changes in Financial Assets and Liabilities Account.
[2] If reverse investment continues to be shown under direct investment, rather than included under portfolio or other investment (see below under direct investment).
[3] If untraded equity instruments are excluded from portfolio investment, as discussed under portfolio investment below.

1. Direct investment

5.11 This section will state the features that distinguish direct investment from other categories and why it requires a separate functional category, along the lines of *BPM5* paras. 359–361 and *BPT* paras. 509-513. The section on direct investment will give a more detailed definition of direct investment than *BPM5*. This section will present, primarily under direct investment, the issues of the borderline between direct investment and other categories. There will be a cross-reference to the appendix on *foreign affiliates trade in services statistics* in Chapter 9 Goods and Services. It will be noted that the definition of foreign affiliate used in *foreign affiliates trade in services statistics* differs from the direct investment definition.

5.12 Data for income, transactions, and positions between enterprises in direct investment relationships will be presented under "direct investment abroad" and "direct investment in the reporting economy." This treatment will also apply in cases of reverse direct investment (described below, i.e., where the direct investment enterprise has less than 10 percent of the ordinary shares or voting power in the direct investor). That is, these claims/liabilities will be recorded, as appropriate, as "claims on direct investor" and "liabilities to direct investment enterprise" and be shown under "assets" or "liabilities." In contrast, these were shown as offsets under "direct investment in the reporting economy" and "direct investment abroad" in *BPM5*. The direction of the direct investment relationship will still be apparent from the title of these items.

a. What is a direct investment relationship?

5.13 The definition of direct investment will be largely the same as *BPM5* and the *Benchmark Definition of FDI*, with the IMF 2002 clarifications. Using the same approach as *BPM5* paras. 359–374, this chapter will state the concept of direct investment (i.e., investment associated with a lasting interest, implying an effective voice in management, so that it tends to behave in a different way from other forms of investment). The operational definition in *BPM5* for the establishment of a direct investment relationship involves 10 percent or more of ordinary shares or voting power by a direct investor in a direct investment enterprise. As in *BPM5*, the operational definition will be endorsed as the sole criterion in order to ensure international consistency and to avoid subjective judgments, such as those about actual exercise of control or an effective voice in management. The definition includes ownership and voting power held indirectly, as discussed in more detail under chains of direct investment below. It will be noted that ownership and voting power are normally the same. Cases where they may differ are for "golden shares" and indirect ownership via partly owned subsidiaries, as discussed under indirect investment below.

[Question: (ii) Should the 10 percent threshold be changed to 20 or 50 percent?]

[Comment: International accounting standards use a 20 percent threshold. Foreign affiliate trade statistics use a 50 percent threshold].

5.14 Subsequent to the definition of direct investment, the terms "direct investor," "direct investment enterprise," and "direct investment finance" will be defined. This section will define the terms "affiliate/affiliated enterprise," "subsidiary," and "associate." "Branch" will also be defined, with a cross-reference to Chapter 4 Economic Territory, Units, Institutional Sectors, and Residence.

5.15 As in *BPM5* para. 367, it will be noted that direct investors may be enterprises, individuals, associated groups of individuals and enterprises (such as unincorporated joint ventures), estates, trusts, or governments. The following specific cases will be mentioned:

(a) A nonprofit institution serving households (NPISH, as defined in Chapter 4 Economic Territory, Units, Institutional Sectors, and Residence) may be a direct investor in a corporation. However, flows between two NPISHs are treated as transfers, rather than investment, because it is considered that financial flows in these cases are seldom driven by investment considerations.

(b) This section will state principles for application to intergovernmental organizations, insurance companies, mutual funds, funds of funds, and pension funds (as both direct investors and direct investment enterprises), to be decided during the review process for this manual.

(c) This section will also guide compilers on how to treat a group of related individuals as a direct investor (e.g., where various members of the same family have interests in the same company).

5.16 The section will discuss the issues for determining whether enterprises are in a direct investment relationship when the enterprises are linked by a chain of direct investment ownership. Options to be considered are:

(a) a narrow definition limited to directly held direct investment enterprises; and

(b) a broader definition to include both directly and indirectly held direct investment enterprises as in:

   (i) the "Fully Consolidated System" (FCS) definition, which includes all directly and indirectly owned subsidiaries, associates, and branches of the direct investor, even if the indirect ownership by the direct investor is less than 10 percent of the ownership or voting power. *BPM5* adopts the FCS definition, although the term is not used (see *BPM5* para. 362; also see *Compilation Guide* para. 687 and *BPT* para. 517 for examples);

   (ii) the "US Methodology" (USM) definition, which uses a cutoff of 10 percent or more ownership for both direct and indirect ownership, but not voting power. It differs from the FCS definition in cases where there is less than 10 percent of ownership but 10 percent or more of indirect voting power (i.e., where one of the links in the chain of ownership is a subsidiary, as illustrated in *BPT* para. 517 example in the case of Company C); and

(iii) the "10/50" definition adopted by the European Union, which uses the normal 10 percent threshold for direct relationships but 50 percent ownership for indirect relationships.

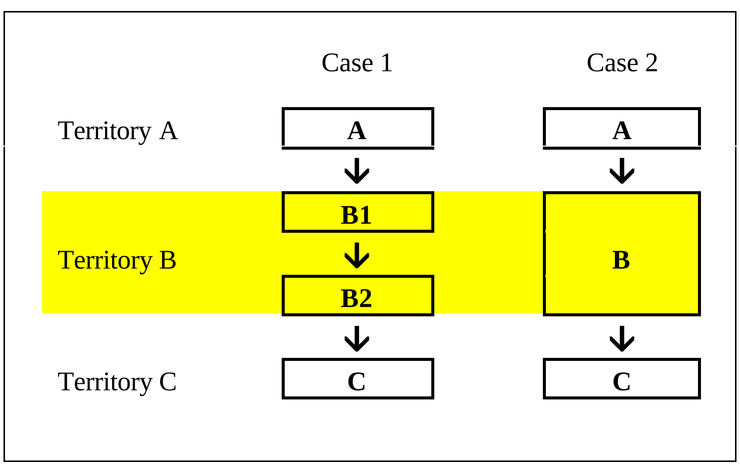
Examples will be provided for the definition adopted. There will be a cross-reference to Chapter 10 Primary Distribution of Income Account for the implications of chains of direct investment for the concept of retained earnings.

[Comments: The complex structures of some international company groups would not be taken into account if indirect holdings are omitted. However, the FCS is difficult to implement, and very few countries are able to fully apply the FCS at present.

Note the relevance of the inclusion of both "ordinary shares" or "voting power" in the definition of direct investment above. The FCS definition is implied by the use of "voting power" in the definition.]

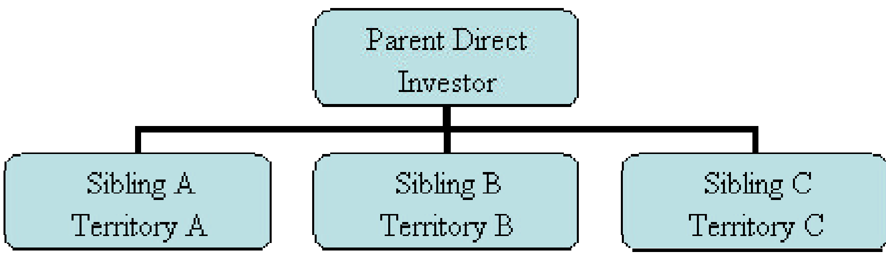
[Question: Which of the definitions specified above should be adopted?]

5.17 If the broader definition for determining direct investment relationship is followed, this chapter will discuss the case of a direct investment chain of ownership where at least one link in the chain involves two enterprises in the same economy. It is proposed that this situation would not preclude direct investment relationships between other enterprises in the chain. For example, where ↓ indicates a subsidiary, it is proposed that A is in a direct investment relationship with C in both situations.



5.18 It will be noted that if two enterprises (sometimes called "siblings") have the same direct investor, those two enterprises are in a direct investment relationship with each other, even if neither has any equity interest in the other. Without a direct investment equity interest between them, the items do not meet the definitions of either "direct investment abroad" or "direct investment in the reporting economy." So the convention in para. 529 of *BPT* that international transactions between siblings are classified according to the direction of the flow is used. To clarify these complex cases, examples will be used.

For example,



if Sibling A has less than 10 percent of the ordinary shares or voting power in Sibling B or vice versa:

(a) a loan by Sibling A to Sibling B would be reported under direct investment abroad in Territory A and direct investment in the reporting economy in Territory B; and

(b) a loan by Sibling B to Sibling A would be reported under direct investment abroad in Territory B and direct investment in the reporting economy in Territory A.

5.19 A term such as "group of affiliated enterprises" or "group of related enterprises" could be adopted. It would be noted that some enterprises may be members of two or more groups.

5.20 The special case of reverse investment by a direct investment enterprise in its direct investor will be discussed, with *BPM5* para. 371 as a starting point. Reverse investment will be defined, that is, when a direct investment enterprise acquires a claim in its direct investor.

(a) When this reverse equity investment constitutes 10 percent or more of the ordinary shares or voting power, then there is a second, separate direct investment relationship, that is, the reverse investment items are shown under the heading of the second direct investment relationship. Accordingly, each enterprise is both the direct investor and direct investment enterprise of the other enterprise.

(b) When the reverse investment does not reach 10 percent of the ordinary shares or voting power, there is not a second direct investment relationship.

- In this situation, *BPM5* para. 375 recommended that such an asset (liability) be recorded as claims on direct investors under direct investment in reporting economy (or as liabilities to affiliated enterprises under direct investment abroad), with the result that they are netted off at the aggregate level of assets and liabilities. In income, *BPM5* paras. 276 and 375 went further and recommended netting the reverse income flows.

- It is proposed that, for the new manual, such claims on direct investors by a direct investment enterprise will be shown, on the asset side, rather than on the liability side. In order to retain the reverse investment nature of this relationship, a heading *Direct investment in reporting economy (claims on direct investor)* will be shown on the asset side. Similarly, for liabilities to affiliated enterprises by the direct investor, it is proposed that this item be shown on the liability side, under *Direct investment abroad: liabilities to direct investment enterprises*. The consequence of this change is that assets and liabilities will each be shown gross. Similarly, income items would be shown gross. It will be noted that it may be useful for analysis to net reverse investment items with their corresponding primary values.

- The reporting of reverse investment data on a gross basis leaves analysts free to choose whether they wish to use net or gross values. At the same time, it eliminates the unacknowledged inconsistency between *BPM5* and the *1993 SNA* and a violation of the statement in *1993 SNA* para. 2.84 that "(n)etting financial assets (changes in financial assets) against liabilities (changes in liabilities) is especially to be avoided." The proposed treatment also has the practical benefit of leaving aggregates less affected by whether compilers are able to implement the separate identification of reverse investment.

The treatments will be illustrated with examples.

[Question: Should the discontinuity between reverse investment above and below the threshold be considered?]

5.21 The special case of "round tripping" will be discussed. It will be defined, that is, the channeling by direct investors of local funds to SPEs abroad and the subsequent return of the funds to the local economy in the form of direct investment. It will be explained that this practice may be motivated by confidentiality, tax planning, and other incentives available to foreign investors. The manual will indicate that, as at present, these transactions are to be treated on a gross basis, that is, as direct investment abroad for the funds channeled to SPEs abroad, and as direct investment in the reporting economy for the subsequent return of the funds to the local economy. (However, transactions and positions directly between the direct investor and the direct investment enterprise in the same economy would be outside the scope of the international accounts, as being resident-to-resident.)

5.22 In cases where round tripping is considered to be significant, compilers will be encouraged to publish supplementary information by partner country that identifies the extent of round tripping. An example will be given of such a presentation of data.[1] (That presentation would also be compatible with the ultimate beneficial owner/ultimate destination presentation of partner data discussed in Chapter 4 Economic Territory, Units, Institutional Sectors, and Residence.)

[Question: Is this treatment suitable?]

5.23 Some special cases will be noted:

(a) Acquisition of land and associated assets and preparatory expenses for future direct investment units will be noted under this heading as giving rise to an imputed direct investment transactions. (There will be a cross-reference to Chapter 4 Economic Territory, Units, Institutional Sectors, and Residence.)

(b) Cases of foreign ownership or influence outside the scope of direct investment—for illustration, enterprises operating under a common name with cross-holdings of less than 10 percent in each other, without a clear “parent”; unrelated foreign investors (from the same or different territories) holding 10 percent or more of the ordinary shares or voting power in total, but where none individually meets the 10 percent threshold; any investments by domestic residents in a direct investment enterprise in the same territory; and franchises and affiliation agreements without ownership. In all those cases, the relationships do not meet the definition of direct investment.

(c) Transactions prior to the establishment of a direct investment relationship are not included under direct investment. For example, an initial acquisition of 7 percent of the voting power is excluded, while a subsequent acquisition of 5 percent later in the same period would be treated as direct investment. At the time of the transaction that reached the direct investment threshold, there would also be two entries for reclassification of the earlier investment in the other changes in financial assets and liabilities account, that is, one entry to subtract the holding from portfolio investment and another to add it to direct investment. Similarly, a reclassification would be made for divestment that takes an interest below the 10 percent threshold.

(d) Notional units for branches, ownership of land, and preliminary expenses. Chapter 4 Economic Territory, Units, Residence, Sectors mentions cases where a separate enterprise is imputed for statistical purposes even though it is not a separate legal entity. It will be noted in this section that such imputed units are almost always direct investment enterprises.

5.24 The relationship with the *1993 SNA* definitions of “direct foreign investment” and “foreign-controlled enterprises” will be discussed along the lines of *BPM5* para. 362.

---

[1] For example, see the presentation in *External Direct Investment Statistics of Hong Kong 2001,* Hong Kong Special Administrative Region, Census and Statistics Department, 2001.

b. What is covered in direct investment transactions, positions, and income?

5.25 It will be noted that, while the instruments for recognizing a direct investment relationship (discussed in subsection (a) above) relate to ordinary shares or voting power, once the relationship is established, all subsequent financial transactions, positions, and income on financial assets occurring between the affiliated enterprises are included in direct investment, not just those financial assets associated with ordinary shares or voting power that define the relationship.

5.26 It will be noted that there may be a need to impute some financial transactions between direct investors and their direct investment enterprises. For example, if goods or services have been supplied to a direct investment entity (in particular, a branch) without explicit payment, there should be an offsetting entry in direct investment in the financial account. Transfer pricing is discussed in more detail in Chapter 10 Primary Distribution of Income Account.

5.27 This section will discuss specific instances of financial transactions and positions between affiliates that are excluded from direct investment:

(a) Nonpermanent debt between affiliated financial intermediaries is excluded from direct investment. (Permanent debt and equity are included). The definition of permanent debt and possible exclusion of all debt between affiliated financial intermediaries will also be considered. (See BOPCOM-01/20B and *IMF, Recommended Treatment of Selected Direct Investment Transactions* (2002).

- "Affiliated financial intermediaries" is defined as "other depository corporations," "other financial intermediaries," and "financial auxiliaries" in the *1993 SNA/MFSM* institutional sector terminology. Insurance corporations and pension funds are not covered by this exception. As clarification, the two parties do not have to be the same type of financial intermediary for the exception to apply, for example, one could be an "other depository corporation" and the other an "other financial intermediary."

- "Permanent debt" will be discussed, as in *BPM5* para. 372, BOPCOM-99/19, *http://www.imf.org/external/np/sta/di/fditran.htm*, and *Clarification Of Foreign Direct Investment (FDI) Concepts: "Permanent Debt."*

- The rationale for the exclusion of this debt from direct investment will be given that these instruments are largely oriented to liquidity management outside the direct investment relationship.

[Questions: (i) Should this exception be extended to all debt? (ii) Alternatively, should "permanent debt" be defined further, and if so, how?]

(b) Debt between special purpose entities (SPEs) that have the primary function of financial intermediation and affiliated nonfinancial enterprises. The possible exclusion of these flows from direct investment will be reviewed in the light of whether such flows are considered to be predominantly oriented to the direct investment relationship or not.

[Questions: (i) How should debt between SPEs that have the primary function of financial intermediation and affiliated nonfinancial enterprises be classified? (ii) What is the meaning of "SPEs that undertake financial intermediation"?]

(c) Insurance technical reserves (*BPM5* para. 379, *BD3* para. 63) are liabilities to claimants and policyholders and are included in other investment. When the claimant or policyholder is in a direct investment relationship (whether both parties are insurers or one is not an insurer and the other is its captive insurer), the investment appears to satisfy the definitions of both direct and other investment. The rationale for excluding these transactions and positions from direct investment will be given, namely, that technical reserves are liabilities to policyholders and claimants, rather than the insurance company. To simplify the reporting and to use the same rationale as the financial intermediary exception (i.e., that this investment is associated with the normal operation of the activity), insurance technical reserves will all be included under "other investment."

[Question: Is this treatment applicable to captive insurance?]

(d) Participation in international organizations is excluded from direct investment (*Benchmark Definition of FDI,* para. 61).

(e) Financial derivatives are excluded from direct investment on the grounds that financial derivatives involve risk transfer, which is distinct from the function of direct investment. Accordingly, financial derivatives between related enterprises are included in the functional category financial derivatives.

[Question: Should any other cases of exclusions of financial transactions/positions between enterprises in a direct investment relationship be listed?]

c. Other issues associated with direct investment

5.28 Consideration will be given to breaking down "debt instruments" into long term and short term, in view of interest in assessing potential vulnerability associated with direct investment. However, the limitations could be noted, as in *BPM5* para. 339. Also, where "debt instruments" contains a variety of instruments other than loans, and where these other instruments are significant, supplementary information could be encouraged to identify the instruments, in order to permit reconciliation with the *1993 SNA* financial account and balance sheets.

[Questions: (i) Should debt in direct investment be broken down (a) between long-term and short-term components, and (b) into the underlying instruments to permit reconciliation with the 1993 SNA financial account and balance sheets? (ii) Are the concerns about the "arbitrary" nature of these debts appropriate?]

5.29 This section will clarify that "debt instruments" includes both intercompany debt (i.e., when the debtor and creditor are separate legal entities, as presently mentioned in both *BPM5* and *Benchmark Definition of FDI*) and intracompany debt (i.e., cross-border debt transactions between direct investors and their branches abroad or other unincorporated direct investment enterprises, a case not mentioned in *BPM5* and *Benchmark Definition of FDI*).

5.30 There will be cross-references to Chapter 6 International Investment Position, Chapter 7 Financial Account, and Chapter 10 Primary Distribution of Income Account.

5.31 In addition to other breakdowns that also apply to other types of investment, such as instrument and geographic breakdowns, two possible supplementary classifications specifically for direct investment will be set out. These are:

(a) Kind of activity. Two possible bases are the industrial classification of the direct investor or the direct investment enterprise. (The most practical option is for the industry of the unit in the compiler's own territory, i.e., industry of the direct investor in the case of direct investment abroad, and industry of the direct investment enterprise for direct investment in the reporting economy. However, this could result in inconsistent classifications by the counterparties.)

[Question: Should kind of activity be discussed as a supplementary item?]

(b) Mergers and acquisitions, in order to separate them from other direct investment, could be identified in the balance of payments (but not the IIP). There is no standard definition among the countries that presently compile data on mergers and acquisitions (as discussed in OECD, *Harmonisation Of Mergers And Acquisitions (M&A) Statistics*). Work would need to be done to develop a harmonized definition so that results could be compared internationally.

[Questions: (i) Should there be an additional breakdown in the standard BOP components that identifies mergers and acquisitions as a subset of direct investment? Alternatively, should the breakdown be a supplementary item? (ii) If so, what definition should be adopted?]

2. Portfolio investment

5.32 Portfolio investment will be defined. Two alternative definitions for portfolio investment could be based on:

(a) legal form of instrument, that is, any securities that are not included in direct investment or reserve assets (as in *BPM5* para. 385); or
(b) whether the securities are traded in organized financial markets.

The two definitions overlap, to a large degree, but differ for untraded or nontradable securities (such as shares in open-end mutual funds, unlisted companies, and unincorporated enterprises). If such securities were excluded from portfolio investment, they would be included under other investment. Possible reasons for changing to the second definition would be as follows:

- The concept behind portfolio investment would be more coherent. At present, it is largely a residual instrument classification.
- The tradability element has clearer implications for economic analysis, for example for volatility.
- Tradability might result in a more meaningful borderline, for example, nontraded debt instrument is similar to a loan.
- The requirement that the instrument be readily traded on organized financial markets will provide a clear link to the valuation principles for portfolio investment based on market prices.

[Question: Should portfolio investment be defined by instrument or by tradability?]

5.33 If the second definition were adopted, there will be an elaboration on the features of organized financial markets.

5.34 Instruments raising particular issues will be mentioned:

(a) Loans that have been traded will be reclassified as debt securities, if certain criteria are met, as described in the *Debt Guide*, para. 3.29.

(b) The treatment of tradable debt securities that once traded but have been delisted or that trade infrequently or not at all will be stated.

- To treat these cases as being reclassified to other investment would have the benefit of keeping "portfolio investment" limited to traded instruments, with observable market prices.

- To treat these cases as portfolio investment would have the benefit of avoiding moves back and forth between portfolio and other investment, and the associated anomaly of the valuation principle between market and nominal values.

[Question: Should debt securities that previously traded but no longer do so be treated as portfolio investment or other investment?]

(c) Securities with embedded derivatives should be included as portfolio investment, and no attempt should be made to separate the option from the underlying.

3. Financial derivatives and employee stock options

5.35 Consistent with the discussion under Section A.2 above (Financial Instruments/Overview of classification), the manual will recommend a new functional category "financial derivatives and employee stock options." This section will cover what is included in *Financial Derivatives Supplement to the Fifth Edition of the Balance of Payments Manual* (2000), as well as including the later decisions (in 2002) that clarified classification of financial derivatives between affiliated entities, and employee stock options. It is proposed that all financial derivatives be included in this functional category, including those related to the management of reserve assets. Depending on decisions made, a revision of the title of the functional category to "financial derivatives and employee stock options excluding reserves" could be considered.

