

THE GENERAL GOVERNMENT AND PUBLIC SECTORS

Prepared by John Pitzer and Jean-Pierre Dupuis

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The General Government and Public Sectors

A. INTRODUCTION

1. A major strength of the SNA is its flexibility for being implemented at different levels of sectors, sub-sectors and even units, and various levels of aggregations of the accounts.
2. Disaggregating the economy into various sectors and sub-sectors makes it possible to observe the interactions between the different parts of the economy that need to be measured and analysed for purposes of policy-making. Two such sectors are the general government sector, as defined in Chapter IV, and the public sector, as defined in this chapter.
3. The general government sector usefully separates the non-market activities of government from those of the rest of the economy because the powers, motivation, and functions of government are different from other sectors. Governments have compulsory powers to raise taxes and other compulsory levies and to pass laws affecting the behaviour of other economic units. They focus on providing public goods considerations rather than profit maximization, and the principal economic activities of government are:
 - To assume responsibility for the provision of goods and services to the community on a nonmarket basis, either for collective consumption (such as public administration, defense, and law enforcement) or individual consumption (education, health, housing and cultural services); and
 - To redistribute income and wealth by means of transfer payments (taxes or social benefits).
4. The broader public sector is also useful because governments often fulfill their public policy objectives through the operation of public corporations (for example, railways, airlines, public utilities and public financial corporations). It may do so by requiring the corporation to service areas of the economy that would not be covered otherwise and by charging subsidized prices, including low interest lending. As a result, the public corporation operates with a reduced profit, or at a loss. Such public policy operations are known as quasi-fiscal activity.
5. For the general government and the public sectors, in addition to the usual sequence of accounts of the SNA, the accounts can be presented in a manner that is more suitable for the government finance analysts and policymakers. The latter increasingly use aggregates and balancing items defined in terms of SNA concepts, definitions, classifications, and accounting rules so that they can be related to other macro-economic variables and compared with the same items in other countries. Some of these items, such as saving and net lending/borrowing are already available in the sequence of accounts. Other items, such as total revenue, total expense and total expenditure, the tax burden, the net operating balance and total debt, are not in the basic system. Aggregates and balancing items of this nature can be used to assess the use of resources to produce individual and collective services, the need to collect tax other revenues, the ability of government to borrow and repay debt, and the sustainability of the desired level of government operations.
6. An alternative presentation to that of the SNA sequence of accounts suggests the need to rearrange the transactions in the current accounts and the capital account to derive aggregates and balancing items of specific

interest to the general government and public sectors. For example, government services are usually financed by a combination of taxes, user fees, and grants from other governments. Data on these types of revenue are located in different parts of the sequence of accounts, but the transactions can be rearranged to be shown as parts of a new aggregate, total revenue. Describing this so-called public finance or government finance presentation of statistics is one reason for a chapter devoted to the general government and public sectors.

7. In practice, macroeconomic accounts can seldom be built up by simply aggregating the relevant micro-data. Government is an exception in that the statistics for government units and public corporations are often derived directly from the micro-data in government financial accounting databases. As a result, compilers of statistics for the government units and public corporations sometimes act more as accountants than as statisticians. In particular, the development in recent years of International Public Sector Accounting Standards by the International Public Sector Accounting Standards Board of the International Federation of Accountants has increased the need for clear guidance on the compilation of government statistics so that the detailed accounting data can be transposed correctly into the SNA framework. Such guidance is especially important when the government financial accounts are compiled on a cash basis and must be converted to an accrual basis to comply with the SNA framework.
8. As a rule, the entries in the System are not consolidated. Consolidation involves the elimination of those transactions or debtor/creditor relationships which occur between two transactors belonging to the same institutional sector or sub-sector. As stated in chapter III, however, consolidation may be relevant for the general government sector. For example, information on debt owned by government units to units outside the general government sector may be more

relevant than gross figures that include debt owed to other government units. Guidance on consolidation is provided in this chapter in Section C, subsection 6.

9. This chapter therefore, is designed to provide an overall picture of the role and activities of governments and the resources they control as measured in the general government and public sectors within the context of the System of National Accounts. Section B summarizes the identification of government units and other units controlled by government units and how those units are grouped into sectors in the System. Secondly, as noted, an alternative presentation to the SNA sequence of accounts, so-called government finance statistics, is advantageous for a number of uses of statistics. The general notion of this type of presentation is described in section C, with details on how this presentation might be implemented described in the annex to this chapter. Thirdly, section D addresses a number of accounting issues that are unique or exceptionally important for governments in more detail than space permits in the chapters detailing the sequence of accounts for all institutional units and sectors.
10. Finally, section E provides information about the potential importance of the public sector, which consists of units of the general government sector and public corporation, and how statistical information may be prepared in a manner roughly parallel to the government finance statistics presentation described in section D.
11. In a nutshell, the statistical definition of the general government sector in the SNA is now widely accepted. This chapter aims at developing and clarifying the principles and recommendations concerning transactions involving the *general government sector* as well as the broader concept, the *public sector*, since the government keeps a close relationship with public corporations.

