IMF COMMITTEE ON BALANCE OF PAYMENTS STATISTICS

CURRENCY UNION TECHNICAL EXPERT GROUP (CUTEG)

ISSUES PAPER (CUTEG) # 11

ALLOCATION OF FINANCIAL FLOWS

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ALLOCATION OF FINANCIAL FLOWS

1. The allocation of financial flows between residents and nonresidents for regional statements can be done in two ways. One approach is to allocate financial flows on the basis of the actual owner of the claim (the creditor) or on the basis of the country that incurs the liabilities (the debtor). The second approach is to allocate financial flows according to the transactor principle, which is the country of the nonresident party of the transactions. Whereas *BPM5* is open to both approaches, the suggestion is that the updated manual should endorse the former.

I. Current international standards for the statistical treatment of the issue

2. In the discussion of regional balance of payments statement, the *BPM5* describes the two principles that may serve as the basis for regional allocation of financial transactions: the debtor/creditor principle and the transactor principle. Under the debtor/creditor principle, changes in financial claims of the compiling economy are allocated to the country of residence of the nonresident debtor, and changes in liabilities are allocated to the country of residence of the nonresident creditor. Under the transactor principle, changes in the claims and liabilities are allocated to the country of residence of the nonresident party to the transaction (the transactor). In many instances, regional allocation of transactions on either basis will coincide (e.g., for bank deposit claims and liabilities, trade credits, and most direct investment transactions). However, in others (i.e., tradable claims), quite different regional allocations may arise, according to which one of the two principles is used. Examples are (portfolio) securities transactions and direct investment acquisitions involving third parties.

3. As concerns the international investment position, *BPM5* recommends that data compiled on a regional basis for stocks of financial assets and liabilities are geographically allocated on the basis of the debtor/creditor principle. Financial claims of the compiling economy are allocated to the country of residence of the nonresident debtor, and liabilities are allocated to the country of residence of the nonresident creditor.

4. The *1993 SNA* makes explicit reference to the use of the creditor/debtor principle as a foundation for allocating assets and liabilities between (domestic or foreign) involved parties in paragraph 11.12. When existing financial assets are exchanged for other financial assets, all entries take place in the financial account and only affect assets. For example, if an existing bond is sold by one institutional unit to another on the secondary market, in his financial account, the seller reduces his holdings of securities and increases equally his holdings of means of payment. The purchaser makes the opposite entries in his financial account. When a new financial asset is created through the incurrence of a liability by an institutional unit, all related entries may also be made in the financial account. For example, a corporation may issue short-term securities in exchange for means of payment. The financial account of the corporate sector accordingly shows an increase in liabilities in the

form of securities and an increase in financial assets in the form of means of payment; the financial account of the purchasing sector shows a recomposition of financial assets - reduction in means of payment and an increase in securities.

5. The transactor principle, on the other hand, can, in practice, be applied in two different ways, i.e., classification either by country of first-known counterpart or by country of settlement, both of which may not in all cases reflect the residence of the actual owner of the asset/liability acquired/incurred.

II. Concerns/shortcomings of the current treatment

6. In *BPM5*, the two approaches leave many compilers with the impression that there is no need to design more accurate data collection system capable of capturing the creditor/debtor principle. This is particularly problematic where there is a strong tradition to collect balance of payments data from resident financial institutions through which crossborder payments are initiated/received. Instead, in times of growing access to international capital market and given the complex interrelation of creditor/debtor and transactor concepts, the transactor principle can not be considered as an alternative to the creditor/debtor. For instance, if the transactor principle is applied to transactions in foreign securities issued by residents, a purchase of these securities by a union member from a non-union member would result in a claim (assets) of the union on the rest of the world (the opposite would happen in case of a sale). This does not properly reflect the resulting positions after the above transactions.

7. Finally, because the update *BPM5* will put due emphasis on stock data, and as economies are increasingly compiling an international investment position statements (together with the balance of payments), the new Manual will underline the need to allow for full (currency union's) reconciliation between financial flows and stocks. As a result, both financial flows and stocks should be compiled based on the creditor/debtor approach.

III. Possible alternative treatments

8. The alternative approach would be to propose the creditor/debtor approach as the only conceptually sound approach.

IV. Points for discussion

(1) *Would the CUTEG members agree to base the allocation of financial flows and stocks in currency union statements on the ground of the creditor/debtor approach, so being consistent with the general principles in the international manuals?*

(2) Would the CUTEG members agree that the updated BPM5 recommends that the transactor principle not be considered as an alternative approach to allocate financial assets and liabilities?

References

Annotated Outline for the Revision of BPM5, IMF, April 2004 (para 4.58).

1993 SNA (paras. 11.12).

BPM5(para 481, 484).

Monetary and Financial Statistics Manual 2000 (paras.).

ECB BOP Manual (para 3.1.5.3)