[Note: This issue is discussed further and a question asked under Reserve Assets.]

5.36 The section will note cases where transactions between two parties for a particular derivative occur in both directions. In such cases, it may not be feasible to apply the netting principle, which requires separate presentation of transactions in assets and transactions in liabilities. The section will note that presenting net changes of transactions in both assets and liabilities for such financial instruments may be acceptable. This issue will also be covered or cross-referenced in Chapter 6 International Investment Position and Chapter 7 Financial Account.

[Question: A question on the recording basis for these transactions is raised in Chapter 3, Accounting Principles, Section E, Aggregation and Netting.]

5.37 When an entity has both asset and liability transactions for financial derivatives, the manual will recommend that transactions be recorded gross, that is, that transactions in assets are to be kept separate from transactions in liabilities. However, it will recognize that "net reporting," that is, that transactions in assets will be netted against transactions in liabilities, may be accepted if gross data are impractical. For positions data, it will be stated that assets should be recorded separately from liabilities in all cases. This issue will also be covered or cross-referenced in Chapter 6 International Investment Position and Chapter 7 Financial Account.

[Question: Is this acceptable? Or should all transactions be reported gross?]

5.38 The classification of employee stock options will be discussed. While employee stock options do not fully meet the definition of financial derivatives, they share some characteristics with financial derivatives. Employee stock options will be classified as a sub-category under "financial derivatives and employee stock options."

5.39 Payments made under a financial derivative contract before net settlement (in those cases where there is a lag between the payment by one party and that of the counterparty) will be classified as "loans." For example, in an interest rate swap, a fixed-for-floating swap may involve a monthly interest payment (e.g., for the floating leg) and an annual coupon payment (e.g., for the fixed leg). In that case, the monthly payment is classified as a "loan" (under "other investment") that is removed from the balance sheet when the reciprocal coupon payment is made. Only at that time will the financial derivative be regarded as having been settled—as the net difference.

[Question: Is this classification suitable?]

5.40 There are cases where an upfront payment is made when over-the-counter (OTC) swaps are entered into. The manual will propose that these upfront payments represent loans, unless they are otherwise identifiable as a fee, in which case they are a financial service.

[Question: Is this treatment suitable?]

5.41 The manual will discuss the treatment of changes in value of swaps that occur merely through the passage of time. It will note that, as financial derivatives do not involve advancing funds, they do not earn interest, and, therefore, such changes in value are valuation changes.

[Question: Is this treatment suitable?]

5.42 Premium payments under credit default swap payments are classified as financial derivatives.

[Question: Is this treatment suitable?]

5.43 Examples could be provided to illustrate some complex derivative arrangements.

4. Other investment

5.44 Other investment will be defined in the same way as *BPM5*, both as a residual and in terms of specific instruments. (As noted under portfolio investment above, there is a proposal to move untraded equity and debt securities from portfolio investment to other investment.) It is a residual concept, that is, instruments other than those included in direct investment, portfolio investment, and reserve assets. Particular components are:

(a) trade credit and advances;

(b) loans;

(c) currency and deposits;

(d) other financial assets/liabilities other than those included under direct investment or reserves (would include untraded equity and debt securities under proposal under portfolio investment above); and

(e) insurance and pension fund technical reserves.

5.45 Instruments raising particular issues will be mentioned:

(a) The conditions for a loan to become sufficiently traded to be reclassified as a security will be noted, following the *Debt Guide* para. 3.29 (and also included in Chapter 5 Classifications, under instruments). The implications for valuation of classifying a particular claim as a debt security will be stated.

[Question: Should the requirements for a tradable loan to become a security include that the debtor is not legally prevented from buying back the debt, which is necessary to ensure that the market value is also relevant to the debtor?]

(b) In some instances, it is difficult to separate deposits from loans. However, in line with *MSFM* (footnote 8, para.139), this section will note that these instruments should, nevertheless, be kept separate and that they should be distinguishable on the basis of the representation in the documents that evidence them.

(c) It will be noted that financial leases will usually be included as part of “other investment” under “loans” (unless between affiliated enterprises, in which case they will be included under direct investment).

(d) Where an upfront payment is made when an over-the-counter swap is entered into, this section will propose that this upfront payment represents a loan, unless it is otherwise identifiable as a fee.

(e) Financial claims imputed for other cases of imputed change in ownership (e.g., goods for processing) will be discussed.

(f) The discussion of “loans” will elaborate on the use of Fund credit and loans from the Fund, along the lines of that presented in the *BPT* para. 592. This could be presented in an appendix (or a box), along with information on other Fund-related issues, such as remuneration, arrears to the Fund, etc.

(g) It will be stated that benefits under life insurance or pension funds will be regarded as “other investment” transactions, that is, they are treated as withdrawals of equity, as in *BPM5*.[2] The results of the ongoing work on this topic by an IMF electronic discussion group and the decision of the ISWGNA on this issue will be taken into account in the new manual. This issue will also be mentioned in Chapter 7 Financial Account and Chapter 11 Secondary Distribution of Income.

(h) Payments made under a financial derivative contract before net settlement (in those cases where there is a lag between the payment by one party and that of the counterparty) will be classified as loans, as noted under financial derivatives above,

(i) Long-term concessional loans to the International Development Association will continue to be treated as loans rather than current or capital transfers.

(j) It will be noted that trade credit and advances have an independent meaning.

(k) Certain financial transactions and positions between affiliated enterprises that have a limited connection to the direct investment relationship are included under other investment, as discussed under direct investment above.

5. Reserve assets

5.46 The definition of reserve assets will be stated, along the lines of para. 424 in *BPM5* and paras. 9 and 64 of the *Reserves Template,* but it is proposed that the definition remove “and/or for other purposes” in para. 424 of *BPM5* as it is too vague.

> *[Questions: (i) Is this change acceptable? (ii) If so, does there need to be a definition of “for balance of payments purposes”?]*

5.47 It will be explained that these assets must be under the effective control of the monetary authorities and be available for use should the need arise. The concepts of “effective control” and “availability for use” will be discussed (see below). This section will also refer to the Fund’s *Guidelines for Foreign Exchange Reserve Management* (*GFERM*) (2001) and explain the relationship between it and the manual. This section will also refer to the supporting document on the Fund’s external website Foreign Exchange Reserve Management: Operational and Technical Issues (2002) (GFERM Documentation). The introductory section will explain the treatment of reserves in the *Reserves Template* and in the *GFERM* (neither of which existed when *BPM5* was drafted).

---

[2] The *1993 SNA* treats benefits from pension funds as both secondary income and as withdrawal of investment. This treatment is rather complex and is designed for reasons related to household income that do not apply to the international accounts. The difference was not noted in *BPM5*.

5.48 This section will state that reserve assets include monetary gold, SDRs, reserve position in the Fund, and foreign exchange, with a further breakdown by instrument (currency and deposits, securities, and other claims). It is proposed that, unlike *BPM5,* as modified in *Financial Derivatives Supplement to the Fifth Edition of the Balance of Payments Manual* (2000), financial derivatives not be included in reserves and that "other claims" be included as a component of foreign exchange rather than shown as a separate component of reserves.

[Question: Are the proposed treatments of financial derivatives and other claims acceptable?]

5.49 It will be noted that SDRs and gold have no counterpart liability.

5.50 The counterpart liability for other reserve assets will be stated as being obligations of nonresidents, that is, obligations of residents will not qualify, as explained in the *Reserves Template* paras. 62 and 69.

5.51 The particular instruments that may or may not be included in reserves will be discussed in more detail, as they are more limited in ways that do not arise for other functional categories:

(a) Gold deposits (also called gold on loan in the *Reserves Template*) will be included under gold (*Reserves Template* para. 99). This item will be limited to monetary gold.

(b) Silver bullion, diamonds, and other precious metal and stones will not be included (*Reserves Template* para. 98). These are outside the scope of IIP.

(c) Gold and securities that have been transferred under gold swaps between monetary authorities, repurchase agreements, securities lending, or as collateral will not be included as reserve assets. (This would represent a change from some treatments in *Reserves Template* paras. 82-88 and para. 101 but avoid double counting of the security and the funds raised through repurchase agreements.)

(d) Assets created under swap agreements will be treated as in *BPM5* para. 434.

(e) Equity can potentially be included in reserves if it meets all the requirements of the definition, as in *Reserves Template* para. 79.

(f) Lines of credit will not be included as they are not assets, as in *Reserves Template* para. 73.

[Questions: (i) Is the change to exclude assets under repurchase agreements acceptable? (ii) Are any other changes necessary?]

5.52 Although it is proposed that this manual no longer use "monetary authorities" as an institutional sector (see Chapter 4 Economic Territory, Units, Institutional Sectors, and Residence), "monetary authorities" will be defined as a functional concept that is essential for holding "reserve assets." Monetary authorities comprise the central bank and certain operations usually attributed to the central bank (and other institutional units, such as currency boards and monetary authorities) but sometimes carried out by other government institutions or commercial banks (*Reserves Template* para. 21).

5.53 This section will explain that the concepts of "effective control" and "usability," as stated in the *Reserves Template* para. 65, underpin the concept of "availability."

5.54 "Effective control" will be applied to determine whether the monetary authorities have control over the liquid foreign currency claims on nonresidents of entities that do *not* comprise part of the monetary authorities. This section will state that, to comprise part of "reserve assets," the liquid foreign currency claims on nonresidents owned by other government or public sector bodies or other depository corporations must meet a test of effective control. Specific guidelines for interpreting effective control over the foreign assets of entities that do not comprise part of the monetary authorities will be provided. This section will also address the question of how the potential double counting of the assets is to be addressed. Other relevant considerations are as follows:

(a) Effective control must be evidenced by prior contractual arrangements that give the monetary authorities access on demand to the assets in question. The contractual arrangements must be actual and definite in intent.

(b) Working balances will need to be considered on the basis of effective control, rather than included by convention, as in *BPM5* paras. 433 and 443.

[Questions: (i) Are there any other issues concerning control to be dealt with? (ii) Should assets owned by other agencies but under the effective control of the monetary authorities be shown as a separate component of reserves and/or should those assets be not recorded as the assets of the owner to avoid double counting?]

5.55 *BPM5* is not explicit on the inclusion of pooled assets in reserve assets. It will be noted that pooling arrangements and investment in securities that are used to hold other securities raise the possibility of the part of the ultimate liability being owed by residents, and hence the potential to generate international liquidity is undermined.

[Question: Should pooled assets be able to be included as reserve assets?]

5.56 The term "available for use" is synonymous with "liquidity," which in turn implies "marketability" for some instruments (e.g., securities). Liquid foreign currency claims on nonresidents owned by the monetary authorities will comprise part of "reserve assets."

Principles will be stated that provide an interpretation of the concept of "available for use," viz.:

(a) only foreign currency assets will be included (*Reserves Template* para. 66);

(b) nonconvertible foreign currency assets will not be included (*Reserves Template* para. 67);

(c) the kind of market for the instrument must be stated (for example, an established secondary market is a sufficient condition; the availability of a potential market could qualify, but the funds will be required to be unambiguously available if the asset is to be included in reserves);

(d) foreign currency assets must be available on demand (for example, deposits (see *Reserves Template* para. 91), and gold loans (see *Reserves Template* para. 99). Or they must be marketable with minimum cost and time and with ready sellers and buyers, for example, securities (*Reserves Template* para. 65, footnote 19);

(e) pledged assets that are encumbered by a nonresident party (such as collateral for a third party loan) will be excluded, as stated in *Reserves Template* para. 72. Pledged assets that are encumbered by the monetary authorities for prudential purposes (such as a sinking fund) will be included, as stated in *BPM5* para. 426;

(f) reserve assets will be required to "be of a sufficiently high quality (investment grade and above)" to qualify as being sufficiently readily available, as in *Reserves Template* para. 89;

(g) the asset's ability to be involved in a repurchase agreement sufficiently enough to make it liquid will be stated. (It is proposed that it not be sufficient for the asset's inclusion or otherwise should be based solely on the liquidity of the instrument itself); and

(h) a noncomprehensive list of examples will be given of instruments that are definitely considered as sufficiently liquid (e.g., gold, SDRs, reserve positions in the Fund, foreign exchange holdings) and those that are definitely not considered to be sufficiently liquid (e.g., long-term loans, real estate). (The examples are from *BPM5* paras. 431–432 and *Reserves Template* paras. 74–76.)

5.57 An appendix will cover the particular issues associated with reserve assets of monetary and currency unions and reserve assets held by a national central bank that is a member of a monetary union.

5.58 This section will note that, in presenting reserves data by institutional sector, compilers may wish to adopt a supplementary institutional sector "monetary authorities," as noted in Chapter 4 Economic Territory, Units, Institutional Sectors, and Residence.

5.59 *BPM5* states (para. 426) that the financial assets comprising reserves cannot unambiguously be identified in a meaningful way simply through the application of objective criteria. It is now proposed to give the concepts of ownership, control, and usability much clearer and tighter operational meaning, in order to reduce the ambiguity in determining which financial assets comprise reserves.

> *[Questions: (i) Is it possible to develop objective criteria for the identification of reserves? (ii) If so, what are those criteria?]*

5.60 It will be noted that this functional category occurs only on the asset side. *BPM5* encouraged Liabilities Constituting Foreign Authorities' Reserves (LCFAR) as a supplementary classification. The classification for LCFAR will be discontinued since it is considered to be impractical and has not been implemented.

5.61 It will also be noted that borrowings that may have been undertaken to bolster reserve assets are not to be shown as negative entries in reserve assets.

5.62 This section will note that reserve assets give an incomplete picture of the authorities' international liquidity position, for example by omitting related liabilities. The *Reserves Template* provides a satellite presentation, that is, it is based on the core concepts of the international accounts but provides considerable extra detail on components of reserve assets, as well as other kinds of assets, associated liabilities, and other foreign currency drains and seeks information on future flows. It is envisaged that the *Reserves Template* will be updated in line with the revised manual.

C. Classification by Maturity

5.63 Debt items can be classified by maturity. This chapter will provide a definition of short and long term, as in *BPM5* para. 336, that is, short-term debt is one year or less, long-term debt is more than one year. It will note the complexity of the distinction in practice (due to rollovers, early termination options, etc.). *MFSM* para. 311 recognizes a medium-term maturity, that is, two years or less, but more than one year.

> *[Question: Should an additional category for more than one to two years be considered?]*

5.64 Maturity can be expressed in terms of original maturity (as adopted in *BPM5*) or residual maturity. This section will adopt original term as the basis for recording. The residual maturity is considered more relevant for analyzing liquidity, which relates to balance sheet positions. To accommodate these needs, this section will adopt, as a supplementary presentation for the IIP, the approach used in the *Debt Guide* (Table 7.1), namely:

(i) short-term debt on an original maturity basis;
(ii) long-term debt due for payment within one year or less; and
(iii) long-term debt due for payment in more than one year.

With this presentation the short-term or long-term split can be presented on either a residual or original maturity basis

[Question: Is this approach suitable?]

5.65 In cases of obligations that consist of tranches with different maturities, it will be stated that the amount should be split into the separate components, as per *Debt Guide* para. 2.76.

D. Classification by Currency

5.66 Classification of data by currency was dealt with in the *Debt Guide* paras. 6.12–6.14 and encouraged for the Coordinated Portfolio Investment Survey. However, the methods are not dealt with in *BPM5* or *CPISG2*.

5.67 In the case of debt, the classification is usually straightforward when all aspects relate to the same currency. In some cases, there are relationships to two or more currencies:

(a) When the debt is payable in one currency but linked to another in amounts, the debt will be classified with the currency that it is linked to, as this reflects the underlying economic reality. (Consistent with Eurostat News Release 24/97, *Accounting Rules Complementary Decisions of Eurostat on Deficit and Debt* and *Debt Guide* para. 7.19; contrary to *BPM5* para. 397, *1993 SNA* para. 7.104.) (This treatment has implications for the measurement of interest and holding gains; see Chapter 10 Primary Distribution of Income.)

(b) Some aspects of the loan are payable according to different currencies (e.g., principal from one currency, accrual of interest in another); then the debt needs to be split according to present values of the components.

5.68 In the case of equity, the classification is according to the currency of the market in which the share is traded or, if not traded, the jurisdiction where the entity is incorporated. This information may be collected on a supplementary basis.

5.69 It will be recognized that a split by currency is of potential analytical interest to the extent that it shows exposure to exchange rate changes. It is useful in deriving changes in value owing to exchange rate changes on debt securities—how these changes are recorded is shown in Chapter 8 Other Changes in Financial Assets and Liabilities Account. However, the manual will point out the limitations in the interpretation of currency splits. In the case of equity, the currency of the market in which the share is traded does not necessarily reflect the currencies to which the equity is exposed. In the case of debt securities, foreign currency exposure may be hedged, so that data could be misleading if information on hedging is not collected (as shown in, for example BOPCOM-02/73).

5.70 The standard components will identify a foreign currency/domestic currency split for external debt. The manual will also urge that the analysis should take into account relevant hedging, if applicable, so that a full view of exposure to exchange rate changes can be obtained.

> *[Question: Should a foreign currency/domestic currency split for external debt be a standard or supplementary item? Should it be encouraged for assets as well?]*

E. Classification by Type of Interest Rate

5.71 This section will note the classification of debt instruments as being either variable-rate or fixed-rate as a possible supplementary breakdown, not to be included in the standard components. The classification is adopted in the *Debt Guide* paras. 6.15–17. The *Debt Guide* definitions would be adopted.

CLASSIFICATIONS: FINANCIAL INSTRUMENTS, FUNCTIONAL CATEGORIES, MATURITY, CURRENCY, AND TYPE OF INTEREST RATE

References:

BPM5:
Ch XVI, XVII-XXIII Instruments
Ch XVIII Direct investment
Ch XIX Portfolio investment
Financial Derivatives: *Financial Derivatives: Supplement to BPM5* (2002 version)
Ch XX Other investment
Ch XXI Reserves
LCFAR paras. 340, 447–450
Maturity paras. 336–339

BPT
Financial instruments paras. 482–483
Functional categories paras. 509–554
Maturity paras. 489–490
Direction of investment para. 529

External Debt Statistics: Guide for Compilers and Users
Financial assets paras. 119–144
Currency paras. 181–183

International Reserves and Foreign Currency Liquidity: Guidelines for a Data Template

IMF, *Guidelines for Foreign Exchange Reserve Management* (2001) (available on www.imf.org/external/np/mae/ferm/eng/index.htm) and the related *Foreign Exchange Reserve Management: Operational and Technical Issues (internal)*

CPISG2 ch 3

OECD Benchmark Definition of Foreign Direct Investment (3rd edition) 1996

1993 SNA Financial assets paras. 11.62–101

MFSM Financial assets Chapter IV and Appendix 2

Australian Bureau of Statistics, *Measuring Australia's Foreign Currency Exposure*, BOPCOM-02/73

Bank of Japan, *Capital Transactions Associated with Permanent Debt with Financial Affiliates Under Direct Investment*, BOPCOM-03/46A

Bank of Japan, *Transactions with Affiliated Financial Intermediaries*, BOPCOM-01/21

Banque de France, *Repo-type Transactions Issue: The French Experience Relating to Stocks*, BOPCOM-01/40

European Central Bank, *Updating BPM5: Possible Expansion of the Sector Breakdown*, BOPCOM-02/64

European Central Bank, Financial Flows and Stocks Task Force, *Financial Derivatives: Framework for Discussion; Full Report on Conceptual Aspects; Full Report on Practical Aspects*, BOPCOM-98/1/30

Eurostat, *Accounting Rules Complementary Decisions of Eurostat on Deficit and Debt*, News Release 24/97

Eurostat, *Treatment of Indirect FDI Relationships*, BOPCOM-02/34

Hong Kong Special Administrative Region, Census and Statistics Department, *External Direct Investment Statistics of Hong Kong 2001*

IMF, *In the Steps of the 1997 Direct Investment Survey—The Need for Clarification of the Recommendations*, BOPCOM-99/19

IMF, *Clarification of the Recommended Treatment of Selected Foreign Direct Investment Transactions*, BOPCOM-01/20B

IMF, *The Macroeconomic Statistical Treatment of Reverse Transactions*, BOPCOM-01/16

IMF, *Mutual Funds and "Fund of Funds": Portfolio Investment or Direct Investment?*, BOPCOM-01/22

IMF, *Working Group on Repurchase Agreements and Securities Lending*, BOPCOM-01/17

IMF, *Recommended Treatment of Selected Direct Investment Transactions (2002)* http://www.imf.org/external/np/sta/di/fditran.htm (based on previous BOPCOM decisions)

IMF, *Classification of Financial Derivatives in Direct Investment: Letter Sent to IMF's Balance of Payments Correspondents Promulgating the Final Decision of the Committee* BOPCOM-02/77

IMF, The "Fully Consolidated System" (paper presented at OECD Workshop on International Investment, March 2003)

R. Kozlow, *Exploring the Borderline Between Direct Investment and Other Types of Investment: The U.S. Treatment* (BOPCOM-02/35)

National Bank of Belgium, *The Practical Implementation of the Directional Principle in Foreign Direct Investment: Some Countries' Experience and the Belgian Case,* BOPCOM-02/33

OECD, *Clarification of Foreign Direct Investment Recommendations*, BOPCOM-01/20A

OECD, *Clarification Of Foreign Direct Investment (FDI) Concepts: "Permanent Debt"* (paper presented at OECD Workshop on International Investment March 2003)

OECD, *Harmonisation Of Mergers And Acquisitions (M&A) Statistics* (paper presented at OECD Workshop on International Investment March 2003)

Changes from *BPM5*:

(a) *Changes proposed:*

There will be greater integration of the financial asset classification with *MFSM*/*1993 SNA*, while containing a debt/equity/other split (paras. 5.4–6, table 5.1).