B. DEFINING THE GENERAL GOVERNMENT AND PUBLIC SECTORS

1. INTRODUCTION

12. A prerequisite to develop the accounts for both the general government sector and the public sector is to clarify the delineation between government units and other public units based on sectorization criteria. Both the general government sector and the public sector consist of public units, which are institutional units that are government units or are controlled, directly or indirectly, by one or more government units. Thus, the identification of public units and the definitions of the general government and public sectors begin with a government unit and then are extended to units controlled by government units.
13. The distinction between the general government sector and the rest of the public sector arises from the distinction between market and non-market producers, which is described in Chapter IV. A government unit is a particular type of non-market producer, namely one that is financed, directly or indirectly, by taxes and/or compulsory social contributions.
14. Units of the general government sector also include non-profit institutions that are non-market producers and are controlled by government or other public units. The general government sector can, therefore, be defined as the collection of all public institutional units that are non-market producers.
15. It is perfectly possible for a non-market producer to produce market output. If all or most of a public unit's output is market, however, the unit is a market producer and becomes a public corporation, a member of

either the financial corporations or non-financial corporations sector. The public sector consists of all institutional units of the general government sector plus all public corporations.

16. The crucial issues for determining the composition of the general government sector and the public sector are, therefore, what constitute control of an institutional unit and the borderline between a market and non-market producer. The following sections deal with these topics. Figure 1 shows the relationship between the general government sector, the public sector, and the other main sectors of the domestic economy.

2. IDENTIFICATION OF UNITS IN THE GOVERNMENT AND PUBLIC SECTORS

A decision tree for government and other public units

17. When classifying resident entities that might be public units, it is recommended to follow the following three steps:
 - (1) Is the entity an institutional unit? If it does not meet the criteria to be considered an institutional unit, it is part of the unit that controls it?
 - (2) Is the institutional unit a public unit? If the unit is a government unit or is controlled by a government unit or another public corporation, it is a public unit and part of the public sector, if not, it is neither a government unit nor a public corporation and is not part of the public sector.

FIGURE 1
THE PUBLIC SECTOR AND ITS RELATION TO OTHER INSTITUTIONAL SECTORS

GENERAL GOVERNMENT SECTOR	FINANCIAL CORPORATIONS SECTOR	NON-FINANCIAL CORPORATIONS SECTOR	NON-PROFIT INSTITUTIONS SERVING HOUSEHOLDS SECTOR	HOUSEHOLDS SECTOR
PUBLIC	PUBLIC	PUBLIC	PRIVATE	PRIVATE
	PRIVATE	PRIVATE		

- (3) If the unit is a public unit, is it a market or a non-market producer? When the principal function of the public unit is to produce non-market services or to redistribute income and wealth, the unit is to be classified in the general government sector. In all other cases, the question to be asked is: does the public unit dispose of all or most of its output at economically significant prices? If no, it is to be classified in the general government sector. If yes, it is to be classified as public corporation.

Government units

18. A government unit is an institutional unit that is a public producer whose output is primarily non-market. Any institutional unit principally engaged in the redistribution of income and wealth should be considered a government unit. An important characteristic of government units is that they are mainly financed by units belonging to other sectors through the collection of taxes, compulsory social contributions, or by transfers from other government units.
19. In all countries, there is an important institutional unit of the general government sector in terms of size and power, in particular the power to exercise control over many other units. It is a single unit of the central government that encompasses the fundamental activities of the national executive, legislative

and judiciary powers. Its revenues as well as its expenses and expenditures normally are regulated and controlled by a Ministry of Finance or its functional equivalent by means of a general budget approved by the legislature.¹ Most of the ministries, departments, agencies, boards, commissions, judicial authorities, legislative bodies, and other entities that make up this central government unit are not separate institutional units, but are part of this primary central government unit because they generally do not have the authority to own assets, incur liabilities, or engage in transactions in their own right. If there are state and/or local governments, as defined in sub-section 2 below, then it is likely that each of these governments will also have a primary government unit that includes the principal executive, legislative, and judicial powers.

20. In addition, there may be government entities with a separate legal identity and substantial autonomy, including discretion over the volume and composition of their expenses and expenditures and a direct source of revenue, such as earmarked taxes. Such entities are often established to carry out specific functions, such as road construction or the non-market production of health or education services. These entities should be treated as separate government units if they maintain full sets of accounts, own goods or assets in their

¹ These units are often referred to as national government or main budget account.

own right, engage in non-market activities for which they are held accountable at law, and are able to incur liabilities and enter into contracts. Such units are often referred to as extra-budgetary units because they have separate budgets, receive substantial transfers from the main budget account, and their primary sources of finance are supplemented with own sources of revenue that falls outside the main budget. Budgets vary widely among countries, and various terms are often used to describe these units. These units are classified in the general government sector to the extent that they are non-market producers and are controlled by another government unit.

21. At the same time, the general budget of any government level might control market producers fulfilling the criteria to be a quasi corporation as defined below. These units should not be classified in the general government sector, but in the non-financial or financial corporations sector, as relevant. As public units, they are, however, part of the public sector.
22. A social security unit is a particular kind of government unit that is devoted to the operation of one or more social security schemes. A social security unit must satisfy the general requirements of an institutional unit. That is, it must be separately organized from the other activities of government units, hold its assets and liabilities separately, and engage in financial transactions on its own account.
23. As noted earlier, non-profit institutions that are non-market producers and are controlled by a government are also units of the general government sector. Although they may legally be established to be independent from government, they are considered to be carrying out government policies and effectively are part of government. Governments may choose to use non-profit institutions rather than government agencies to carry out certain government policies because NPIs may be seen as detached, objective, and not subject to political pressures. For example, research and development and the setting and maintenance of standards in fields such as health, safety, the environment, and education are areas in which

NPIs may be more effective than government agencies.

24. The case of units engaged in financial activities needs special consideration. Financial intermediation is usually considered a market activity, and financial intermediaries are classified in the financial corporations sector. However, an important characteristic is that a financial intermediary does not simply act as an agent for other institutional units but places itself at risk by incurring liabilities on its own account. In this context, if a public financial unit does not place itself at risk by incurring liabilities on its own account, it will not be considered a financial intermediary and the unit is to be classified in the general government sector rather than in the financial corporations sector.

Public units

25. This section describes those two characteristics. The public sector includes all general government units and all public corporations. To be classified as a public corporation, an institutional unit must not only be controlled by another public unit, but it also must sell most of its output for economically significant prices. Control is defined as the ability to determine the general policy or program of an institutional unit. Government is in a position to exercise control over many kinds of units: miscellaneous extra-budgetary agencies, non-profit institutions and corporations (non-financial or financial).

Government control of non-profit institutions²

26. Control of a NPI is defined as the ability to determine the general policy or programme of the NPI. All NPIs allocated to the general government sector should retain their identity as NPIs in statistical records, to facilitate analysis of the complete set of NPIs. To determine if a NPI is controlled by the

² Criteria developed for non-profit institutions (NPIs) apply also to other kinds of non-profit units like extra-budgetary agencies.

government, the following five indicators of control should be considered:

- The appointment of officers. The government may have the right to appoint the officers managing the NPI either by the NPI's constitution, its articles of association or other enabling instrument.
- Other provisions of enabling instrument. The enabling instrument may contain provisions other than the appointment of officers that effectively allow the government to determine significant aspects of the general policy or programme of the NPI. For example, the enabling instrument may specify and/or limit the functions, objectives and other operating aspects of the NPI, thus making the issue of managerial appointments less critical or even irrelevant, give the government the right to remove key personnel or veto proposed appointments, require prior approval of budgets or financial arrangements by the government, or prevent the NPI from changing its constitution, dissolving itself, or terminating its relationship with government without government approval.
- Contractual agreements. The existence of a contractual agreement between a government and an NPI may allow the government to determine key aspects of the NPI's general policy or programme. As long as the NPI is ultimately able to determine its policy or programme to a significant extent, such as by being able to renege on the contractual agreement and accepting the consequences, by being able to change its constitution or dissolving itself without requiring government approval other than that required under the general regulations, then it would not be considered controlled by government.
- Degree of financing. An NPI that is mainly financed by government may be controlled by that government.

Generally, if the NPI remains able to determine its policy or programme to a significant extent along the lines mentioned in the previous indicator, then it would not be considered controlled by government.

- Risk exposure. If a government openly allows itself to be exposed to all or a large proportion of the financial risks associated with a NPI's activities, then the arrangement constitutes control. The criteria are the same as in the previous two indicators.
27. Totality of all indicators. A single indicator could be sufficient to establish control in some cases, but in other cases, a number of separate indicators may collectively indicate control. A decision based on the totality of all indicators will necessarily be judgmental in nature.