Claims by direct investment enterprises on direct investors and liabilities to direct investment enterprises by direct investors will be shown on the asset and liability sides, as appropriate (Table 5.3, para. 5.20).

A new financial instrument and a functional categories will be introduced for "Financial derivatives and employee stock options" with subcategories for "financial derivatives" and "employee stock options" (para. 5.7(g)).

A definition of when tradable loans are to be classified as securities will be introduced (paras. 5.8(f), 5.45(a)).

The treatment of Islamic financial instruments will be discussed (para. 5.8(j)).

The applicability of direct investment outside the usual corporate structures will be clarified (unincorporated joint ventures, mutual funds, insurance companies, trusts) (para. 5.15).

The treatment of permanent debt between affiliated financial intermediaries will be clarified in line with previous Committee decisions (para 5.27(a)).

Debt between a branch and its parent will be discussed (para. 5.29).

The definition of reserve assets will remove "and/or for other purposes" (para. 5.46).

Financial derivatives will be excluded from reserve assets (para. 5.48).

Securities provided under repurchase agreements will be removed from reserve assets (para. 5.51(c)).

“Other claims” in reserve assets will be included under “foreign exchange,” rather than as a separate item (Table 5.3).

The concept of LCFAR will be dropped (para. 5.60).

Debt instruments indexed to a particular currency will be classified to that currency (para. 5.67).

(b) *Changes raised as an option:*

Additional breakdowns of equity in mutual funds could be introduced (para. 5.7(e)).

Additional breakdown of financial derivatives is proposed (para. 5.7(h)).

Arrears and/or nonperforming loans could be shown as a supplementary subclassification of relevant instruments on an “of which” format, where relevant (para. 5.7(i)).

Financial gold could be considered as a financial instrument (para. 5.7(j)).

The threshold for direct investment could be reviewed (para. 5.13).

The definition of direct investment in cases of complicated structures will be clarified or changed (with the options being the “directly held,” “FCS,” “USM,” and “10/50” definitions). This issue is linked to the use of voting power and/or ownership in the definition of direct investment (paras. 5.16–5.18).

“Round tripping,” “mergers and acquisitions,” and kind of activity splits could be introduced as supplementary data for direct investment (paras. 5.22, 5.31).

Direct investment debt finance could be broken down into long-term and short-term instruments (para. 5.28).

Debt between special purpose entities that have the primary function of financial intermediation and affiliated nonfinancial enterprises could be excluded from direct investment (para 5.28(b)).

Non-traded equity and debt securities could be included in other investment, rather than portfolio investment (paras. 5.32, 5.34).

Treatments of various financial derivatives are proposed (paras. 5.39–5.42).

The inclusion of pooled assets in reserves will be considered (para. 5.55).

A classification for medium-term maturity is raised as a possibility (para. 5.63).

Debt could be broken down into variable-rate and fixed-rate interest as a supplementary item (para. 5.71).

Terms to be included in glossary
(for inclusion in a cumulatively developed glossary for all chapters):

Accounts receivable (asset) / payable (liability)
Affiliate/Affiliated enterprise
Arrears
Asset
Asset-backed security
Associate
Bonds and notes
Branch
Claim
Convertible bond
Credit derivatives
Currency (and deposits?)
Currency swaps
Debt
Debt security
Deposits
Direct investment
Direct investment abroad
Direct investment enterprise
Direct investment finance
Direct investment in reporting country
Direct investor
Employee stock option
Equity, equities
Equity security
Financial asset
Financial derivatives
Financial gold (if adopted as financial asset); contrast with industrial gold
Financial instrument
Financial leases/leasing
Financial reinsurance
Fixed-rate interest

Foreign currency
Forward
Fully consolidated system (FCS) – if adopted as definition, proposed to replace this term by something clearer, such as “indirectly-held direct investment relationships”
Gold—see financial, monetary, nonmonetary
Gold deposit
Gold on loan
Gold swap
Hedging
Indirectly-held direct investment relationships
Insurance technical reserves
Interest rate swaps
International reserves (or just “reserves” or “reserve assets”?)
LCFAR (if retained as a concept)
Liability
Loan
Long-term
Monetary gold
Money market instrument
Money market mutual funds
Mutual fund (includes unit trusts)
Nonmonetary gold
Nonpermanent debt
Obligation
Options
Original maturity
Other debt instrument
Other deposit
Other investment
Over-the-counter
Permanent debt
Portfolio investment
Reinvested earnings
Repurchase agreement (repo)
Residual maturity
Retained earnings (contrasted with reinvested earnings)
Reverse direct investment
Reverse repo
Round tripping
Securities lending
Securitization
Short-term
Sibling

Special Drawing Right (SDR)
Special purpose entity (SPE), special purpose vehicle (SPV)
Subsidiary
Swap
Trade credit and advances
Trade-related credit
Transferable deposit
Underlying
Variable-rate interest

Chapter 6. International Investment Position

A. Concept and Coverage

6.1 This chapter will explain the coverage of the international investment position (IIP), its relationship to transactions and other changes in financial assets/liabilities, and its relationship to national balance sheets. This discussion will be based on *1993 SNA* paras. 13.1-7, *BPM5* paras. 461-463, and *BPT* paras. 680-689.

6.2 The chapter will state that the international investment position is the balance sheet of the stock of external financial assets and liabilities. The financial items that comprise the position consist of monetary gold, SDRs, claims on nonresidents, and liabilities to nonresidents. Financial assets and liabilities will be cross-referenced to Chapter 5, Classifications.

6.3 The manual will define the assets boundary, as in the *1993 SNA*. It will note that guarantees, operating leases, other nonfinancial contractual obligations, and contingencies are excluded from the definition of financial assets/liabilities (see the instrument classification in Chapter 5 Classifications). For example, contractual agreements between a franchisor and a franchisee that a certain percentage of the franchisee's income will be paid to the franchisor are not included in the asset boundary. However, it will be noted that these kinds of off-balance sheet obligations can have a significant impact, and there is increasing interest on recording them in business accounting and for use in economic analysis. Accordingly, the manual will be encourage compilers to consider providing information on a supplementary basis where these obligations are identified as being economically significant. This would be an extension of *BPM5* but consistent with the direction in the *Reserves Template* and *Debt Guide*.

> *[Question: Does this proposal have the right balance between recognition of the issue and avoidance of specific standards?]*

6.4 A table showing the structure and components of the IIP with numerical examples will be presented. It will set out how changes in the IIP result from financial account transactions and other changes in financial assets and liabilities during a period. The table below shows only the main components, but the manual will provide a breakdown, along the lines of Table 5.3 in Chapter 5 Classifications. Full standard components will be presented in an appendix.

Table 6.1. Overview of International Investment Position (including link to financial and other changes accounts)

	Beginning of period IIP	Changes due to: Transactions (= financial account of the balance of payments)	Changes due to: Other (= other changes in financial assets and liabilities account)	**End of period IIP**
Assets:				
Direct investment				
Portfolio investment				
Financial derivatives and employee stock options				
Other investment				
Reserve assets				
Total assets				
of which:				
Equity finance				
Debt instruments				
Other instruments				
***Liabilities*:**				
Direct investment				
Portfolio investment				
Financial derivatives and employee stock options				
Other investment				
Total liabilities				
of which:				
Equity finance				
Debt instruments				
Other instruments				
Net IIP				

6.5 The full standard presentation will include additional instrument detail, as well as sector, maturity, and currency detail. Other presentations could use different foci, emphasizing different aspects of the IIP. The *Debt Guide*, for example, focuses on the role of institutional sectors. Other various approaches can be developed through satellite accounts. The following is an example based on the balance sheet in the *1993 SNA* (but is designed for sector perspective rather than time series analysis).

Table 6.2 Overview of International Investment Position (with resident institutional sector breakdown)

Assets						Liabilities				
Total economy	**Households and NPISHs**	**General government**	**Financial corporations**	**Nonfinancial corporations**		**Nonfinancial corporations**	**Financial corporations**	**General government**	**Households and NPISHs**	**Total economy**
					Direct investment					
					Portfolio investment					
					Financial derivatives and employee stock options					
					Other investment					
					Reserve assets					
					Total assets/liabilities					
					Net IIP					

6.6 The manual will emphasize that a consistent ordering and level of detail should be used for assets and liabilities in tabulations of each of positions, financial account transactions, and other changes in financial assets and liabilities so as to allow the relationships between them to be analyzed. Similarly, a consistent level of detail for income (and, holding gains, where appropriate) and positions assists in the estimation of rates of return. (The concept of rate of return will be explained.)

6.7 The section will note that the *Debt Guide*, *CPISG2*, and *Reserves Template* can be seen as satellites of the IIP with their own specialized datasets and manuals, that is, they are based on core components that come from the IIP, with additional elements, such as more detail, alternative valuations, and supplementary data on contingencies, guarantees, and other off-balance sheet items.

B. Scope and Characteristics

6.8 The usual order of priority for classification of components in international accounts statistics is according to:

(a) Assets/liabilities—defined in Chapter 3 Accounting Principles;
(b) Functional category—defined in Chapter 5 Classifications;
(c) Direction of investment (in the case of direct investment), that is, direct investment abroad/direct investment in the reporting economy—defined in Chapter 5 Classifications;
(d) Instrument—defined in Chapter 5 Classifications;
(e) Institutional sector of resident party—defined in Chapter 4 Economic Territory, Units, Institutional Sectors, and Residence;
(f) Maturity (in the case of debt instruments)—defined in Chapter 5 Classifications; and
(g) Currency (in the case of debt instruments)—defined in Chapter 5 Classifications.

6.9 It will be noted other presentations may be used. The level of dissection may vary according to circumstances.

6.10 As in Chapter 5 Classifications, Chapter 7 Financial Account, and Chapter 10 Primary Distribution of Income Account, it will be stated that the level of detail should be the same as related income flows and transactions.

6.11 Particular cases relating to classification and treatment will be discussed:

(a) Financial leases. It will be noted that a financial lease is treated as a loan. (Because financial leases affect services, income, financial transactions, and positions, the manual will include an appendix to deal with all these aspects.) (Financial leases are dealt with briefly in *BPM5* para. 417 and at more length in *1993 SNA* paras. 13.23–24.)

(b) Reverse transactions, such as repurchase agreements, sell- and buybacks, carries, gold swaps, securities lending. It will be noted that although these arrangements involve a change in legal title, the obligation to return the security means that the original owner retains the risks and benefits of ownership. The manual follows economic concepts, rather than legal form, for a repo—the original owner retaining the economic ownership and the repurchase arrangement effectively being a loan, with the security acting as collateral. This proposal will be modified if necessary in the light of continued international discussions. (As reverse transactions affect income, financial transactions, and positions, an appendix will deal with all these aspects.) (Repurchase agreements were mentioned in *BPM5* para. 418, but securities lending was not discussed. They are dealt with at length in BOPCOM-01/16.)

(c) Short positions. Short positions occur when a unit sells assets (usually securities) that it does not own, so that the assets of an equivalent nature must be acquired later to make delivery. (For example, this technique is used when an investor believes the price will drop.) The short position will be shown as a negative holding. (In aggregate global holdings, the negative values will offset the holdings recorded by the counterparty to the short position, so that the aggregate value of the security is not under- or overstated.) This issue was not mentioned in *BPM5*.

(d) Assets and liabilities of the central bank of a monetary union. *BPM5* para. 90 stated that such financial assets and liabilities should be prorated to the member states of the monetary union. This issue will be considered, including reference to currency in circulation, and the reserves held by national central banks that are members of the monetary union. The residence of central banks of monetary and currency unions is discussed in Chapter 4 Economic Territory, Units, Institutional Sectors, and Residence. The treatment of monetary unions will be discussed in an appendix.

[Question: What treatments should be adopted?]

(e) Shares and other equity. As in *BPM5* and the *1993 SNA*, there will be no split according to the historic transactions that gave rise to it—funds contributed by owners, reinvested earnings, accumulated holding gains, reserves, etc.

[Comment: The objective of the position statement is to show the current value, rather than the type of transactions or other flows that gave rise to the value, which are shown in other accounts.]

C. Timing

6.12 As it shows stocks, the IIP relates to a particular point of time, usually the end of a (fiscal or calendar) year or a quarter, in contrast to other aggregate data in the international accounts statistics, which are flows and relate to a whole period. It will be noted that this characteristic means that stocks are converted at exchange rates at a point in time, while other data should use the exchange at the time of the flow.

6.13 Overnight deposits (or sweep accounts) involve funds being swept back and forth overnight. They should be consistently measured either before or after they are swept. If they are measured after they are swept, the sweeps would be shown in financial flows and the IIP. As these deposits give rise to interest flows, it appears preferable to measure data after the sweeping so that positions and flows are consistent.

[Question: What treatment should be adopted for sweep accounts?]

6.14 It will be noted that different time zones mean that items may be recorded at slightly different times (such as the varying closes of business) and, therefore, values. While this means that assets and liabilities may not be recorded exactly consistently, the differences are considered to be small and, in any case, not solvable.

D. Valuation Principles

6.15 The general principle for valuation throughout the international accounts is the market value. It will be noted that market prices for some types of positions are not available, so that market price equivalent valuation should be used. Chapter 3 Accounting Principles will deal with the basic principles, while this chapter will focus on issues particular to financial assets and liabilities. The presentation will be set out as in the *MFSM* paras. 196–198, 202, and 219–224; and, mainly for debt instruments, the *Debt Guide* paras. 2.31–2.52. The subsequent detailed methods provide advice on how to implement that general principle in particular cases.

6.16 Specific guidelines will be given for the valuation of loans. They will be discussed along the lines of *MFSM* paras. 205–207 and the *Debt Guide* paras. 2.35–2.41, taking into account any developments in international accounting standards.

(a) The current valuation principle is nominal value (including accrued interest), as defined in *MFSM* para. 206, *BPM5* para. 471, and *Debt Guide* para. 2.32. *MFSM* and *BPM5* appear to be the same, although the former uses the term “book value.” “Nominal value” will be continued as the terminology in the new manual. The new manual will distinguish between nominal and face value, as in the *Debt Guide* para. 2.33, in contrast to *BPM5* para. 471.

(b) Another possible valuation principle is “fair value.” This principle will be defined, explaining that this basis takes into account default risk and, in the case of fixed-rate arrangements, changes in interest rates. Depending on developments in international accounting standards, fair value could be adopted as a valuation basis (i) in all cases; (ii) for creditors only; or (iii) as a supplementary or memorandum item.

- Fair value is a more realistic approximation of market value measure of financial position, especially when a debtor is insolvent. It avoids the anomalies noted below when a loan changes hands below the nominal value. Its use in business accounting is likely to increase, particularly if *IAS39* is adopted. Statistical principles should take into account developments in accounting practice.
- While symmetry of reporting between debtors and creditors is essential to a statistical system, it may not be followed in some accounting practices.

[Question: (i) Should either nominal value or fair value be adopted, and should the valuation not adopted be considered as a memorandum item? (ii) Or should a decision be postponed until developments in international accounting standards are clear?]

(c) If nominal value is adopted, the following issues will need to be dealt with:

i. Provisions for bad debts/expected loan losses/nonperforming loans. These terms will be explained. The nominal value does not take into account these factors; however, they are analytically interesting and important for showing financial position. Accordingly, bad debt provisions and/or expected loan losses should be recorded for the creditor as a memorandum item, as per *MFSM* para. 207. In addition, it will be recommended that metadata on the definitions used to identify impaired loans be provided, because these definitions may differ between economies and over time. Loans should be reduced or eliminated at the point of write-off or write-down, which will be defined. (This topic will be dealt with in Chapter 8 Other Changes in Financial Assets and Liabilities Account.)

ii. Traded loans. For loans that are traded, but not sufficiently to be reclassified as securities, the nominal value would differ from the transaction value. If the nominal value is used for positions, the difference between nominal and transaction values will be shown as a valuation change in the other changes financial assets and liabilities account. This issue will be discussed fully in Chapter 3 Accounting Principles with a cross-reference in this chapter. (In *BPM5* para. 471, in some cases of traded loans, the position of the debtor is recorded at nominal values and the creditor at transaction values.)

iii. The point of write-off or write-down. This could be specified as in *1993 SNA* para. 11.23 and *MFSM* para. 194.

(d) Deposits and accounts payable/receivable give rise to the same issues of nominal and fair values as loans. The valuation principles will take into account the decision on loan valuations.

6.17 Guidelines will be given for the valuation of equity where there is no recent, observable market price. Important cases include much of direct investment, shares that cease trading (due to suspension, default, bankruptcy), and private equity (unlisted companies, joint ventures, unincorporated enterprises). The general principles for use of a market price equivalent will be discussed in Chapter 3 Accounting Principles. Particular methods were not dealt with in *BPM5*, but they were covered in *BPT* paras. 716-720 and Kozlow (2002). It is proposed to mention briefly some of the options and to emphasize the misleading nature of historic cost values.

[Question: (i) How far should compilation issues be discussed in this section? (ii) Should any particular method(s) be endorsed in order to encourage international standardization?]

6.18 Specific guidelines will be given for the valuation of other instruments for particular issues:

(a) Monetary gold and other reserve assets. These items will be valued at market prices (*BPM5* para. 473).

(b) SDRs, use of Fund credit, and reserve position in the Fund. These items should be valued as calculated by the IMF (*BPM5* para. 473 and *Reserves Template* paras. 136-7).

(c) Debt instruments generally. For all debt instruments, the value used for the IIP should include the accrual of interest, as at the reference date. In this connection, the manual will explain the notions of "clean" and "dirty" prices.

(d) Debt securities. While the market value will be adopted as the standard, compilation of the nominal value will be a supplementary item for issuers of the security, for its own analytical interest, and for the purposes of compiling external debt statistics (see the *Debt Guide* para. 2.42, where both nominal and market values are recommended).

(e) The treatment of deposits at banks in liquidation. This will be discussed in Chapter 3 Accounting Principles.

(f) Insurance and pension fund liabilities to their policyholders, claimants, and beneficiaries. These should be valued at market prices or the market price equivalent. The manual will discuss actuarial valuation of insurance and pension fund liabilities. Insurance policies should not be valued at their surrender value, contrary to *BPT* para. 721. It will be recognized that, in many economies, these activities have very little, if any, cross-border element. Depending on the outcome of current discussions, liabilities of unfunded pension schemes may also be recognized.

(g) Financial derivatives. Valuation of positions will be discussed as per paras. 469–470 and 473a of the *Financial Derivatives Supplement to the Fifth Edition of the Balance of Payments Manual* (2002).

(h) Employee stock options. Positions in employee stock options will be valued at market prices, or by using a suitable option pricing model.

Appendices:

Comparison with the *Debt Guide:*

- A concordance table will show components of IIP that are included in debt.

References

BPM5 ch 16 and 23

1993 SNA ch 13

GFSM ch 7

Banque de France, *Repo-type Transactions Issue: The French Experience Relating to Stocks*, BOPCOM-01/40

A. Bloem and C. Gorter, *The Treatment of Nonperforming Loans in Macroeconomic Statistics*, IMF Working Paper 01/209

Bank of Japan, *Classification and Valuation of Domestic Loans Sold to Non-residents at a Discount in the Balance of Payments Statistics and International Investment Position,* BOPCOM-00/15

IMF, *The Macroeconomic Statistical Treatment of Reverse Transactions,* BOPCOM-01/16

IMF, *Treatment of "Short" Positions,* BOPCOM-03/15

IMF, *Working Group on Repurchase Agreements and Securities Lending*, BOPCOM-01/17

R. Kozlow, *Valuing the Direct Investment Position in U.S. Economic Accounts,* BOPCOM-02/29

L. Laliberté, *Foreign Portfolio Investment in Canadian Bonds,* CBOPWP/97/01

A. Ridgeway, *Treatment of Allowances for Loans Losses and Non-Performing Loans,* BOPCOM-01/23

R. Tremblay, *Calculation of Position and Interest on Canadian Bonds Held by Non-Residents*, CBOPWP97/03

Changes from *BPM5*

(a) *Changes proposed*:

The priority of classifications will be standardized (para. 6.8).

Totals for equity, debt, and other instruments will be shown (Table 6.1).

For untraded equity, adoption of proxy methods when book values are inadequate will be encouraged and the limitations in the analytical usefulness of historic cost data will be emphasized (para. 6.17).

Introduction of the notions of “clean” and “dirty” prices (para. 6.18(c)).

(b) *Changes raised as an option*:

Consideration to be given by compilers to record significant off-balance sheet commitments (para. 6.3).

Financial assets and liabilities of central banks of monetary unions will be discussed (para. 6.11(d)).

The possible treatment of sweep accounts is discussed (para. 6.13).

Possibility of adopting fair value as a replacement or supplementary valuation basis. Possible supplementary data of impaired loans. Clarification of valuation of traded loans (para. 6.16).

Possible methods of valuing untraded equity to market-equivalent values could be discussed and/or endorsed (para. 6.17).

Glossary

Book value
Buy-sell spread
Clean price
Dirty price
Face value
Fair value
Impaired loans
Nominal value
Nonperforming loans (relationship to impaired loans/bad debts/bad debt provisions/expected loan losses)
Overnight deposits
Rate of return
Repo

Reverse transaction (include sell and buy backs, carries, gold swaps)
Securities lending
Short positions
Sweep accounts

Chapter 7. Financial Account

A. Concept and Coverage

7.1 The financial account will be defined, and its structure and purpose outlined along the lines of *BPM5* paras. 313–342, *BPT* paras. 446–447, and the *1993 SNA* Chapter XI. It shows transactions in monetary gold, SDRs, residents' claims on nonresidents, and nonresidents' claims on residents. Then, the section will show the relationship of the financial account and its balancing item, to other elements of the international accounts.

7.2 Transactions in financial assets and liabilities will be discussed (with cross-references to Chapter 5 Classifications, to give examples of financial assets/liabilities, and Chapter 6 International Investment Position, to show the stocks of financial assets and liabilities).

7.3 The functions of the financial account will be presented from different perspectives:

(a) In its own right, it shows transactions in financial assets and liabilities, grouped by functional category and thence by instrument.

(b) In the context of the international investment position, it identifies which changes during the period arise from transactions, as distinct from valuation effects, reclassifications, etc., as in *BPM5* paras. 310 and 436. The identity for the closing balance sheet being equal to the opening balance sheet, plus changes due to transactions and other flows, will be stated.

(c) In the context of the international transaction accounts, it shows how the net balance of transactions in the capital and current accounts is financed.

(d) In conjunction with the national accounts, it shows total national borrowing/lending, the instruments and functional categories employed, and the contribution of the domestic institutional sectors.

7.4 Financial account entries will be explained as being counterpart entries to goods, services, income, transfers, capital, or other financial entries.

7.5 This chapter will state that financial transactions can be classified in a number of ways—functional categories, instruments, currency, maturity (definitions for which will appear in Chapter 5 Classifications). It will be noted that the relevant positions—see Chapter 6 International Investment Position—and income—see Chapter 10 Primary Income—should be classified in the same way so as to facilitate comparisons.

7.6 A table showing the structure and components of the financial account with a numerical example will be presented. The financial account will have the same structure as the international investment position—the only difference being the inclusion of "reinvestment of earnings" under "direct investment abroad" and "direct investment in the reporting economy" in the financial account. Table 7.1 below shows only the main components, but the manual will provide a breakdown, along the lines of Table 5.3 in Chapter 5 Classifications. Full standard components will be presented in an appendix.

Table 7.1. Overview of the Financial Account

	Net change
Net lending/borrowing	
Net changes in assets arising from transactions	
Direct investment	
Portfolio investment	
Financial derivatives and employee stock options	
Other investment	
Reserve assets	
Total changes in financial assets resulting from transactions	
Of which:	
Equity finance	
Debt instruments	
Other instruments	
Net changes in liabilities arising from transactions	
Direct Investment	
Portfolio investment	
Financial derivatives and employee stock options	
Other investment	
Total changes in financial liabilities resulting from transactions	
Of which:	
Equity finance	
Debt instruments	
Other instruments	

7.7 The manual will also note that there are many possible presentations as to signs, netting, ordering, and balancing items. A two-column presentation of this table could also be made, that is, one column for each of net changes in assets and net changes in liabilities. The two-column presentation has the benefit of facilitating comparisons of the changes in assets with the corresponding changes in liabilities category. However, the two-column presentation is not suitable for use for time-series data, and the one-column presentation aligns with the presentation of the opening and closing international investment positions reconciled with financial account transactions and other changes in assets and liabilities given in Chapter 6 International Investment Position.

7.8 Another alternative is a matrix presentation, as shown below, that allows compilers or analysts to clearly identify the sectoral dimensions of international financial transactions but that is not suitable for time series analysis. (This format is not being proposed as a standard presentation; the objective is to show that the underlying information can be presented in different ways to emphasize different aspects.)

Table 7.2 Overview of the Financial Account—Institutional Sector Presentation

Net changes in assets						Net changes in liabilities				
Total economy	Households and NPISHs	General government	Financial corporations	Nonfinancial corporations		Nonfinancial corporations	Financial corporations	General government	Households and NPISHs	Total economy
					Direct investment					
					Portfolio investment					
					Financial derivatives and employee stock options					
					Other investment					
					Reserve assets					
					Total changes in assets/liabilities					
					Net lending/borrowing					

B. Scope and Characteristics

1. General

7.9 Financial transactions are classified according to the following hierarchy of dimensions:

(a) Assets/liabilities—defined in Chapter 3 Accounting Rules;
(b) Functional category—defined in Chapter 5 Classifications;
(c) Direction of investment (in the case of direct investment), i.e., direct investment abroad/direct investment in the reporting economy—defined in Chapter 5 Classifications;
(d) Instrument—defined in Chapter 5 Classifications;

(e) Institutional sector of resident party—defined in Chapter 4 Economic Territory, Units, Institutional Sector, and Residence;
(f) Maturity (in the case of debt instruments)—defined in Chapter 5 Classifications; and
(g) Currency (in the case of debt instruments)—defined in Chapter 5 Classifications.

7.10 In *BPM5*, the classification of transactions differs in order and level of detail from the classifications for incomes and positions. Standardization of transactions, other flows, positions, and income for each functional category will be recommended in order to facilitate analysis of the interrelationships.

7.11 The netting of values in the financial account will be explained. As explained in Chapter 3 Accounting Principles, netting in the financial account means offsetting increases in one type of asset with reductions in the same type of asset, and offsetting increases in one type of liability with reductions in the same type of liability. The reasons for net recording in the financial account, but not other accounts, will be explained. The potential usefulness of gross values in understanding financial markets will be considered, but they will not be introduced as standard components. (See *BPM5* paras. 324–327.)

2. Particular issues

7.12 Examples of some more complex transactions with financial account entries will be given, for example, loan repayment; accrual of interest; payment of previously accrued interest; payments at inception, completion, and during a financial derivative contract.

7.13 Special cases will be discussed:

(a) Reinvestment of earnings for direct investment, reinvestment of income attributed to life insurance and pension policyholders. In these cases, the financial account entry and counterpart income entry are both imputed. (See *BPM5* para. 321.) However, it will be noted that the values can be observed; it is the transaction that is imputed.

[Question: The term "reinvestment of earnings" is proposed for the financial account entry, to distinguish it from the equal and opposite income item. Is this change suitable?]

(b) Conversion of a convertible bond, rollover of a debt instrument, one party assuming obligations of another, and other changes in contractual terms. In these cases, this chapter will explain that two transactions are recognized—the original instrument is regarded as being canceled and a new one issued. (See *BPM5* para. 322.)

(c) Buy-sell spreads on financial instruments. The value of some transactions may need to be partitioned into a financial transaction and a financial service. The financial service component is the buy-sell spread or margin of traders. It is limited to dealers' "trading book" to exclude holding gains or losses. *BPM5* recognizes that there is a service margin for foreign exchange (para. 258) but not for other financial instruments (para. 323). This issue also concerns Chapter 9 Goods and Services and the *1993 SNA* production boundary and has recently been taken up by the OECD Task Force on Financial Services. The manual will follow the proposals adopted by the ISWGNA.

(d) Assets/liabilities of individuals changing residence ("migrants' transfers" of financial assets and liabilities). Under *BPM5* para. 354, there is an imputed transaction to cover the change in status of the financial assets, financial liabilities, and real estate of the individuals involved. As discussed in Chapter 3 Accounting Principles, it is proposed to remove this imputation from the financial account and treat these changes in the residence of the owner as reclassifications, to be included in the Other Changes in Financial Assets and Liabilities Account.

(e) Debt forgiveness. An entry is shown in the financial account, with a contra-entry in the capital account. Debt forgiveness (a mutually agreed outcome) will be contrasted with debt write-offs (a unilateral decision), which appear in the Other Changes in Financial Assets and Liabilities Account. (See *BPM5* para. 532 and relevant part of Chapter 12 Capital Account.)

(f) Allocation of SDRs and monetization/demonetization of gold. It will be noted that these are not financial transactions. (They should be shown in the Other Changes in Financial Assets and Liabilities Account.) (See *BPM5* para. 436.)

(g) Depository receipts and similar instruments. These instruments will be mentioned. That is, as having the residence and other characteristics of the underlying security, rather than according to their legal form as independent securities, which is an issue in determining whether a transaction in the depository receipt is cross-border. (Note: Issue of whether the existing treatment should be continued was raised in Chapter 4 Economic Territory, Units, Institutional Sectors, and Residence.) (See *CPISG2* paras. 3.80–3.85.)

(h) Strips. The manual will discuss strips and how they are to be treated: as the issue of a new instrument, following *Debt Guide* paras. 2.77–2.80 and *CPISG2* paras. 3.86–3.93.

(i) Financial or finite risk reinsurance. As little or no risk is transferred under financial reinsurance, it is in economic essence a financial transaction, rather than insurance. Regulatory practice usually means that financial reinsurance is already identified as being a financial transaction rather than insurance.

(j) Resident-to-resident transactions of a claim on a nonresident, for example, if a foreign bond is sold by one resident to another. This case was treated as an exception to the definition of balance of payments in *BPM5*; however, it is included in the more comprehensive definition of international accounts proposed in Chapter 1 Introduction, which is expressed in terms of resident-to-nonresident transactions and positions. (See *BPM5* footnote 1 to para. 13, and para. 318.) Despite being resident-to-resident transactions, these are included in the balance of payments because they involve a cross-border asset. If the transactors are residents of different sectors, it is necessary to record the transaction to report correctly the holdings of each sector and to reconcile opening and closing balance sheet positions. In practice, many of the transactions occur within a single sector, so they cancel out. The same principles apply for nonresident-to-nonresident transactions in claims on a resident. Because of data collection difficulties and the fact that these transactions cancel out for the economy as a whole, it will be recognized that correct reporting of these transactions may be a low priority in most cases.

(k) Counterparts to other imputed transactions. Since an imputed entry occurs for goods sent for processing, a counterpart financial account entry should be imputed, if possible. (If migrants' transfers are maintained in capital transfers, then imputed financial account entries are needed for the financial assets and real estate of the individuals.)

(l) Interest accrued. The manual will note that accrued interest will be added to the relevant instrument, rather than as an account receivable/payable. This is consistent with the valuation of positions. (This issue will be cross-referenced to the discussion in Chapter 3 Accounting Principles).

(m) Reverse transactions. This section will note the issue of reverse transactions, with a cross-reference to the appendix that will present the transactions and related positions. (Reverse transactions were also mentioned in the context of positions data in Chapter 6 International Investment Position.)

(n) Real estate ownership by nonresidents. As noted in Chapter 4 Economic Territory, Units, Institutional Sector, and Residence, a notional resident unit is imputed for real estate purchase, so these transactions will be regarded as direct investment, rather than acquisition of land.

(o) Gold transactions. Transactions in gold between monetary authorities are included. If nonmonetary gold is not treated as a financial asset, as discussed in Chapter 5 Classifications, there will be a clarification of how monetization of gold will be recorded. Without recognition of nonmonetary gold as a financial asset, the acquisition of gold by a monetary authority would be treated as a goods transaction, followed by a reclassification shown in the other change in financial assets and liabilities account.

(p) The debtor/creditor and transactor principles for financial transactions. These are discussed under Chapter 4 Economic Territory, Units, Institutional Sector, and Residence under partner data.

[Question: Are there any other cases that should be mentioned?]

FINANCIAL ACCOUNT

References

BPM5, paras. 313–342, *Financial Derivatives Supplement*

BPT Chapter VIII

External Debt Statistics: Guide for Compilers and Users, paras. 253-254

International Reserves and Foreign Currency Liquidity: Guidelines for a Data Template

CPISG2 paras. 3.60–3.79

1993 SNA Chapter XI

MFSM paras. 429–433, 448–465

Banque de France, *Repo-type Transactions Issue: The French Experience Relating to Stocks*, BOPCOM-01/40

International Department Bank of Japan, *Classification and Valuation of Domestic Loans Sold to Non-residents at a Discount in the Balance of Payments Statistics and International Investment Position*, BOPCOM-00/15

IMF, *The Macroeconomic Statistical Treatment of Reverse Transactions*, BOPCOM-01/16

IMF, *Working Group on Repurchase Agreements and Securities Lending*, BOPCOM-01/17

Changes from *BPM5*

Changes proposed:

The word "capital" in financial account entries will be replaced by "finance" (Table 7.1).

The presentation, signs, netting, and ordering in the financial account will be consistent with IIP and income (para. 7.5).

Change of terminology for financial account entry to "reinvestment of earnings" (para. 7.13(a)).

Glossary

Captive insurer
Debt finance
Debtor/creditor principle
Equity finance
Financial lease
Financial reinsurance.
Gold swaps
Monetary gold
Monetization of gold/demonetization
Other finance
Reinvestment of earnings
Repos
Securities lending
SDRs
Strips

Chapter 8. Other Changes in Financial Assets and Liabilities Account

A. Structure of the Account

8.1 This chapter will discuss the purpose and structure of the other changes in financial assets and liabilities account along the lines in the *1993 SNA* Chapter XII and *GFSM 2001* Chapter 10. It will state that this account captures changes in financial assets and liabilities that are not transactions, which are recorded in the financial account. The manual will propose that the scope of this account is determined by the scope of the international investment position, which includes only financial instruments. The manual will, however, note that events other than transactions occurring between residents and nonresidents may give rise to changes in holdings of nonfinancial nonproduced assets by residents (for example, the seizure of nonproduced intangible assets by nonresidents). The manual will propose that such information, particularly when important, should be provided as supplementary information. Information on changes in holdings of nonfinancial nonproduced assets due to other changes in volume of assets occurring between residents and nonresidents is necessary to prepare national balance sheets.

8.2 The manual will explain that other changes in assets and liabilities are genuine economic phenomena that should be recorded separately from transactions. These flows are not residual items but reflect economic realities. This section will contrast the flows recorded in this account with transactions recorded in other international accounts in terms of their economic nature and accounting entries. Two types of the other flows will be distinguished: (1) holding gains/losses (revaluations); and (2) other changes in volume of assets. Within the first category, the holding gains/losses due to exchange rate changes and price changes will be distinguished. Definitions of these concepts will be given. The relationship of this account with other international accounts as well as with the balance sheets of the national accounts will be discussed.

8.3 A table showing the structure and components of the other changes in financial assets and liabilities account with a numerical example will be presented. The table below shows only the main components, but the manual will provide a breakdown, along the lines of Table 5.3 in Chapter 5 Classifications. Full standard components will be presented in an appendix.

TABLE 8.1. Overview of Other Changes in Financial Assets and Liabilities Account

	Holding gains/losses		
	Exchange rate changes	**Other price changes**	**Other changes in volume**
Net changes in financial assets arising from other flows			
Direct investment			
Portfolio investment			
Financial derivatives and employee stock options			
Other investment			
Reserve assets			
Total net changes in financial assets resulting from other flows			
Of which:			
Equity finance			
Debt instruments			
Other instruments			
Net changes in liabilities arising from other changes			
Direct investment			
Portfolio investment			
Financial derivatives and employee stock options			
Other investment			
Total net changes in liabilities resulting from other flows			
Of which:			
Equity finance			
Debt instruments			
Other instruments			
Changes in net IIP			

B. Scope and Characteristics

1. Holding gains/losses

8.4 This section will define holding gains and losses. It will state that holding gains and losses in the international accounts apply only to financial assets and liabilities. The notions of realized and unrealized holding gains will be explained. The manual will note that changes in the value of assets arising from a change in quantity of a financial asset are transactions but are not holding gains/losses, and it will give examples of such cases (e.g., the accrual of interest). The meaning of nominal holding gains will be discussed. The manual will state that unless specifically mentioned, the term "holding gains" refers to nominal holding gains and losses. The holding gains owing to exchange rate changes and price changes will be defined. It will be stated that such a separation is applicable only to financial instruments denominated in a foreign currency. It will mention that the *1993 SNA* classifies nominal holding gains further into neutral and real holding gains.

8.5 There will be separate paragraphs discussing holding gains for specific types of assets. The following particular cases may be distinguished and discussed:

(a) Currency and deposits. The manual will state that monetary values of currency denominated in the currency used for the international accounts remain constant over time; hence, holding gains on these assets are always zero (along the lines of the *1993 SNA* para. 12.107). Assets denominated in another currency can change in value, owing to a change in exchange rate which is recorded as holding gains. The manual will explain that using different currencies to compile international accounts will have effects on this account, because changes in values resulting from exchange rate changes are holding gains/losses. For deposits, an issue is raised in Chapter 3 Accounting Principles about whether nominal and fair values should be followed. Based on the decision on this question, the manual will describe the issue of holding gains for deposits.

(b) Write-off and write-down of loans. The manual will discuss the treatment of write-off and write-down of loans, and loans sold at discount, including loans that are traded but not sufficiently to become securities. The treatment of these items is not fully clear in various macroeconomic statistics manuals. According to the *1993 SNA* (para. 11.23), writing-off of debts (recognition by a creditor that a financial claim can no longer be collected owing to bankruptcy or other factors) is recorded in the other changes in volume of asset accounts for both the creditor and the debtor. Write-downs that reflect actual market values should be accounted for in the revaluation account. Write-offs or write-downs that are imposed solely to meet regulatory or supervisory requirements and do not reflect the actual market values of those financial assets should not be recorded (*1993 SNA*. para. 11.23). The *BPM5* mentions write-offs as changes resulting from the unwillingness or inability of a debtor to make full or partial repayment (para. 310). However, it states only that these write-offs are not transactions, without discussing whether they are revaluation or other changes in volume. The *MFSM* states that the value of a loan portfolio should be adjusted downward only when (1) loans are actually written off as uncollectible, or (2) the outstanding amount of the loan has been reduced through a formal debt reorganization (para. 206). These issues are also related to the issue of valuation of nontraded financial instruments (nominal or fair values), as raised in Chapter 3 Accounting Principles and in Chapter 6 International Investment Position. Clarification on the above issues will be given in the new manual.

(c) Loans sold at discount, including loans that are traded but not sufficiently to become securities. The *1993 SNA*'s treatment for loans subject to discounts as stated in para. 14.51, is also suggested in the *BPM5*, para. 471 (market value on the creditor's side and nominal value on the debtor's side). However, it is not consistent with the overall concept of symmetric recording. If the nominal value is used for positions, the difference between nominal and transaction values will be shown as a valuation change. This issue will be discussed fully in Chapter 3 Accounting Principles, with a cross-reference in this chapter.

(d) Debt reorganizations. The manual will explain debt rescheduling, debt refinancing, debt assumption, and debt swaps (debt-debt swap and debt-equity swap).

(e) Accrual of interest on debt instruments. The manual will describe changes in the value of debt securities resulting from change in their quantity from the accrual of interest. It will state that these changes are not holding gains. (Cross-references will be made to Chapters 3, 5, 6, and 7).

(f) Debt securities. The manual will discuss holding gains on debt securities as the change in their value owing to interest rate changes that reflect, among other things, changes in credit ratings. The treatment of foreign currency-denominated securities and index-linked securities will be discussed. In the case of debt instruments denominated in a foreign currency, the current recommendation is to classify changes in the value of the principal in domestic currency terms that arise from exchange rate variations as holding gains (nontransactions). However, in the case of debt instruments indexed to a foreign currency, such changes are treated as interest (transactions). The manual will recommend that for debt instruments with both principal and coupons indexed to a foreign currency, the change in principal in domestic currency terms that arises from a change in the exchange rate should be shown as a revaluation, and the effect of changes in the exchange rate on the amount of accrued interest expressed in domestic currency is to be included in interest.

(g) Financial derivatives and employee stock options. The manual will describe holding gains/losses on financial derivatives based on para. FD14 of the *BPM5 Supplement*. Holding gains and losses on employee stock options will be discussed.

(h) Equity finance. The manual will discuss holding gains on shares and holding gains on equity of quasi-corporations, including the equity of a notional unit owning immovable assets such as land and buildings.

(i) Insurance technical reserves and equity on pension funds. The manual will discuss holding gains on these assets/liabilities.

2. Other changes in volume of assets

8.6 This section will define other changes in the volume of assets. The *BPM5* shows other changes in the volume of financial assets and liabilities only. The new manual will note that changes in nonfinancial nonproduced assets arising from transactions with nonresidents enter into the national balance sheets through the capital account. The changes in the resident holdings of nonfinancial nonproduced assets resulting from events, occurring between residents and nonresidents, other than transactions are to be classified as other changes in the volume of assets. The manual will propose that the scope of this account be limited to the scope of the IIP, which includes only financial instruments. However, it will recommend that supplementary information on nonproduced nonfinancial assets be prepared where it is considered to be significant or analytically useful.

8.7 The manual will describe events that give rise to the recording of other changes in the volume of assets in the international accounts. These events will be divided into three broad categories:

(a) Catastrophic losses and uncompensated seizures. The events that are to be classified under this category will be described. Changes in sovereignty over areas occurring involuntarily (such as arising from a war) will be noted as other changes in the volume of assets (BOPCOM-02/59).

(b) Changes in classifications. This category will cover (i) changes in classification of assets and liabilities [for example, classification between direct and portfolio investment, monetization and demonetization of monetary gold, etc.], (ii) changes in sector classification and structure, and (iii) changes in residence of individuals/households. In view of importance of changes in financial claims and liabilities owing to changes in residence of individuals for assessing mode 4 delivery of services in the context of the General Agreement on Trade in Services (GATS), the manual will explore whether supplementary information on them is desirable.

[Question: Is supplementary information on changes in financial claims and liabilities owing to changes in residence of individual desirable?]

(c) Other volume changes. This category will mention (i) allocation and cancellation of SDRs, (ii) shutdown of a direct investment enterprise, including enterprises set up for natural resources exploration, and (iii) miscellaneous other volume changes.

C. Timing

8.8 The section will describe the time of recording for holding gains and other volume changes in assets and liabilities.

D. Valuation Principles

8.9 The section will discuss general valuation principles applicable to holding gains and other volume changes in assets and liabilities.

OTHER CHANGES IN FINANCIAL ASSETS AND LIABILITIES ACCOUNT

References

BPM5 chapters 2 and 23;

1993 SNA chapter XII;

GFSM chapter 10;

MFSM chapter V;

IMF, *Clarification of Foreign Direct Investment Recommendations*, BOPCOM-01/20A; and

IMF, *Residence* (BOPCOM-02/59).

Changes from *BPM5*

(a) *Changes proposed*:

Limit Other Changes in Financial Assets and Liabilities Account to the scope of IIP, which includes only financial instruments (para. 8.1).

For debt instruments with both principal and coupons indexed to a foreign currency, the change in principal in domestic currency terms that arises from a change in the exchange rate represents a revaluation (para. 8.5(a)).

Treat "migrants' transfers" as "other changes in financial assets/liabilities," instead of as a capital account transaction (para. 8.7(b)).

(b) *Changes raised as an option*:

Provide supplementary information on changes in holdings of nonfinancial nonproduced assets owing to other changes in volume of assets occurring between residents and nonresidents, where significant (para. 8.1).

Clarification on the treatment of write-off and write-down of loans, and loans sold at discount, including loans that are traded but not sufficiently to become securities (para. 8.5(b)).

Whether supplementary information is desirable on changes in financial claims and liabilities arising from changes in residence of individual (para. 8.7(b)).

Glossary

Holding gains
Other changes in volume of assets

Debt rescheduling
Debt refinancing
Debt assumption
Debt swaps
Debt-debt swap
Debt-equity swap
Catastrophic losses
Uncompensated seizures
Changes in classification of assets and liabilities
Changes in sector classification and structure
Changes in residence of individuals/households

Chapter 9. Goods and Services Account

A. Introduction to the Current Account

9.1 The current account will be introduced, as in Chapter 2 Overview.

B. Introduction to the Goods and Services Account

9.2 This section will deal with the purpose of the goods and services account. It will define goods and services, showing their special economic role, as the outputs of the production process. It will be noted that the focus on goods and services in the balance of payments is not the point of production but the point when they are exchanged between a resident and a nonresident, that is, exported or imported. The section will show the relationship of the goods and services account and its balancing item to other international accounts.

9.3 Goods and services will be identified as outcomes of the production process, in contrast to income and transfers. The scope of goods and services will follow the *1993 SNA* definition of production as the process of combining inputs to produce an output or putting a produced fixed asset at the disposal of another entity. Production will be contrasted with property income, which involves putting a nonproduced asset at the disposal of another entity. Some examples of the borderlines between production and other entries will be given, for example, payment to contractor vs. compensation of employees; rent of land vs. rental of buildings; use of internet domain names; charges by financial institutions for early redemption of term deposits; rebates; government fees.

9.4 The manual will maintain the *BPM5* distinction of goods and services, which reflects in part the means by which products are supplied and the sources of data. While the new manual will still make the *BPM5* distinction, it will note the increasing blurring of the distinction between goods and services and that the distinction is based on data sources, as opposed to following the *1993 SNA* definition (paras. 6.7–6.8).

9.5 The manual will illustrate the overall structure of the goods and services account along the following lines:

Table 9.1 Overview of Goods and Services Account

	Exports CR.	**Imports DR.**
General merchandise on a BOP basis		
of which: re-exports		
Nonmonetary gold		
Goods for processing		
Total goods		
Balance on trade in goods		
Services		
Repairs on goods		
Transport		
Travel		
Information technology services		
Construction services		
Insurance services		
Financial services		
Franchise fees and payments for the use of proprietary rights		
Other business services		
Personal, cultural, and recreational services		
Government services, n.i.e.		
Total services		
Balance on trade in services		
Total goods and services		
Balance on goods and services		

9.6 Separate balances have been shown in the above table for each of goods and services. The goods balance would differ from the one shown in international merchandise trade statistics, but the international accounts balance is more comprehensive and involves a consistent f.o.b. valuation basis for both exports and imports.

[Question: Should separate balances be shown for each of goods and services?]

9.7 There is interest in separating goods and services trade that occurs between related parties, called *foreign affiliates trade statistics*. They are discussed as an appendix to this manual.

C. Classification and Coverage

1. Goods

a. General merchandise

Concepts and coverage

9.8 General merchandise will be defined along the lines of *BPM5* paras. 196 and 205–215. This concept will be linked to the United Nations *International Merchandise Trade Statistics: Concepts and Definitions (IMTS)* with differences noted.

9.9 The coverage of merchandise trade will be unchanged from *BPM5*, except for excluding the personal effects of individuals who change their territory of residence (see Chapters 3 Accounting Principles and 8 Other Changes in Financial Assets and Liabilities Account of this annotated outline). However, the discussion of the treatments of financial leases and flows of goods between branches and parents will emphasize that in these cases legal title does not coincide with economic ownership and that the manual follows economic concepts.

9.10 The section will emphasize that international accounts statistics include all flows between residents and nonresidents, so that trade omitted (or inappropriately included) from the main data source may need to be adjusted (e.g., military equipment, aid goods, ships, airplanes, oil rigs, shuttle trade below customs thresholds, goods procured in ports by carriers, and smuggling). It will also be recognized that data collection problems may imply that the data are poor. Goods whose export or import is illegal will be specifically included in the scope of this item, although practical data problems will be recognized.

9.11 The section will recognized that "general merchandise" will typically be a large and very broad item, so that compilers may wish to provide more detailed breakdowns for particular products or groups of products as supplementary items. For example, they may specify primary products, industry of origin, and major commodities that are particularly important to the economy. However, it is proposed not to have international standards for these breakdowns within the international accounts, but to encourage breakdowns that are related to national conditions or to make reference to other sources for these breakdowns. (*Note:* The proposal below for a reconciliation table for differences between balance of payments and international merchandise trade statistics is designed to enhance users' understanding of linkages between these statistics.)

9.12 Furthermore, the section will note that transit trade is excluded from the merchandise trade of the territory of transit. It will note that the distinction between transit trade and re-exports is becoming blurred by trade liberalization, so that a high proportion of re-exports may be, in effect, transit trade or may involve minor additional services, such as reconsignment. In such cases, the economic interpretation of re-exports is unlike other exports and more like transit trade. Two options to deal with this situation are to:

(a) show re-exports separately, when significant; or

(b) exclude re-exports from both imports and exports. (The estimate of imports for re-export would be slightly smaller than re-exports, with the difference shown as exports of services for transport, etc. Any timing differences between import and re-export would be ignored unless information were available about particularly large consignments being held over the end of the reporting period.)

The first solution is proposed, as being less elaborate than the second, while making it possible to see the extent of re-exports relative to both exports and imports.

[Question: Which treatment is preferred—no change, re-exports to be shown separately, or re-exports to be excluded from merchandise?]

Particular issues

9.13 This section will specify the treatment of a number of specific cases. If an entry is not included under general merchandise, the manual will state where it should be included, if at all. Except where noted, all the treatments follow existing guidelines in *BPM5*, *BPT*, or *IMTS*. A rationale for any deviations from the change of ownership principle will be given. Samples of cases requiring specific treatment are:

(a) banknotes and coin not in current circulation and unissued securities (*BPM5* para. 215); it will be noted that movements of banknotes and coin in circulation and issued securities represent financial account transactions;
(b) books, newspapers, and magazines (*BPM5* para. 212);
(c) electricity, gas, and water (*BPM5* para. 215);
(d) empty bottles (*IMTS* para. 40);
(e) fish and other marine products caught and sold abroad directly from the compiling economy's ships (*BPT* para. 196);
(f) goods acquired by travelers, diplomats, nonresident workers, etc. (*BPM5* para. 208);
(g) goods changing ownership that are temporary or not related to significant economic activity (*BPM5* para. 208);
(h) goods changing ownership without crossing frontiers (*BPM5* para. 208);
(i) goods crossing frontiers but not changing ownership (*BPM5* para. 209);
(j) goods dispatched by post or courier (*BPM5* para. 215);
(k) goods delivered to or dispatched from offshore installations, embassies, etc. (*BPT* para. 201);
(l) goods in bonded warehouses (*IMTS* paras. 89–90);
(m) goods lost or destroyed (*BPT* para. 213);

(n) goods procured in port by carriers (defined in *BPM5*, paras. 156 and 201) will be included under general merchandise (in contrast, in *BPM5*, these were shown as a separate item under goods);
(o) goods supplied between unincorporated branches and parents (*BPM5* para. 205);
(p) goods temporarily exported, for display, exhibitions, etc. (*BPT* para. 214);
(q) goods transferred from or to a buffer stock organization (*BPM5* para. 215);
(r) goods for merchanting (see *BPM5* paras. 207 and 262; net changes in inventories shown as imports to the country of the merchant—and, in principle, exports in the country of location—possibly including negative entries; otherwise not shown; merchant's margin shown in country of merchant as export, goods shown at full value including merchant's margin in country of import);
(s) goods under financial leases (*BPM5* para. 206);
(t) goods under operating leases (*BPT* para. 209);
(u) livestock driven across frontiers (*BPM5* para. 215);
(v) migrants' effects (to be excluded from balance of payments statistics, contrary to *BPM5* para. 215);
(w) minerals from the sea bed (*IMTS* paras. 38, 58);
(x) ships, aircraft, and other mobile equipment that changes hands outside the country of residence of the original owner (*IMTS* para. 36);
(y) ships, aircraft, and other mobile equipment that enters a territory on a temporary basis (*BPT* para. 210);
(z) returned goods (*BPM5* para. 210, *BPT* para. 205);
(aa) salvage landed from vessels (*IMTS* paras. 38, 58);
(bb) software (*IMTS* paras. 27 and 48);
(cc) waste and scrap (*IMTS* paras. 41 and 54);
(dd) samples (*BPM5* para. 209); and
(ee) products such as software and music that are generally available (that is, not customized) and delivered electronically will be classified as goods.

[Questions: (i) Is the proposed treatment of products delivered electronically appropriate? (ii) Do any of the other treatments need to be reconsidered?]

9.14 Where published international merchandise trade statistics differ from estimates of general merchandise on a balance of payments basis, the manual will suggest that a reconciliation table be provided, so that the reasons are available to users. A sample reconciliation table is shown in Table 9.2 below (based on Appendix B in *BPM4*; a similar appendix is not included in *BPM5*). It will be recognized that compilers may not be able to publish fully such a table, particularly for short periods, because of confidential items. Nevertheless, they should be able to prepare one internally, because it is simply a tabulation of adjustments already made.

Table 9. 2. Reconciliation between Merchandise Trade Statistics and General Merchandise on a BOP Basis

	Exports	Imports
Merchandise trade as published		
Coverage adjustments (major factors specified)		
Classification adjustments (major factors specified)		
Timing adjustments (major factors specified)		
Valuation adjustments fob/cif adjustment for imports (other major factors specified)		
Other adjustments (major factors specified)		
General merchandise on a BOP basis		

b. Other goods

9.15 The treatment of goods for processing where the processor does not acquire ownership (i.e., the processing is done for a fee or commission) will be spelled out, following the existing treatment, described in *BPM5* paras. 197–199. The related financial account entries will be elaborated. This section will note the difference with the *1993 SNA* (i.e., the *1993 SNA* only treats the processing as an export of goods if there is substantial change) and will continue with a rationale of the difficulty of separately identifying goods subject to minor processing. It will provide a rationale for treatments (e.g., the creation of one type of good from another is an economic event that should be treated as a transaction, although legal title does not change hands; data availability concerns could arise; the large flows in each direction should be shown separately because of their different characteristics from other goods flows). It will note that where goods for processing change ownership, they are treated as general merchandise.

> *[Question: Would it be preferable to merely show the processing as a service charge, like repairs?]*

9.16 It is proposed to show separately goods for processing abroad and goods for processing in the compiling economy because these each have quite different relationships to the economy. Goods for processing abroad comprises:

(a) goods owned by residents of the economy being sent for processing abroad (credit); and
(b) goods owned by residents of the economy being returned after processing abroad (debit).

Goods for processing in the compiling economy comprises:

(a) goods owned by nonresidents of the economy being received for processing in the economy (debit); and
(b) goods owned by nonresidents of the economy being returned after processing in the economy (credit).

[Comment: The existing presentation combines goods processed abroad with goods processed in the compiling economy.]

[Question: Would it be desirable to separate goods for processing abroad and goods for processing in the compiling economy?]

9.17 The option will be raised of showing goods purchased and sold by merchants as a separate category, instead of showing the margin as a service. (In that case, "merchants" would need to be defined more narrowly than its usual meaning, as those who undertake "merchanting," as defined in *BPM5* para. 262. Alternatively, a specific term would need to be developed.)

[Comments: This proposal would avoid the need for an exception to the change of ownership principle, avoid the possibility of a negative import flow, remove the asymmetry between exports and imports, and allow the gross flows to be netted out if desired, while bringing the treatment into line with goods for processing.

If this treatment were adopted, the goods flows would be recorded gross, and there would be no item for merchanting services. If adopted, the flows would be shown separately from other goods flows.]

[Question: (i) Should the treatment of merchanting be changed?]

[Question: (ii) Should the treatment of goods in transit, re-exported goods, goods for processing, repair, storage, and merchanting be reviewed together with a view to developing either a coherent approach or a rationale for different approaches to them?]

[Comment: Implications for supply and use/input-output tables would need to be considered.]

9.18 Nonmonetary gold will be discussed, as per *BPM5* para. 202. There will be a cross-reference to transactions in monetary gold (Chapter 7 Financial Account) and the monetization and demonetization of gold (Chapter 8, Other Changes in Financial Assets and Liabilities Account). The possibility of reclassifying financial gold as a financial asset is discussed under Chapter 5 Classifications. If that change is adopted, only industrial gold would be included in goods.

Timing

9.19 The discussion will follow *BPM5* paras. 216–218 and Chapter 3 Accounting Principles. In principle, exports and imports of goods should be recorded when economic ownership of the good changes from a resident to a nonresident, or vice versa. The manual will note that this principle for recording change of economic ownership may not coincide with the recording in the books of the parties involved. In view of the difficulties in obtaining the data on the correct conceptual basis, balance of payments compilers often use trade statistics.

9.20 It will be noted that trade statistics are usually recorded on the basis of customs documents, reflecting the physical movements of goods across the national or customs frontier of an economy, which is taken for balance of payments statistics as an approximation to change of economic ownership. It will be stated as preferable to take the customs data reflecting the timing of the goods crossing the frontier rather than those reflecting the time when customs declarations are processed.

9.21 In cases when data sources record large individual flows of goods in one period, but the changes in ownership and the corresponding financial transactions occur in another period, the manual will recommend that adjustments be made to the flows of goods. However, it will be recognized that identification of timing differences is not always practical, and it would only be considered for particularly significant individual transactions. This issue was discussed in *BPM5* para. 217.

9.22 In some cases, goods leave the territory without a transaction having occurred, for example, for storage or on consignment. Ideally, these goods flows would be excluded from exports, with adjustments made later if and when the goods are subsequently sold. Goods on temporary loan should be excluded. It may be practical to make adjustments for large commodity shipments or major trading corporations. In other cases, it may be necessary to accept data based on the time that the goods left the territory as the best available approximation. This issue was discussed in *BPM5* para. 218.

Valuation

9.23 The general principles for valuation (transactions/market price) will be stated briefly. The issues will be discussed along similar lines to *BPM5* paras. 219–229, and *BPT* paras. 218–249 and 281–286, as well as *BPM4* paras. 236 to 247.

9.24 Valuation on the f.o.b. basis will be stated as the standard, that is the price including costs of freight and insurance to the ship's rail or other carrier, but excluding subsequent freight, insurance, and taxes. The definition will be discussed following *IMTS* paras. 115–120. The valuation for balance of payments statistics coincides with the "f.o.b.-type" valuation in *IMTS*, in that f.o.b. is, strictly speaking, a shipping concept not applicable to other modes of transport (see *IMTS* para. 118). This section will note that the arrangements between exporters and importers as to who pays for components of associated services and taxes can vary. Payments for loading, storage, handling, and insurance, as well as import duties and other taxes, may be arranged between exporter and importer for each transaction according to the circumstances. To provide a consistent basis for valuing goods and including associated services, the f.o.b. valuation basis is adopted for both exports and imports. It will be noted that this will differ from the transaction price, except when the contractual terms are f.o.b. This section will cross-reference the consequent effects on transport and insurance (discussed under services below).

9.25 A rationale for the use of f.o.b. valuation of imports will be given. The section will note that, even though the f.o.b. valuation basis may not align with the value at the time of change of ownership, a consistent valuation and split between goods and service components is considered to be a higher priority. It will be noted that national accounts and international trade statistics typically value imports at c.i.f. value, which reflects the good plus the costs incurred up to the time of arrival in the port of destination.

9.26 Market prices will be specified as indicating the price received by the seller after taking into account the application of rebates, discounts, refunds, adjustments, etc. paid by the seller.

9.27 Export taxes are included in exports f.o.b., so that the tax is shown as being paid and received in the territory of export. If an importer of a good had contractually agreed to pay export taxes, then the amount of the taxes should be added to the contract price to get the f.o.b. price.

9.28 Import duties are excluded from imports f.o.b., because the duties only become payable after the good arrives in the territory and are therefore outside the scope of the balance of payments. If an exporter of a good had contractually agreed to pay import duties, then the amount of the duties should be deducted from the contract price to get the f.o.b. price. An example will be given.

9.29 In the cases of gifts, aid, barter, and transactions within a company (e.g., between a parent and a nonresident branch), prices may not be assigned by the parties. The manual will state that, in these cases, a market equivalent price should be used. Similarly, an artificial or unrealistic price may be designated by the parties (e.g., for tax minimization, transfer pricing, avoidance of exchange controls, or for pro forma reasons in the absence of a known price). In these cases, the manual will recommend that a market equivalent price should be used, to the extent feasible. It will be noted that such adjustments to the value of goods will require offsetting adjustments to other items (e.g., understated price of imports supplied by a subsidiary to a direct investor may be treated as an addition to dividends).

9.30 When goods on consignment or for auction leave the territory without the selling price having been determined, the ideal result would be to exclude them from exports until they are sold. While this treatment may be practical for large transactions or traders, in other cases, it may be necessary to accept data based on physical movement of the goods, valued on an estimate of the selling price.

2. Services

a. Concepts and coverage

9.31 Services will be introduced, along similar lines to the *Manual on Statistics of International Trade in Services (MSITS)* paras. 1.1–17 and Box 1. As in Box 1 of *MSITS*, this section will note that although the international accounts measure has some variations from the *1993 SNA* definition of services, it is still considered to be a useful grouping. It will be noted that for some components (most notably travel, government services n.i.e, and construction services), the service provided/consumed is actually a mixture of goods and services.

9.32 The manual will refer to the more detailed discussion of services in *MSITS*. Any differences from *MSITS* will be noted. (The only changes proposed are a rearrangement of computing and information services, different terminology for royalties, a reclassification of expenditures by nonresident construction enterprises in the economy in which they are working, and a lower level of detail.)

9.33 The standard classification of services is shown in Table 9.3 and will be broadly the same as *BPM5*. The classification will be described as a mixture of transactor-based (for travel and government services n.i.e.) and product-based (other cases) components. It is not proposed to introduce the full *MSITS* classification of services and the associated memorandum items as standard components. It is proposed that there be a link table between the classification of services in the balance of payments standard components with the Central Product Classification (CPC). Such a table would provide specific information on the coverage of items and assist in the use of the data for other purposes, notably the construction of supply and use tables in the national accounts. A reconciliation of the CPC and services classification will be given, along the lines of *BPM5* Appendix III, or the detailed version in *MSITS* Table A.III.1 will be cited.

Table 9.3. Comparison between Classification of Services: Proposed Classification and *BPM5* Classification

Proposed classification	***BPM5* classification**
0. Repairs on goods	(included in goods)
1. Transport	1. Transportation
of which:	
Passenger†	
Freight†	
Other†	
1.1 Sea transport	1.1 Sea transport
1.1.1 Passenger	1.1.1 Passenger
1.1.2 Freight	1.1.2 Freight
1.1.3 Other	1.1.3 Other
1.2 Air transport	1.2 Air transport
1.2.1 Passenger	1.2.1 Passenger
1.2.2 Freight	1.2.2 Freight
1.2.3 Other	1.2.3 Other
1.3 Other transport	1.3 Other transport
1.3.1 Passenger	1.3.1 Passenger
1.3.2 Freight	1.3.2 Freight
1.3.3 Other	1.3.3 Other
2. Travel	2. Travel
2.1 Business	2.1 Business
Expenditure by border and seasonal workers†	
Other†	
2.2 Personal	2.2 Personal
Health-related†	Health-related*
Education-related†	Education-related*
Other†	Other*
3. Information technology services 3.1 Communications services 3.2 Computer services 3.3 Internet provision services 3.4 Other information provision services	3. Communications services 7. Computer and information services
4. Construction services	4. Construction services
4.1 Construction abroad	
4.2 Construction in the compiling economy	
5. Insurance services	5. Insurance services
	Gross premiums**
	Gross claims**

Proposed classification	*BPM5* classification
6. Financial services	6. Financial services
8. Franchise fees and payments for the use of proprietary rights	8. Royalties and license fees
9. Other business services	9. Other business services
9.1 Merchanting and other trade-related services	9.1 Merchanting and other trade-related services
9.2 Operational leasing services	9.2 Operational leasing services
9.3 Miscellaneous business, professional, and technical services	9.3 Miscellaneous business, professional, and technical services
Legal, accounting, management consulting, and public relations†	Legal, accounting, management consulting, and public relations*
Advertising, market research, and public opinion polling†	Advertising, market research, and public opinion polling*
Research and development†	Research and development*
Architectural, engineering, and other technical services†	Architectural, engineering, and other technical services*
Agricultural, mining, and on-site processing†	Agricultural, mining, and on-site processing*
Services between related enterprises n.i.e.†	
Other business services†	Other*
10. Personal, cultural, and recreational services	10. Personal, cultural, and recreational services
10.1 Audiovisual and related services	10.1 Audiovisual and related services
10.2 Other personal, cultural, and recreational services	10.2 Other personal, cultural, and recreational services
Health services†	
Education services†	
Other services†	
11. Government services, n.i.e.	11. Government services, n.i.e.
Alternative breakdown of travel services:	
Goods†	
Transport services†	
Accommodation services†	
Food and beverage serving services†	
All other expenditure†	

Note: † indicates supplementary information

Note: * indicates *supplementary information*
** indicates memorandum items

[Question: Are there areas, including those identified in MSITS, where more detailed classification should be recommended?]

b. Particular issues

Repairs on goods

9.34 The treatment of repairs on goods will be spelled out. Repairs will be treated as a service. Repairs will be distinguished from goods for processing. This section will also note that "renovations and enlargements" are included under goods for processing. Other exclusions will be noted, as in *BPM5* para. 200.

> *[Question: Should repairs on goods be classified as a service?]*

Transport

9.35 Transport will be discussed along the lines of *BPM5* Chapter XI. The classification will be unchanged. The section will refer to *MSITS* paras. 3.53–76, which has a more detailed classification, adding items for space transport, inland waterways, pipeline transport, and electricity transmission.

> *[Question: Should there be an expansion of the modes of transport beyond the BPM5 level of detail of sea transport, air transport, and other transport, for example as recommended in MSITS?]*

9.36 It will be noted that international transport of passengers should be included in this item.

> *[Question: Would it be more appropriate to include international transport of passengers with travel?]*

9.37 A breakdown of total transport services into freight transport, passenger transport, and other transport is proposed as an alternative breakdown for those countries that are unable (for example for reasons of confidentiality) to provide the recommended breakdown into the air, sea, and other modes of transport.

9.38 In addition, the section will discuss the coverage of freight and insurance and the adjustments that are necessary to make them compatible with the f.o.b. valuation of goods, along the lines of paras. 248 to 257 in *BPM4*. This section will discuss alternative arrangements for transporting and paying for the transport of goods.

Travel

9.39 The section will discuss travel along the lines of *BPM5* Chapter XII. The question of whether international transport of passengers should be included in this item, rather than under transport, as at present, was raised under transport above.

9.40 The section will recommend that compilers provide supplementary detail for the business category of travel services, to separately identify expenditure by border and seasonal workers (who are not travelers, although their expenditure is included here) from all other expenditure by business travelers.

9.41 As supplementary items, an alternative five-way breakdown of total travel services is recommended into (i) total goods, (ii) transport services, (iii) accommodation services, (iv) food and beverages, and (v) all other expenditure. This would allow for closer links with the tourism satellite accounts.

9.42 It will be noted that "shuttle trade" is included under goods, not travel, because travel excludes goods for resale, as noted in *MSITS* para. 3.78. The manual will note that expenditure in the territory by students and patients who are classified as nonresidents should be included under travel, not personal, cultural, and recreational services, as in *BPM5* para. 244. The accompanied baggage of travelers should be included under travel, although some taxed items may be identified in customs data on goods.

Information technology services

9.43 The section will explain this item in about the same level of detail as *MSITS* paras. 3.87–91 and 3.116–120. However, it will introduce information technology services as a single item that combines telecommunications and computing services, which were treated as separate items. A new set of components will be used but with the same total coverage:

(a) communications services (which includes telecommunications, postal, and courier services);
(b) computer services;
(c) internet provision services; and
(d) other information provision services.

[Comment: The components will be changed to allow compilers to more clearly classify, in particular, the provision of internet services between residents and nonresidents—both from providers to final consumers and between the various tiers of providers of such services. Communication and computing overlap in internet provision services.]

[Question: Would postal and/or courier services be more appropriately included in other transport services?]

9.44 Borderlines between goods components and services components will be elaborated—for example, software ("off-the-shelf" software should be included in goods if separately identifiable, but may come included with hardware, while customized software (that is, software that is produced to order) is included in computer services)—consistent with *IMTS* paras. 27 and 48 and *MSITS* Box 1 and para 3.118. License fees for use of software are included in services under franchise fees and payments for the use of proprietary rights.

[Question: How can the distinction between "off-the-shelf" software and license fees for the use of software be clarified?]

9.45 In view of the close substitutability of software included in goods, information technology services, and franchise fees, etc., some compilers and users may wish to combine these elements as supplementary items.

9.46 The recommendations of the OECD Task Force on Software Measurement in the National Accounts will be considered.

Construction services

9.47 Construction services will be discussed along the lines of *BPM5* para. 254, with a cross-reference to the distinction between when a contractor from abroad undertakes construction with a resident institutional unit and when construction services are treated as imported services. The section will explain the conditions for construction activity to give rise to a separate unit, discussed in Chapter 4 Economic Territory, Units, Institutional Sectors, and Residence.

9.48 The section will recommend classifying, to construction services, the expenditures by nonresident construction enterprises in the economy in which they are working, following *MSITS* para. 3.92. Thus, the standard components will be construction abroad and construction in the compiling economy.

Construction abroad comprises:

(a) construction services provided to nonresidents by enterprises resident in the compiling economy (credit); and
(b) the goods and services purchased in the host economy by these enterprises (debit).

Construction in the compiling economy comprises:

(a) construction services provided to residents of the compiling economy by nonresident construction enterprises (debit); and
(b) the goods and services purchased in the compiling economy by these nonresident enterprises (credit).

Insurance services

9.49 The treatment of non-life insurance services will be articulated. The manual will note that to calculate the value of insurance services, including reinsurance, the following formula will be used:

premiums earned
plus adjusted premium supplements
less adjusted claims.

These terms will be defined and elaborated. The Advisory Experts Group in National Accounts (AEG) agreed, in principle, with this approach for determining non-life insurance services.

9.50 The AEG also supported the proposal for a new treatment of reinsurance, where all reinsurance flows are treated on a gross basis and the same approach is followed as that used for direct insurance. The manual will incorporate further elaboration of the approach adopted in the update of *1993 SNA.* The manual will note that some aspects of the formula for calculating insurance services may be insignificant or impractical to measure for some economies. Because insurance involves services, property income, current transfers, and financial transactions, a comprehensive description will be given in an annex. It will be noted that financial reinsurance (finite risk insurance) is treated as a loan.

Financial services

9.51 In *BPM5*, financial services includes only those services that are explicitly charged. Coverage will be extended to include financial intermediation services indirectly measured (FISIM), consistent with the *1993 SNA* paras. 6.124–125 and as developed during the SNA Review (see *SNA News and Notes,* Issue 16, April 2003 for specific methods adopted by Eurostat).

> *[Comment: This change will bring about consistency with the national accounts, and give a fuller picture of this fast-growing aspect of international service provision.]*

9.52 In addition to explicit fees and FISIM, there are other potential extensions of the scope of financial services exist, for example buy/sell spreads that could be seen as similar to wholesalers' margins. Possible extensions to the scope of financial services are being considered by the OECD Task Force on Financial Services. The manual will adopt any of these extensions adopted by the ISWGNA.

9.53 The manual will note that FISIM and extensions to financial services are issues that may be insignificant or too difficult to measure for some economies. Calculation of FISIM involves corresponding adjustments to interest.

Franchise fees and payments for the use of proprietary rights

9.54 Franchise fees and payments for the use of proprietary rights will be explained along the lines of *BPM5* para. 260 and *MSITS* para. 3.121. It will include payments for the use of intangible nonproduced assets, such as patents, copyrights, and industrial processes and designs. That part of royalties and license fees that covers income receivable by a unit for putting nonproduced assets at the disposal of another unit should be classified as primary income—rent.

> *[Comment: The component will be renamed because the previous term "royalties" is also used to cover other types of payments, for example, as noted in the 1993 SNA para. 7.87.]*

9.55 This section will note that sales of the right to use nonproduced nonfinancial assets, or of the assets themselves, are included in the capital account. The issues may be clarified based on the work done by the Canberra II Group.

Other business services

9.56 The following components will be included:

(a) Merchanting and other trade-related services will be discussed along the lines of *BPM5* para. 262 and *MSITS* Box 6. A question was raised on the treatment of merchanting in Section C. 1, b above. It will be noted that wholesaling activity where the goods are present in the territory of the owner is recorded under goods and is not separately identified.

(b) Operational leasing services will be discussed along the lines of *MSITS* para. 3.125. They will be distinguished from financial leases.

(c) Legal, accounting, management consulting, and public relations will be discussed along the lines of *MSITS* paras. 3.126–128.

(d) Advertising, market research, and public opinion polling services will be discussed along the lines of *MSITS* para. 3.129. Call centers will be stated as being included under this item.

(e) Research and development will be discussed along the lines of *MSITS* para. 3.130.

(f) Architectural, engineering, and other technical services will be discussed along the lines of *MSITS* paras. 3.131–132.

(g) Agricultural, mining, and on-site processing will be discussed along the lines of *MSITS* para. 3.133. The borderline between on-site processing and goods for processing will be explained.

(h) Services between related enterprises n.i.e. will be discussed along the lines of *MSITS* para. 3.135.

(i) Other business services will be discussed along the lines of *MSITS* para. 3.134.

Personal, cultural, and recreational services

9.57 Audiovisual and related services will be discussed along the lines of *MSITS* para. 3.137. Clarification will be given to distinguish the coverage of this subcomponent from other personal, cultural, and recreational services.

9.58 Health services and education services will be discussed along the lines of *MSITS* para. 3.138. The manual will note that expenditure in the territory by students and patients who are classified as nonresidents should be included under travel, but not under personal, cultural, and recreational services (as in *BPM5* para. 244). Other services will be discussed along the lines of *MSITS* para. 3.138.

[Question: Is the breakdown of other personal, cultural, and recreational services in this way suitable?]

Government services n.i.e.

9.59 Government services n.i.e will be discussed along the lines of *BPM5* para. 266. The section will clarify the definition of government services n.i.e. to identify more clearly the types of activities that are included, in particular emphasizing the residual nature of this category. Accordingly, where possible, particular transactions should be classified to the appropriate goods and services components, and payments for rent of land (without buildings) should be included in primary income, not in services.

Other issues

9.60 This section will discuss various borderlines between:

(a) the provision of services and the provision of labor;

(b) a service and income—in particular, the contrast between putting a produced fixed asset at the disposal of another unit (a service) and putting a nonproduced asset at the disposal of another unit (income)—for example, in relation to the fee payable on securities lending and gold swaps (also noted in Chapter 10 Primary Distribution of Income Account); the work of the Technical Group on Reverse Transactions will be taken into account when the manual is drafted; and

(c) the acquisition of services (resulting from production) and requirement to pay taxes (not linked to the costs or amount of production but rather to the payment of a fee in order carry out an activity).

[Question: Are there any other borderlines between services and other items that should be mentioned?]

9.61 The section will note that the provision of technical assistance provided by an entity resident in the donor economy should be recorded as an export of a service of the economy of the resident of the donor, and the use of technical assistance should be recorded as an import of the service of the recipient economy. It will be noted that technical assistance covers a variety of different services and should be classified to appropriate types of service, such as legal and accounting services, research and development. It should not be automatically classified to government services, n.i.e., by default.

c. Timing

9.62 Following the economic principle, the time of recording of services transactions is the time at which the service is delivered. For services that are provided over a period of time, progress payments may be made (for example, for construction, architectural, or engineering services) so that a trade credit asset/liability is eliminated. Similarly, advance payments may be made by the purchaser of the output, which create a trade credit asset/liability. These would be recorded following normal accrual principles (see Chapter 3 Accounting Principles). It will be noted that there may be small timing differences between the provision of a service, on the one hand, and the time it is entered into the books of account of the relevant parties, on the other.

d. Valuation

9.63 Transactions will be valued at market prices, following the principles in Chapter V of *BPM5*, and Chapter 3 of *MSITS.* General principles are described in Chapter 3 Accounting Principles of this Annotated Outline, including those relating to transfer pricing.

Appendices:

Volume and price components

Links between the goods and services account and the tourism satellite account

Link between the services classification and that of the *Manual on Statistics of International Trade in Services*

Differences between IMTS and BOP

Bridge table between BOP services classification and CPC

Link between BOP and the four modes of supply as used in GATS (See *MSITS* paras. 2.72–2.101)

References

BPM5 ch. 9–13, App. 3

1993 SNA ch 6

International Merchandise Trade Statistics: Concepts and Definitions (*IMTS)*

International Merchandise Trade Statistics: Compilers Guide

Manual on Statistics of International Trade in Services (*MSITS*)

Eurostat "Allocation of Financial Intermediation Services Indirectly Measured (FISIM) in the European Union Countries" (*SNA News and Notes,* Issue 16, April 2003)

Changes from *BPM5*

(a) *Changes proposed*:

Goods procured in port by carriers will be included under goods rather than as a separate item (Table 9.1).

Show goods for processing abroad and in the compiling country separately (para. 9.16).

Repairs on goods will be recorded as services (para. 9.34).

Introduction of information technology services (four-way breakdown) to replace telecommunications services and computing services (para. 9.43).

Noncustomized ("off-the-shelf") goods delivered electronically will be classified as goods (para. 9.44).

The classification of expenditures by nonresident construction enterprises in the economy in which they are working to be changed to show separately construction abroad and construction in the compiling economy (para. 9.48).

The treatments of insurance services to be reviewed in line with the review of insurance transactions for the update of the *1993 SNA* (paras. 9.49–9.50).

FISIM will be introduced as a part of financial services while incorporating any further extensions agreed by the ISWGNA as a result of the work of the OECD Task Force on Financial Services (paras. 9.51–9.53).

Drop the term "royalties" because it is used to cover several types of payments, including rent. Use the term "franchise fees and payments for the use of proprietary rights" for payments for the use of intangible nonproduced assets (para 9.54).

More detail of personal, cultural, and recreational services will be provided (paras. 9.57–9.58).

(b) *Changes raised as an option*:

Separate data on related party trade in goods and services (para. 9.7).

Possibilities for dealing with re-exports separately from other exports (para. 9.12).

Review of treatment of goods for processing (para. 9.15).

Showing merchanting on a gross basis (para. 9.17).

Additional supplementary detail proposed for travel (paras. 9.35, 9.37).

Possible inclusion of international transport of passengers in travel (para. 9.36).

Reclassification of postal and/or courier services to other transport services (para. 9.43).

Glossary

business services
c.i.f.
Central Product Classification (CPC)
claims
communications services
computer services

consignment
construction services
FATS (Foreign Affiliates Trade in Services)
financial reinsurance (finite risk insurance)
financial lease (also finance lease)
financial services
FISIM (Financial intermediation services indirectly measured)
f.o.b.
free trade zones
general merchandise
good
goods for processing
goods procured in ports by carriers
government services
information provision services
information technology services
insurance (general, direct, life, nonlife)
intangible fixed asset
internet provider services
inventories
maintenance
merchandise
merchanting
nonmonetary gold
operating lease
personal, cultural, and recreational services
patent
premium supplements
re-exports
reinsurance
repair of goods
service
shuttle trade
telecommunications services
tourism satellite account
trade balance
transit trade
transport services
travel services
waste

Chapter 10. Primary Distribution of Income Account

A. Concept and Coverage

10.1 The purpose of the primary distribution of income account will be stated along the lines of the introduction to Chapter VII of the *1993 SNA*. The nature of the economic process of income generation and distribution will be outlined, along the lines of *1993 SNA* para. 7.2, and linked to gross national income. Then, the section will show the relationship of the primary income account and its balancing item to other international accounts. Primary income will be shown as the return for contributions to the production process and for provision of financial assets or renting tangible nonproduced assets to other units. Distribution of primary income will be contrasted with other economic processes, namely, production, secondary redistribution of income, and holding gains.

10.2 The manual will adopt the *1993 SNA* use of "primary income" for "income" in *BPM5* terminology. (Correspondingly, the *1993 SNA* uses "secondary income" for what are called "current transfers" in *BPM5*.)

[Question: Should the terminology be harmonized with the 1993 SNA?]

10.3 The manual will include an example to show the presentation of the primary income account, along the lines of Table 10.1.

Table 10.1 Overview of Primary Distribution of Income Account

	Credits	Debits
Balance of goods and services account		
Compensation of employees		
Investment income:		
Direct investment		
Direct investment abroad:		
Income on equity:		
Dividends, distributed branch profits		
Reinvested earnings		
Income on debt (interest)		
Long-term		
Short-term		
Claims on direct investors		
Income on equity: dividends		
Income on debt (interest)		
Long-term		
Short-term		
Direct investment in reporting economy:		
Income on equity:		
Dividends, distributed branch profits, and other income on equity		
Reinvested earnings		
Income on debt (interest)		
Long-term		
Short-term		
Liabilities to direct investment enterprises		
Income on equity: dividends		
Income on debt (interest)		
Long-term		
Short-term		
Portfolio investment:		
Income on equity (dividends)		
Income on debt (interest):		
Long-term		
Short-term		
Income on other instruments		
Other investment		
Income on equity (dividends and other income on equity) (if untraded equity moved from portfolio investment)		
Income on debt (interest) – by instrument		
Income on other instruments		

PRIMARY DISTRIBUTION OF INCOME ACCOUNT

	Credits	Debits
Reserve assets		
Other primary income: Rent Taxes on products and production Subsidies on products and production *Total income credits and debits* *Balance on primary income* *Balance on goods, services, and primary income*		

The debits on direct investment abroad and credits on direct investment in the reporting economy are caused by reverse investment.

10.4 The presentation will be compatible with that for the financial account and international investment position in terms of detail. This will facilitate analysis of rates of return. Some presentational changes from *BPM5* will be incorporated. Income on reserve assets will be shown separately from income on other investment. This presentation will mean that there is consistency between income and the corresponding financial flows and positions. Rent will be shown separately so that it is not confused with returns on financial assets. Property income attributed to insurance policyholders and pension fund beneficiaries will be shown as a separate item, if relevant.

> *[Question: BPM5 uses the term "investment income" as a synonym for "property income" in the 1993 SNA. The new manual will clarify this term as being limited to income from financial assets. Is this suitable?]*

B. Scope and Characteristics

10.5 This section will outline the components of income and how they each represent returns to different economic contributions:

(a) Compensation of employees (return to labor);
(b) Dividends and reinvested earnings (return to equity finance);
(c) Interest (return on debt finance); and
(d) Rent (return on nonproduced nonfinancial assets).

It will then discuss each component in more detail.

1. Compensation of employees

10.6 Compensation of employees will be defined as amounts receivable/payable in return for the supply of labor, as discussed in *BPM5* paras. 269–272 and *1993 SNA* paras. 7.21–7.47. The linkage to the residence of the employer and employee (Chapter 4, Economic Territory, Units, Institutional Sectors and Residence) will be referenced. The section will deal with the borderline between service contracts and employment.

10.7 There will also be discussion of supplements to wages and salaries, such as pension contributions and benefits in kind. There will be a mention that the employees who are employed outside their economy of residence may have expenditure in their economy of employment in travel (Chapter 9 Goods and Services Account) and be subject to the payment of income taxes (Chapter 11 Secondary Distribution of Income Account). The manual will take into account any change in the treatment of unfunded pension schemes that is made to the *1993 SNA*, to recognize the accrual of unfunded obligations with consequent effects in the primary distribution of income and financial accounts.

10.8 Benefits in kind will be discussed, that is, compensation of employees in the form of goods, accommodation, other services, shares, etc., rather than as financial payment. The principle will be given that these benefits should be valued at the market equivalent price. It will be noted that to give a consistent and economically meaningful way of recording benefits in kind, there may be "rerouting." That is, although the benefits are purchased by the employer, the benefits are treated as if the employer paid the amount of the benefit to the employee who, in turn, acquired the item. The rerouting may affect the resident-to-nonresident nature of the transaction.

10.9 Employee stock options are an example of a benefit in kind. The treatment of employee stock options in terms of valuation and classification will be stated.

2. Dividends, distributed branch profits, and other income on equity

10.10 The concept of dividends will be explained, following *BPM5* and the *1993 SNA* paras. 7.112–7.118. The concept will be linked to the instrument classification. In addition to dividends from corporations, all income arising from equity should be included under this heading, including from quasicorporations (unincorporated branches, unincorporated joint ventures), mutual funds, trusts, income accruing to partnerships, and sole proprietorships. However, since equity in insurance and pension funds does not give rise to dividends, it is classified as income on other instruments.

10.11 The timing principle for dividends will be set out, that is, that dividends are recorded at the time they are declared payable, as in *1993 SNA* para. 3.99 (which could differ slightly from "the date payable" in *BPM5* para. 282).

10.12 It will be noted that income on mutual funds is to be recorded as dividends, even when some or all of the mutual fund's income is derived from debt instruments. This treatment will be explained as based on the nature of the ownership by the mutual fund investors, that is, as equity.

10.13 Income attributed to insurance policyholders and beneficiaries of funded pension schemes will be explained. This item will also be required as a supplementary item for national accounts purposes, as in *BPM5*.

10.14 Treatment of unfunded pension schemes will be covered, in accordance with the results of discussions currently under way (including through an electronic discussion group operated by the Fund).

10.15 Income that is retained by mutual funds could be attributed to unitholders or shareholders (consistent with *ESA95* paras. 4.49(b) and 4.54(b)) or not (consistent with *BPM5* and the *1993 SNA*).

> *[Question: Should retained earnings of mutual funds be treated as other collective investment schemes, or is there some reason to make a distinction?]*

10.16 There will be a section on stock dividends, bonus shares, and liquidating payments. These will be explained and treatments given, consistent with *BPM5* para. 290:

(a) stock dividends, that is, where the stockholder elects to receive payment of dividends in the form of issue of new shares. These arrangements are treated as income payable (in the primary distribution of income account), which is then immediately reinvested (in the financial account);

(b) issue of bonus shares, that is, where new shares are issued to all stockholders in proportion to existing ownership. These arrangements are treated as not being transactions because no resources change hands; and

(c) liquidating dividends, whether partial or total, on the termination of a company. These are treated as a withdrawal of investment, shown in the financial account, as a convention based on the assumption that liquidation dividends are more likely to involve previously existing equity rather than current income.

> *[Question: Is there any need to change any of these treatments or mention any other special cases of dividends?]*

10.17 Issues specific to reinvested earnings will be dealt with in detail under direct investment (in this chapter ahead).

3. Interest in general

10.18 The concept of interest will be explained, following *1993 SNA* para. 7.93. The concept will be linked to the instrument classification. It will be noted that interest accrues continuously (with a cross-reference to Chapter 3 Accounting Principles) and that it is capitalized as a part of the financial instrument. No entry is made for interest not yet accrued (as in *BPM5* para. 532).

10.19 It will be noted that interest payable to or receivable from a financial intermediary is designed to allow a margin to cover the costs, bad debts, and operating surplus of the intermediary. The treatment of this margin (FISIM) and its measurement will be dealt with in Chapter 9 Goods and Services Account. Consequent to the treatment there, this chapter will note that if FISIM is included in services, then interest payable to a financial intermediary will have a service charge subtracted to give the pure investment income component, with the comparable adjustment to the interest receivable by the financial institution. (Splitting a transaction into interest and service components is an example of "partitioning.") Similarly, interest receivable from a financial intermediary is seen as having had a service charge already deducted, so the interest receivable will be increased by the value of the service received. There will be a cross-reference to Chapter 9 Goods and Services Account for the derivation of FISIM from the reference rate.

10.20 The manual will discuss the treatment of indexed-linked debts where principal and/or interest payments are adjusted on the basis of a price index or other indicators, or exchange rate. Such adjustments are treated as interest in the *1993 SNA* para 7.104 and *BPM5* para. 397. The manual will recommend that for debt instruments with both principal and coupons indexed to a foreign currency, the change in principal in domestic currency terms that arises from a change in the exchange rate should be shown as a revaluation. At the same time, the effect of changes in the exchange rate on the amount of accrued interest expressed in domestic currency is to be included in interest.

10.21 The manual will clarify the calculation of interest for other index-linked debt instruments in view of the inadequate guidance given in the existing statistical manuals.

4. Interest on debt securities

10.22 As interest accrues continually over the life of the debt and is added to the principal, it will be noted that payments (such as coupons) are financial account transactions for the instrument concerned and do not represent "interest."

10.23 The section will explain premiums and discounts on issue of debt securities, including deep discount and zero coupon bonds. An example of calculating interest, to take into account premiums and discounts, will be given, along the lines of *BOP Compilation Guide* Table 16.5.

10.24 The section will briefly introduce the issues associated with measuring interest on securities that cover more than one period. The manual will outline the alternatives, viz., implicit rate on issue (often called the "debtor approach"), current market yield to maturity (often called the "creditor approach"), and acquisition approaches. A numerical example will be given and papers on the issue cited. The implications for the other changes account will also be noted. As agreed by the Advisory Experts Group on National Accounts (AEG) in its February 2004 meeting, the manual will state that interest is recorded following the debtor approach, as embedded in the *1993 SNA*. In view of this decision, it may be useful to provide data according to the creditor approach as memorandum or supplementary items.

> *[Question: Should data on interest according to the creditor approach be included either as memorandum or supplementary item?]*

5. Accrual of interest on impaired loans

10.25 The valuation of interest accrued on impaired loans will be discussed. The treatment will be linked to the treatment of the principal and nonperforming loans and bonds (to be discussed in Chapter 6 International Investment Position). Like the principal, the interest remains a legal liability of the debtor, so interest should continue to be accrued unless the liability has been legally extinguished (i.e., by repayment, or after winding up of the debtor due to bankruptcy, or other write-off). However, for some analysis, it may be more useful to exclude, from primary income measures, interest that is not realistically expected to be collected. It will, therefore, be proposed that a memorandum item for these components could be shown when they are significant and quantifiable. As methods of quantification of expected losses differ, it will be emphasized that metadata should provide information on the method adopted.

> *[Question: Is this approach to interest suitable?]*

10.26 The liability for interest when guarantees are activated will be addressed. There will be guidance on when the interest switches from accruing to the original debtor to accruing to the guarantor.

6. Interest on financial leases

10.27 It will be noted that the implication of treating financial leases as a loan is that interest accrues on the loan. There will be a cross-reference to the appendix to the manual on financial leases, which will bring together the goods, services, income, and loan transactions and positions as they related to financial leasing and provide an example of the calculation of the interest component.

7. Rent

10.28 Rent will be defined as covering income receivable for putting tangible nonproduced assets at the disposal of another unit. Examples will be given including rent of land, fishing rights, grazing rights, mining rights. In addition, putting intangible assets at the disposal of another unit, such as internet domain names, would be rent, except in the case of intangible assets associated with research and development (which are included in services). Payments for the combined use of land and buildings will be mentioned as being classified as a service, so they are excluded from rent and included as rentals under services. It will be noted that payment or receipt by government of rent of land without buildings (e.g., for military bases) should be shown as rent, not as government services n.i.e.

10.29 The manual will discuss the distinction between rent arrangements and cases where some ownership of the asset is transferred (e.g., a ten-year fishing right would convey ownership of an asset and would be shown in the capital account, while a six-month fishing right would be rent). Criteria that assist in distinguishing capital and current arrangements will be given—cancellability, demonstrable value, risk of holding gains or losses, transferability, length of license (given in Dippelsman and Maehle)—while recognizing that the delineation is difficult.

10.30 The manual will note that notional direct investment enterprises created for holdings of land and long-term leases will normally generate rent (or rental services if there is a building on the land). When the land or buildings are used by their owners (who are nonresidents), an imputation for rent or rental services (credit entries) would be necessary, if considered significant (e.g., in territories that had a large number of vacation homes owned by nonresident households). The income from direct investment is treated as income from financial assets.

8. Taxes and subsidies on products and production

10.31 Taxes and subsidies on products and production will be included in the primary distribution of income account to be consistent with the *1993 SNA*. (Taxes on income and wealth are included in the secondary distribution of income account.) *BPM5* included all taxes as current transfers. At present, cross-border taxes and subsidies on products and production do not appear to be significant but may occur in economic unions. They would arise if an international or regional organization levied its own taxes or paid subsidies (which are believed to be done through national governments in all cases at present), and if there was cross-border activity that was insufficient to constitute a branch (so the values are likely to be relatively small and difficult to measure).

10.32 However, this treatment will be included in case the situation arises—to maintain the conceptual consistency with the *1993 SNA* and to ensure the equality between the primary income account balance and the difference between GDP and gross national income. If they exist, subsidies would be shown separately from taxes, rather than netted off taxes.

10.33 In some cases, an exporter of a good contractually agrees to pay import duties. In such cases, the duties are outside the scope of the primary distribution of income account. The payment of duties is treated as an obligation of the importer, with the amount of duties treated as a reduction in the f.o.b. value of the goods. Similarly, if an importer agrees to pay export taxes, the tax is still an obligation of the exporter, with the amount of the tax treated as an increase in the f.o.b. value of the goods. (Chapter 9 Goods and Services Account deals with this issue under valuation.)

[Question: Are these proposals suitable?]

9. Other primary income

10.34 It will be noted that ownership of financial derivatives does not give rise to interest or any other kind of income.

10.35 The treatment of revenue from lending of securities and gold and other valuables (whether a service or a primary income) has yet to be determined. The recommendations of the Technical Group on Reverse Transactions will be incorporated into the new manual (following discussions with BOPCOM, the ISWGNA, and other interested groups.)

[Question: Are there other possible issues under primary income that could be mentioned here?]

10. Issues specific to direct investment

10.36 There will be a cross-reference to Chapter 5 Classifications, where direct investment relationships are defined. This section will note that direct investment gives rise to dividends, distributed branch profits, and interest. Direct investment income is limited to income from financial assets. (Mixed income is potentially included, but the rare cases of other income such as compensation of employees and rent are excluded from direct investment income.) The general principles for income on direct investment are the same as those already described for income earlier in this chapter. In addition, this section will deal with the following issues concerning income that are specific to direct investment, namely, reinvested earnings, income flows on reverse investment, and transfer pricing.

[Comment: The classification of interest on nonpermanent debt between financial intermediaries, and income on mutual funds, pension, and insurance technical reserves, etc. in a direct investment relationship is discussed under Chapter 5 Classifications.]

a. Reinvested earnings

10.37 This section will introduce the concept of the imputation of reinvested earnings as an income flow and the imputed counterpart flow as reinvestment in the financial account. It will be noted that it is proposed in Chapter 7 Financial Account to rename the counterpart entry in the financial account as “reinvestment of earnings.” This section will give the rationale for the imputation of reinvested earnings.

[*Comment: Reasons for the imputation are as stated in 1993 SNA para. 7.121.]*

10.38 In the *1993 SNA*, retained earnings of an entity are generally treated as the income and savings of that entity, rather than its owners. However, exceptions are made for life insurance companies, pension funds, and foreign direct investment enterprises, where there is an imputed income flow to the policyholders, beneficiaries, and owners, with an equal financial account flow. The BOPCOM-03/25 discusses inconsistencies between treatments of different kinds of income. In particular, it was noted that retained earnings are attributed to owners of insurance and pension fund technical reserves but not mutual fund holders. It also noted that the relationship between dividends and income was equivocal, for example, that dividends could be paid even if there were losses or be payable out of holding gains, and there was no clear distinction between dividends and withdrawals of equity. The paper considered a number of changes to the concept of income and raised a question on the imputation of a transaction for reinvested earnings. The AEG, in its February 2004 meeting noted that no sufficient new circumstances warrant a review of the current treatment of reinvested earnings on direct investment and decided against including this issue in the agenda for the update of the *1993 SNA*. It favored keeping the current treatment for imputing transactions (income and financial) for foreign direct investment.

10.39 The measurement of reinvested earnings will be described, referring to equivalent national accounting concepts, as shown in *1993 SNA* para. 7.122, *BPM5* para. 278, and *BPT* para. 411. Reinvested earnings will be explained as the direct investor's share of the direct investment enterprise’s saving, before deducting reinvested earnings. The measurement principles for reinvested earnings will be the same as *BPM5* paras. 278 and 285–289, *BPT* paras. 408–412, and *BOP Compilation Guide* paras. 602–613. The explanation in the manual will be more detailed than in *BPM5* but will focus on principles, rather than data sources as in the *Compilation Guide*. There will be a discussion of how profits and other proxies may differ from the concept (without going far into the data issues). In addition to what was included in *BPM5*, there will be a minor correction to *BPM5* para. 285 to treat research and development costs as an expense. Moreover, it will be stated that debt amortization, unlike debt interest, is not taken into account in deriving reinvested earnings.

10.40 The terms “reinvested earnings” and “reinvested earnings and undistributed branch profits” are both used in *BPM5*. The former is adopted here, because the term “reinvested earnings” is considered to be fully applicable to branches. In contrast, the expression “dividends and distributed branch profits” is considered appropriate, in that dividends are not applicable in the case of branches.

10.41 It will be noted that reinvested earnings can be negative when the direct investment enterprise makes a loss on its operations. In such cases, the negative entries will be shown as an offset to the positive entries. That is, if direct investment abroad generates negative earnings, then the entry is shown as a negative income credit, not as a debit. While this is the converse of positive earnings, the recording of negative earnings and disinvestment in the enterprise does not fit well with the rationale for reinvested earnings in terms of the direct investor’s influence over the decision to pay dividends or not.

[Question: (i) Should negative reinvested earnings be recorded as an imputed transaction of negative income and disinvestment? (ii) If so, what is the rationale?]

10.42 The treatment of reinvested earnings in situations of chains of direct investment relationships will be stated, consequential to the decisions made under Chapter 5 Classifications.

(a) If the decision were made to limit the direct investment relationship to direct ownership only, reinvested earnings would be limited to the first level.
(b) If the decision were made to continue to recognize indirect holding of direct investment, the options for the imputation of reinvested earnings would be either:
  (i) limited to directly held interests; or
  (ii) paid and received up through each link in the chain.

An example will be used to illustrate the measurement of reinvested earnings, built on the corresponding example of the identification of direct investment relationships given in Chapter 5 Classifications.

[Questions: (i) In chains of direct investment, how should reinvested earnings be imputed? (ii) Should the first-level approach be adopted simply for practical reasons? (iii) What should happen for reinvested earnings where both the relevant enterprises are in the same territory or if two of the enterprises in a chain of ownership are in the same territory?]

10.43 The basis for calculation of reinvested earnings measured in another currency will be stated. Using accrual principles, the earnings should be converted at the exchange rate at the time they were earned. In practice, it is usual that average exchange rates for the whole period to which earnings relate will be used. To the extent that exchange rates change, the approximation will be better if calculations are made for shorter periods, for example, a better annual estimate would be derived from the four component quarters each converted at their own exchange rate.

b. Income flows on reverse investment

10.44 The treatment of income associated with reverse investment will be stated. Reverse investment will be defined in Chapter 5 Classifications.

(a) If Enterprise B has 10 percent or more of the ordinary shares or voting power in Enterprise A, then an additional direct investment relationship is recognized. That is, Enterprise B is both a direct investment enterprise of Enterprise A and a direct investor in Enterprise A. In that case, any resulting income payable and reinvested earnings are shown according to the direction of the direct investment relationship (e.g., income payable by Enterprise A to Enterprise B is shown in Territory X balance of payments as an income debit under direct investment in the reporting economy).

(b) If Enterprise B has less than 10 percent of the ordinary shares or voting power in Enterprise A, then there is no additional direct investment relationship. Under *BPM5,* the flows are recorded under the heading of the original relationship and so are netted off income in the other direction (e.g., income payable by Enterprise A to Enterprise B is shown in Territory X balance of payments as a negative income credit under direct investment abroad). It is proposed that the new manual will show separately the income on reverse investment, in the format shown in Table 5.3 of Chapter 5 Classifications (i.e., under "direct investment in the reporting economy" under assets; and "direct investment abroad" under liabilities). Both the income on claims on direct investors and income on liabilities to direct investment enterprises will have a breakdown of "income on equity: dividends" and "income on debt." Reinvested earnings are not imputed to the direct investment enterprise in this case because the 10 percent threshold has not been met.

[Comment: The gross recording is proposed to be consistent with the general principle of using gross data in the current account; to bring about comparability with the corresponding positions data; and to produce a more consistent effect on total income flows whether or not the reverse investment was just under or over the 10 percent threshold.]

[Question: Is the proposed treatment suitable?]

c. Transfer pricing

10.45 Transfer pricing is usually associated with shifting resources between related enterprises, so it relates to direct investment income measures. Examples will be given of the provision of goods and services free, or at understated or overstated values, or employee stock options provided to employees of a subsidiary at no charge to the subsidiary. The section will state that in the relatively rare cases where transfer pricing is identified and quantified, the relevant entry should be adjusted to an arm's length value. (See Chapter 3 Accounting Principles on valuation issues.) In addition to the adjustment to the flow itself, there should be a consequent counterpart entry, as stated below:

(a) If a direct investment enterprise is overinvoiced on a good or service provided by the direct investor; or

(b) If a direct investor is underinvoiced on a good or service provided by the direct investment enterprise;

then the transfer pricing acts as a hidden dividend from the direct investment enterprise, so dividends should be increased.

(c) If a direct investment enterprise is underinvoiced on a good or service provided by the direct investor; or

(d) If a direct investor is overinvoiced on a good or service provided by the direct investment enterprise;

then the transfer pricing acts as a hidden investment in the direct investment enterprise, so direct investment equity flows should be increased.

(It will be noted that the adjustments should also be made in a corresponding way in the national accounts and the counterpart economic territories. Reinvested earnings should also be adjusted.)

[Question: Are these treatments correct?]

Appendices:

Alternative concept of interest excluding inflation component of interest (See Hill, Handbook for High Inflation Countries)

Alternative income concepts: Imputation of reinvested earnings in all cases, inclusion of holding gains.

References

BPM5 ch 14

BPT ch 6

BOP Compilation Guide chapter 13

1993 SNA ch 7

Benchmark Definition of FDI

IMF, *The Fully Consolidated System*, paper presented at OECD Workshop on International Investment, March 2003

Australian Bureau of Statistics, *Income from Bonds: The 1993 SNA Approach*, BOPCOM-02/45

Banque de France, *Reinvested Earnings—The French Experience*, BOPCOM98/1/17

Banque de France, *The Estimate of Reinvested Earnings*, BOPCOM-02/31

A. Bertrand, *Calculating the Accrual of Interest on Tradable Debt Securities*, BOPCOM-01/11

R. Dippelsman and N. Maehle, *Treatment of Mobile Phone Licenses in the National Accounts,* IMF Working Paper 01/72

ECB, *The Statistical Treatment of Income Accruing on Securities Lending and Reversible Gold Transactions*, 2003

IMF, *Accrual Accounting Of Interest Electronic Discussion Group: Report Of The Moderator*, BOPCOM-02/44

IMF, *Accrual Recording of Interest: Is there a Case for Revising the 1993 SNA?*, BOPCOM-02/44-A

IMF, *Differences in the Treatment in Macroeconomic Statistical Standards of Retained Earnings/Savings of Entities in Various Economic Relationships*, BOPCOM-03/25

IMF, *Employee Stock Options in Balance of Payments Statistics*, BOPCOM-02/69

L. Laliberté, *Foreign Portfolio Investment in Canadian Bonds*, CBOPWP/97/01

National Bank of Belgium, *Retained Earnings of Mutual Funds*, BOPCOM-01/31

National Bank of Belgium, *Income of Mutual Funds*, BOPCOM-02/41

R. Tremblay, *Calculation of Position and Interest on Canadian Bonds Held by Non-Residents*, CBOPWP97/03

Changes from *BPM5*:

(a) *Changes proposed:*

Income on other investment and reserve assets will be shown separately (Table 10.1).

Income to be renamed to "primary income" to be consistent with the *1993 SNA*; the meaning of "investment income" will be clarified (para. 10.2).

Investment income will be presented in a consistent format with the corresponding financial account transactions and positions (para. 10.4).

Rent will be included explicitly as a primary income item. It was not discussed but implicitly included in investment income under "other investment" in *BPM5* (paras. 10.4 and 10.28).

Changes for pension schemes to maintain consistency with the national accounts (para. 10.7).

The timing basis for dividends will be changed from "payable" to "declared payable" (para. 10.11).

Interest income would be adjusted to remove the FISIM component (para. 10.19).

Debt instruments with both interest and principal indexed to a foreign currency will be classified and treated as if they are denominated in foreign currency (para. 10.20).

Clarification on the calculation of interest for index-linked instruments will be given (para. 10.21).

Taxes on products and production, if any, would be included as primary distribution of income (para. 10.31).

The definition of reinvested earnings would be modified slightly (para. 10.39).

Income flows arising from reverse investment where the direct investment enterprise owns less than 10 percent of its direct investor are to be recorded on a gross, rather than net, basis (para. 10.44).

(b) *Changes raised as an option:*

The possibility is raised of treatment of retained earnings of mutual funds in the same way as direct investment reinvested earnings and income on insurance technical reserves (para. 10.15).

Taxes and subsidies on products and production could be included under income to be consistent with the *1993 SNA* (para. 10.31).

The method of recording reinvested earnings could be amended to eliminate multiple counting at a global level in instances of extended chains of ownership (para. 10.42).

Glossary

Benefits in kind
Bonus shares
Compensation of employees
Consumption of fixed capital
Coupon (contrasted with accrued interest)
Debt amortization
Deep discount bonds
Discounts on issue of bonds
Distributed branch profits
Dividends
Employee stock options
Financial leases
FISIM
Income on insurance technical reserves attributed to policyholders
Insurance technical reserves
Interest (accrued contrasted with coupon; observed contrasted with partitioned, i.e., net of FISIM)
Investment income
Mixed income
Nonperforming loans
Nonproduced asset
Operating lease
Operating surplus (gross, net)
Partitioning

PRIMARY DISTRIBUTION OF INCOME ACCOUNT

Premiums on issue of bonds
Primary income
Property income
Quasicorporations
Reinvested earnings
Rent (contrast with rental)
Rerouting
Retained earnings
Reverse investment
Royalties (note: can be service or rent)
Stock dividends
Subsidies
Taxes on products and production
Transfer pricing
Zero coupon bonds

Chapter 11. Secondary Distribution of Income Account

A. Concept and Coverage

11.1 This section will introduce the function of this account, that is, to show the contribution of transactions between residents and nonresidents to the secondary redistribution of the income account in the *1993 SNA*. (In *BPM5,* this account was labeled as "current transfers." Note the issue of terminology raised in Chapter 10 Primary Distribution of Income Account. "Current transfers" is also used in the *1993 SNA* terminology for the components of this account, but the title "secondary redistribution of income" emphasizes transfers in their role in the process of income distribution).

11.2 The section will describe a broad definition of the flows covered in this account:

(a) in the context of the balance of payments, the links to other accounts in the balance of payments; and,

(b) in the context of the *1993 SNA*, the links to the other sectors of the domestic economy.

It will also note where transactions are imputed in cases of current transfers in kind. It will contrast the different economic roles and meaning of primary distribution of income with secondary distribution of income. It will note that current transfers affect disposable income and, hence, the current account balance, but capital transfers do not.

11.3 This chapter will include an illustrative presentation of the secondary distribution of income account.

Table 11.1. Overview of Secondary Distribution of Income Account

	Credits	Debits
Balance on goods, services and primary income		
Current taxes on income, wealth, etc.		
Social contributions		
General government		
Other		
Social benefits		
General government		
Other		
Net nonlife insurance premiums		
Nonlife insurance claims		
Current international cooperation		
Workers' remittances		
Other current transfers		
General government		
Other		
Total current transfers credits and debits		
Balance on secondary distribution of income		
Current account balance		

B. Scope and Characteristics

11.4 This section will define transfers in more detail (citing *BPM5* paras. 291–294 and *1993 SNA* para. 8.27), contrasting transfers with other types of transactions.

11.5 The manual will state the distinction between current and capital transfers, that is, that capital transfers are linked to acquiring of an asset or forgiving a liability. It will then discuss the distinction between current and capital transfers in more detail, as in *BPM5* para. 295 and *1993 SNA* paras. 8.31–8.33, and give examples of the most common types of current transfers. To avoid duplication, the current/capital split will be discussed at length primarily in this chapter, with a brief introduction and cross-reference in Chapter 12 Capital Account.

11.6 The manual will set out a more detailed classification of current transfers than in *BPM5*, on the basis of the *1993 SNA*. See the illustrative presentation for details.

11.7 This section will also set out the distinction between taxes and charges for government services, which will clarify para. 300 in *BPM5*.

11.8 Different types of current transfers will be discussed:

(a) Current taxes on income, wealth, etc. Current taxes on income and wealth will be discussed in somewhat more detail than in *BPM5* paras. 299-300, consistent with, but shorter than, *1993 SNA* paras. 8.43–8.54 and *GFSM 2001* paras. 5.54–5.59 and 5.99. This section will describe types of taxes, fees, and fines that will be included in this item. Inheritance taxes will be treated as capital transfers, following *1993 SNA* para. 8.33. The distinction between taxes and payments in return for services provided by governments will be stated, as in *1993 SNA* para. 8.45, noting that both may be called “fees.”

(b) Social insurance contributions and benefits. This component will be defined. It will be recognized that this item may be immaterial in many cases but may be important in a few economies where a significant number of residents have or had employment in another economy. The *1993 SNA* treatment is complex because it is designed to treat social insurance scheme transactions simultaneously as income distribution and financial transactions. *BPM5* included payments associated with unfunded schemes as current transfers, but other cases as financial account transactions.

(c) Nonlife insurance net premiums, nonlife insurance claims. The treatment of nonlife insurance services as agreed by the Advisory Experts Group in National Accounts (AEG) in its February 2004 meeting is discussed in Chapter 9 Goods and Services Account, Section C.2. The treatment of the transfer portion of nonlife insurance net premiums and claims will be consistent with the proposed treatment for the review of the *1993 SNA*. It is proposed that reinsurance net premiums and claims be treated in the same manner as nonlife insurance net premiums and claims. In *BPM5*, there were no transfers for reinsurance.

(d) Current international cooperation. This component will be shown separately and defined as in the *1993 SNA* para. 8.92. When goods and services acquired from market producers are provided to governments or other entities by international organizations, other governments, or nonprofit institutions serving households, without charge to the recipient, they should be valued at the market prices, that is, the prices paid by the purchasers. When transfer in-kind involves goods and services produced by international organizations, other governments, or nonprofit institutions serving households, the valuation will be based on cost of production, consistent with the valuation of services produced by general government and nonprofit institutions serving households. The manual will also provide guidance on how technical assistance is treated. It will be stated that in accordance with the treatment of grants for capital projects (*BPM5 Textbook* para. 442), technical assistance that is tied to or part of capital projects is classified as capital transfers. For other technical assistance, the cost of the assistance should be shown as “other current transfers” to the government or other entities in the recipient territory. (There will usually be consequential imports of services, as discussed in Chapter 9 Goods and Services Account.) This rerouting is adopted in *BPM5* para. 69 and *1993 SNA* para. 14.18 (less explicitly recognized in *GFSM* para. 5.77). OECD DAC Reporting Statistical Directives will be referred to in order to distinguish between current and capital transfers.

[Question: Is the above clarification of technical assistance appropriate? Should any further guidance be provided on the treatment of technical assistance?]

(e) Concessional interest rates. Loans with concessional interest rates could be seen as providing a current transfer equal to the difference between the actual interest and the market equivalent. If such a transfer were recognized, it would usually be recorded as current international cooperation, and the interest recorded would be adjusted by the same amount. At present, the concessional element is not recognized. However, commercial situations are different in that concessional interest rates may be used to encourage the purchase of the goods, and so should not be treated in the same way.

[Questions: Should concessional interest be recognized as a transfer? Alternatively, would a memorandum item be sufficient recognition?]

(f) Workers' remittances. These will be discussed, as per *BPT* paras. 430–433. The connection to the residence status of the person concerned will be highlighted, as in *BPM5* para. 302 and *BPT* para. 435. The manual will clarify borderlines between workers' remittances and other types of transactions that involve financing by workers resident abroad. The situation of joint accounts mentioned in Chapter 4 Economic Territory, Units, Institutional Sectors, and Residence can arise with workers resident abroad who have joint accounts with relatives in their home countries. In this case, a convention may be needed to identify when international transactions are made through the account.

(g) Other transfers:

i. Gambling. It will be noted that gambling losses and winnings, net of the service charge, will be included here.

ii. Gifts and donations. It will be noted that gifts and donations not included elsewhere will be included here. However, it will be noted that membership dues and subscription to nonprofit institutions are to be treated as payments for services.

iii. Subscriptions to international and regional organizations. These could be current transfers, capital transfers, services, or financial account transactions, depending on what is provided in return.

iv. Alimony and compensation for torts and nonfulfillment of contracts will be included, as in *1993 SNA* para. 8.98. However, early or late repayment penalties agreed as part of the original contract will be included along with the associated good or service. For example, a penalty imposed by a bank for early withdrawal of a term is a fee for financial services.

11.9 The manual will note that, while standard components will show the institutional sector of recipient (for credits) and sector of provider (for debits) a full institutional sector split should be collected for other purposes. In some cases, compilers may be interested in compiling data classified by sector of provider for credits and sector of recipient for debits.

11.10 For economies that are major recipients of assistance, the manual will suggest that it would be desirable to show current and capital transfers with consistent classifications to allow them to be compared.

C. Timing

11.11 The manual will describe the time of recording for current transfers, with reference to the discussion of general principles in Chapter 3 Accounting Principles.

D. Valuation Principles

11.12 The valuation issues for current transfers provided in kind will be noted, with reference to the discussion of general principles in Chapter 3 Accounting Principles.

SECONDARY DISTRIBUTION OF INCOME ACCOUNT

References

BPM5 ch 15

1993 SNA ch 8

BPT ch 7

GFSM ch 5

Changes from *BPM5*

(a) *Changes proposed*:

More detailed classification, taken from *1993 SNA* (para. 11.6).

(b) *Changes raised as an option*:

Clarification on technical assistance as a part of investment projects to be classified as capital transfers (para. 11.8(d)).

Treatment of concessional interest rates as a current transfer (para. 11.8(e)).

Glossary

Current international cooperation
Net insurance premiums
Social contributions
Social benefits
Transfers in cash
Transfers in kind
Workers' remittances

Chapter 12. Capital Account

A. Concept and Coverage

12.1 This section will introduce the function of this account, that is, to show the process of accumulation (other than of financial assets/liabilities) and capital transfers. The capital account in the *1993 SNA* shows how savings is used to finance accumulation of nonfinancial assets and how capital transfers are made to fund acquisition of assets or forgive liabilities. In the case of international accounts, the capital account does not cover the accumulation of nonfinancial produced assets. Instead, it covers the acquisition and disposal of nonfinancial nonproduced assets and other capital transfers, notably the forgiveness of debt. This section will contrast accumulation with other economic processes. The section will state the meaning of the balancing item to this account, and the cumulative balance of the current and capital accounts, namely, the net lending by the total economy (the net borrowing by the rest of the world); or the net borrowing by the total economy (the net lending by the rest of the world).

12.2 The section will show the relationship of the capital account, and its balancing item, to other international accounts. It will note that transactions in fixed capital and valuables appear in the goods and services account in the international accounts and that transactions in financial assets and liabilities appear in the financial account.

12.3 This section will also discuss the relationship of the capital account to the *1993 SNA*. (The capital account plays an important role in relation to the *1993 SNA* balance sheets. International flows of nonfinancial assets change national balance sheets but not IIP, because only financial assets can have cross-border elements.)

12.4 A table will show the components and layout of the capital account with a numerical example, similar to the following table.

Table 12.1. Overview of Capital Account

	Credits	Debits
Current account balance		
Acquisitions (DR.)/disposals (CR.) of nonfinancial nonproduced assets		
Land and other tangible nonproduced assets		
Intangible nonproduced assets		
Capital transfers		
General government		
Debt forgiveness		
Other		
Other sectors		
Debt forgiveness		
Other		
Capital account balance		
Net lending/borrowing		

B. Scope and Characteristics

1. Transactions in nonfinancial nonproduced assets

12.5 This section will define nonfinancial nonproduced assets and give examples (land, patents, leases, and licenses). It will note cases outside this category, for example, computer software and artistic originals are included in goods and services.

12.6 In connection with land and subsoil assets, this section will explain the guideline of imputation of a resident (direct investment) unit to own immovable assets, which prevents most of these purchases from being international transactions. However, there are a few cases where land changes economic territory as a result of a transaction, namely., sale of land for an embassy or military base, and voluntary transfer of sovereignty over a particular area. It will be explained that in those cases, the value of any associated buildings and equipment would be shown separately in the goods and services account. (Cases where the transfer occurs for other reasons, such as a seizure, would be classified as other changes in the volume of assets.)

12.7 Other nonproduced intangible assets include leases, transferable contracts, licenses, patents, and internet domain names. The borderline issues between a current right to use (a service or property income) and when the right to use becomes an asset will be discussed, along the lines of Dippelsman and Maehle. Length of the right and cancellability are among the most important factors to be considered.

[Question: Should the treatment of land also be extended to acquisition of interests in land through long-term leases? And should it be extended to related interests such as rights to extract minerals from the land or fish from the sea?]

2. Capital transfers

12.8 This section will define transfers in more detail (citing *BPM5* paras. 344–345 and *1993 SNA* paras. 8.27), contrasting transfers with other types of transactions. It will then state the distinction between current and capital transfers, namely, that capital transfers are linked acquiring an asset or forgiving of a liability. It will give criteria for making the distinction based on *1993 SNA* paras. 8.31–8.33 and *BPM5* para. 295. It will note that only current transfers affect income. Examples of different kinds of transfers will be given. The case of transfers viewed as current by one party and capital by the other party will be discussed.

12.9 To avoid duplication, the current/capital split for transfers will be dealt with at greater length in Chapter 11 Secondary Distribution of Income Account, with a brief introduction and cross-reference in this chapter.

12.10 There will be paragraphs on different categories of capital transfers:

(a) Capital transfers in cash and in kind will be distinguished, as in *1993 SNA* para. 10.132.

(b) Different types of capital transfers will be discussed:

  i. Investment grants will be defined and explained, as in *BPM5* paras. 349 and 357 and *1993 SNA* paras. 10.137–138.

  ii. Capital taxes will be introduced and distinguished from current taxes on wealth as in *1993 SNA* para. 10.139.

  iii. Debt forgiveness will be explained and contrasted with debt write-off and bad debt provisions, based on *BPM5* para. 348 and *GFSM 2001* Appendix 2 paras. 9–10 (debt forgiveness). The *1993 SNA* paras. 10.139–140 contrast debt reductions that are capital transfers with those that are write-offs. It will be noted that debt forgiveness is limited to the value of the liability (principal and accrued interest). It will note that interest is recorded on an accrual basis and is capitalized as a part of the financial instrument. Debt forgiveness covering both original principal and accrued interest is treated as capital transfer. No entry is made for interest not yet accrued (as in *BPM5* para. 532).

iv. Debt restructuring (also called "debt reorganization") may give rise to a capital transfer, to the extent that there is an element of transfer.

v. Other cases that will be mentioned include compensation for losses of assets, whether ordered by courts or settled out of court, and legacies or large gifts to individuals or nonprofit institutions, as in *BPM5* paras. 349 and 357 and *1993 SNA* paras. 10.139–141.

vi. "Migrants' transfers" will be stated as not being transactions and, consequently, shown in the other changes in financial assets and liabilities account rather than as a capital transfer. (The discussion of this proposal occurs in Chapter 3 Accounting Principles and Chapter 8 Other Changes in Financial Assets and Liabilities Account.)

vii. Inheritance taxes will be treated as capital transfers, following *1993 SNA* para. 8.33.

viii. OECD DAC Reporting Statistical Directives will be referred to in order to distinguish between current and capital transfers.

(c) Classification by the institutional sector will be discussed. The standard components will show the institutional sector of recipient (for credits) and sector of provider (for debits). In the standard components, the sector split will be limited to "general government" and "other," but a full institutional sector split should be collected for other purposes. In some cases, there may also be interest in compiling data classified by sector of provider for credits and sector of recipient for debits.

12.11 For economies that are major recipients of assistance, the manual will suggest that it would be desirable to show current and capital transfers with consistent classifications to allow them to be compared.

C. Timing

12.12 There will be a discussion of timing issues that arise specifically for capital account items, as in *GFSM* paras. 5.79 and 6.66.

D. Valuation Principles

12.13 The valuation issues for capital transfers in kind will be discussed with references to the discussion of general principles in Chapter 3 Accounting Principles.

References

1993 SNA Chapter 8, 10.

BPM5 paras. 311–312 (on the capital account as such); para. 295 also deals with the current/capital transfer split; Chapter XVII deals with the components of the capital account.

BPT paras. 437–444

GFSM paras. 5.77–79, 6.64–66 (capital transfers) Appendix 2 paras. 9–10 (debt forgiveness)

R. Dippelsman and N. Maehle, *Treatment of Mobile Phone Licenses in the National Accounts*, IMF Working Paper 01/72

Changes from *BPM5*

(a) *Changes proposed*:

This chapter proposes to present the capital account as a separate account with its own balancing item. *BPM5* sometimes treats capital and financial accounts in conjunction (Table 12.1).

Intangible assets are discussed at greater length and detail. Although no new principles are introduced, new situations will be discussed (para. 12.7).

Migrants' transfers will be removed from the capital account, based on the definition of a transaction (para. 12.10(b)).

Glossary

Capital account
Capital taxes
Capital transfers
Debt forgiveness
Debt restructuring/reorganization
Intangible assets
Net lending/borrowing
Nonproduced assets
Transfers
Tangible assets

Chapter 13. Uses of Balance of Payments and International Investment Position Data

13.1 This section will introduce the BOP and IIP statistics as important sources for economic policy and analysis. The structure of the chapter will be:

(a) general issues;
(b) the accounting framework (along the lines of Appendix 5 in *BPM5*);
(c) discussion of an analytical framework that focuses on international liquidity; and
(d) other possible presentations of data.

A. General Issues

13.2 The manual will discuss analytical and policy areas where BOP and IIP statistics have the most relevance and use. It will explain data uses for which BOP and IIP statistics are specifically designed and those areas where users might make use of these data (such as when no better alternative data are available).

13.3 The general issues to be covered include the following:

(a) The use of the IIP and BOP financial account to analyze vulnerability to external shocks in a world of increasingly mobile financial flows. The role of timely and comprehensive balance of payments statistics: market expectations and uncertainties in fundamentals.

(b) The current account balance as an indicator of excess or under-spending. Temporary and cyclical deficit /surpluses on the current account, and their impact on inflation and country’s terms of trade.

(c) The use of BOP data for an understanding the movements in the exchange rate through analysis of the supply and demand of foreign currencies driven by the trends in the BOP components.

(d) The use of BOP statistics in explaining changes in the money supply, an important indicator for the determination of monetary policy. The possibility that BOP/IIP could be used as a supplementary data source for monetary statistics under certain circumstances will be described (in particular, they can be used to adjust monetary aggregates for holdings by nonresidents of monetary instruments).

(e) The use of BOP/IIP statistics in the context of analyzing globalization and its effect. The manual could usefully describe the contribution of BOP/IIP statistics and highlight the conceptual implications for national BOP, for example toll processing, transfer pricing, and provision of group-wide IT services. Reference could be made to the *Manual on Globalization Indicators*.

(f) The role of BOP data in the money market operations of central banks. Changes in the net foreign assets of the central bank as important explanatory variables of changes in the liquidity requirement in the money market.

(g) Statistics on international trade in services in understanding structural changes in the economy and the penetration of foreign markets. Decomposition analysis of price and volume effects of nominal and real exchange rate changes on the balance on goods and services.

(h) Statistics on inward and outward foreign direct investment in assessing the role of foreign financing, including ownership and control, in the corporate sector (both financial and nonfinancial), and the income generating capacity of investments abroad.

(i) Trends in the financial account in response to financial market conditions and economic developments for understanding the link between a change in interest rate conditions and the amount, direction, and structure of external financial flows.

(j) Statistics on international banking flows and stocks may be useful to understand issues in the globalization of international banking and to help focus on the soundness of the domestic banking system.

(k) The use of IIP data as an alternative way of assessing an economy's relations with the rest of the world.

B. Accounting Framework

13.4 Most of the material in Appendix 5 of *BPM5* will be included to explain what are the accounting identities in the balance of payments and how they relate to other macroeconomic statistical variables.

C. Analytic Presentation Focusing on International Liquidity

13.5 This section will present “the analytic presentation” of the *Balance of Payments Yearbook* and *International Financial Statistics* as a basis for analysis of international liquidity issues. The new manual will not refer to it as “the” analytic presentation, in that there are several ways in which data can be presented for analytical purposes.

D. Other Analytical Presentations

13.6 This section will introduce the notion and analytical meaning of different balances, such as trade balance, current account balance, basic balance, official settlements balance, and the overall balance. The manual will include a discussion of the monetary presentation of balance of payments. A concept of liquidity abroad (extended M3) will be explained.

References:

BPM5, paras. 7, 9, Appendix 5

1993 SNA—no equivalent

GFSM Chapter 4. The Analytic Framework

MFSM—no equivalent

External Debt Guide, Part. III, Use of External Debt Statistics

Abdulrahman Al-Hamidy, *Use of Balance of Payments Statistics: Case of Saudi Arabia* (BOPCOM-02/50)

M. Atingi-Ego, *Policy Applications of Balance of Payments and IIP Statistics* (BOPCOM-03/37)

Allan D. Brunner and Kanda Naknoi, *Trade Costs, Market Integration, and Macroeconomic Volatility,* IMF Working Paper, WP/02/54

Capital Mobility and the Output-Inflation Tradeoff, IMF Working Paper, WP/00/87

Debt- and Reserve- Related Indicators of External Vulnerability, IMF Paper, March 23, 2000

European Central Bank, *Use of Balance of Payments Statistics* (included on BOPCOM website)

IMF, *Manual on Globalization on Indicators*

Samir Jahjah and Peter Montiel, *Exchange Rate Policy and Debt Crises in Emerging Economies,*. IMF Working Paper, WP/03/60

Frederic Lambert and Laurent Paul, *The International Investment Position: Measurement Aspects and Usefulness for Monetary Policy and Financial Stability Issues* (BOPCOM-02/74)

Philip R. Lane and Gian Maria Milesi-Ferretti, *Long-Term Capital Movements,* IMF Working Paper, WP/01/107

Lehmann, Alexander, *Foreign Direct Investment in Emerging Markets: Income, repatriations and Financial Vulnerabilities,*. IMF Working Paper, WP/02/47

USES OF BALANCE OF PAYMENTS AND INTERNATIONAL INVESTMENT POSITION DATA

E. J. van der Merwe, *The Use of Balance of Payments Statistics in the Determination of Monetary and Fiscal Policy* (BOPCOM-02/51)

Office for National Statistics, *Use of Balance of Payments Statistics in the United Kingdom* (BOPCOM-01/36)

S. G. Shcherbakov, *Foreign Reserve Adequacy: Case of Russia* (BOPCOM-02/53)

S. Shcherbakov, *Use of Balance of Payments Statistics in Foreign Exchange Policy Formulation: Russia's Experience* (BOPCOM-02/49)

Statistics Department, International Monetary Fund, *Training in the Use of Balance of Payments Statistics—Staff Notes* (BOPCOM-00/12)

The Current Account Deficit in an International and Historical Prospective, Central Bank of Iceland, Quarterly Bulletin, 2001/1

The Two Monetary Approaches to the Balance of Payments: Keynesian and Johnsonian, IMF Working Paper, WP/01/100

Trade Policy in Financial Services, IMF Working Paper, WP/00/31

U.K.'s Office for National Statistics, *Use of International Investment Position Statistics in UK* (BOPCOM-02/52)

List of (Possible) Appendices
(to be included at end of manual)

(Other topics that relate to a single chapter will be dealt with in appendices to the relevant specific chapter.)

Changes from *BPM5*
—more detailed than overview in Chapter 1 or Preface

Reconciliation with *1993 SNA*
—similar to *BPM5* Appendix I

Process for amending *IASM 200X*
—as per BOPCOM newsletter

Issues specific to monetary/currency/economic unions
—to be completed by ECB/others

Risk issues
—links to Financial Soundness Indicators

Exceptional financing
—based on *BPM5* Appendix IV

Insurance
—as per *1993 SNA* Appendix IV

Financial services
—FISIM, interest, and service elements

Finance leasing
—bring together relevant general merchandise, service, interest, and financial entries

Foreign Affiliates Trade Statistics
—describes the statistics, as in *MSITS*

Listing of standard components
—as per Tables 7-9 in *BPM5* Appendix I
—new coding system, perhaps more closely integrated to the *1993 SNA* and *ESA95*

APPENDICES

Nonpermanent workers
—bring together relevant service, compensation of employees, workers' remittances, and migrants' transfers elements

Debt reorganization
—bring together transfers, financial transactions, debt; include HIPC examples

Reverse transactions (repos, securities lending, gold swaps, and gold loans)
—explain basic principles, bring together cross-cutting issues; numerical example

Financial derivatives
—example of transactions and positions for derivatives with multiple payments

Other appendices that may be considered

Tourism
—possibly largely relevant to Chapter 9 Goods and Services, so may be placed after that chapter, but direct investment dimension also of interest

Direct investment, possibly other functional categories
—could bring together classification, positions, financial flows, and income issues in a single appendix; possibly also affiliate trade in goods and services

Data dissemination standards, Data Quality Assessment Framework

Research agenda
—issues that are under discussion and that require further work.

Payments for use of assets
—borderlines between service, property income, and sale of an intangible asset (right to use)

Treatments of transactions and positions with IMF
—with examples

Globalization
—The manual could usefully describe the contribution of BOP/IIP statistics and highlight the conceptual implications for national BOP, for example toll processing, transfer pricing, provision of group-wide IT services.