Government control of corporations

28. A corporation is a public corporation if a government unit, another public corporation, or some combination of government units and public corporations controls the entity; where control is defined as the ability to determine the general corporate policy of the corporation. The expression "general corporate policy" as used here is understood in a broad sense to mean the key financial and operating policies relating to the corporation's strategic objectives as a market producer.
29. Because governments exercise sovereign powers through legislation, regulations, orders and the like, care needs to be applied in determining whether the exercise of such powers amounts to a determination of the general corporate policy of a particular corporation and therefore control of the corporation. Laws and regulations applicable to all units as a class or to a particular industry should not be viewed as amounting to control of these units.
30. The ability to determine the general corporate policy does not necessarily include the direct control of the day-to-day activities or operations of a particular corporation. The

officers of such corporations would normally be expected to manage these in a manner consistent with and in support of the overall objectives of the particular corporation.

31. The ability to determine the general corporate policy of a corporation also does not include the direct control over any professional, technical or scientific judgments, as these would normally be viewed as part of the core competency of the corporation itself. For example, the professional or technical judgments exercised by a corporation set up to certify aircraft airworthiness would not be considered controlled in respect of individual approvals and disapprovals, though its broader operating and financial policies, including the airworthiness criteria, may well be determined by a government unit as part of the corporation's corporate policy.
32. Determining the general corporate policy of a corporation while acting as a fiduciary would not imply control. This is because the trustee, in executing its fiduciary obligations, would be obliged to act strictly in accordance with the trust deed. The trustee would act in the interests of the beneficiaries and not at the behest of its controlling entity. Two examples where this may apply relate to autonomous government employee pension funds and public trustees.
33. Because the arrangements for the control of corporations can vary considerably, it is neither desirable nor feasible to prescribe a definitive list of factors to be taken into account. The following eight indicators, however, will normally be the most important and likely factors to consider:
 - Ownership of the majority of the voting interest. Owning a majority of shares will normally constitute control when decisions are made on a one-share one-vote basis. The shares may be held directly or indirectly, and the shares owned by all other public entities should be aggregated. If decisions are not made on a one-share one-vote basis, the classification should be based on whether the shares owned by other public entities provide a majority voice.

- Control of the board or other governing body. The ability to appoint or remove a majority of the board or other governing body as a result of existing legislation, regulation, contractual, or other arrangements will likely constitute control. Even the right to veto proposed appointments can be seen as a form of control if it influences the choices that can be made. If another body is responsible for appointing the directors, it is necessary to examine its composition for public influence. If a government appoints the first set of directors but does not control the appointment of replacement directors, the body would then be part of the public sector until the initial appointments had expired.
- Control of the appointment and removal of key personnel. If control of the board or other governing body is weak, the appointment of key executives, such as the chief executive, chairperson, and finance director, may be decisive. Non-executive directors may also be relevant if they sit on key committees such as the remuneration committee determining the pay of senior staff.
- Control of key committees of the entity. Sub-committees of the board or other governing body could determine the key operating and financial policies of the entity. Majority public sector membership on these sub-committees could constitute control. Such membership can be established under the constitution or other enabling instrument of the corporation.
- Golden shares and options. A government may own a "golden share," particularly in a corporation that has been privatized. In some cases, this share gives the government some residual rights to protect the interests of the public by, for example, preventing the company selling off some categories of assets or appointing a special director who has strong powers in certain circumstances.

A golden share is not of itself indicative of control. If, however, the powers covered by the golden share do confer on the government the ability to determine the general corporate policy of the entity in particular circumstances, and those circumstances currently existed, then the entity should be in the public sector from the date in question. The existence of a share purchase option available to a government unit or a public corporation in certain circumstances may also be similar in concept to the golden share arrangement discussed above. It is necessary to consider whether the circumstances in which the option may be exercised currently exists, the volume of shares which may be purchased under the option and the consequences of such exercise means that the government currently has “the ability to determine the general corporate policy of the entity” by exercising that option. An entity’s status in general should be based on the government’s existing ability to determine corporate policy exercised under normal conditions rather than in exceptional economic or other circumstances such as wars, civil disorders or natural disasters.

- Regulation and control. The borderline between regulation that applies to all entities within say a class or industry group and the control of an individual corporation can be difficult to judge. There are many examples of government involvement through regulation, particularly in areas such as monopolies and privatized utilities. It is possible for regulatory involvement to exist in important areas, such as in price setting, without the entity ceding control of its general corporate policy. Choosing to enter into or continues to operate in a highly regulated environment suggests that the entity is not subject to control. When regulation is so tight as to effectively dictate how the entity performs its business, then it could be a form of control. If an entity retains

unilateral discretion as to whether it will take funding from, interact commercially with, or otherwise deal with a public sector entity, the entity has the ultimate ability to determine its own corporate policy and is not controlled by the public sector entity.

- Control by a dominant customer. If all of the sales of a corporation are to a single public sector customer or a group of public sector customers, there is clear scope for dominant influence. The presence of a minority private sector customer usually implies an element of independent decision-making by the corporation; and the entity would not be considered controlled. In general, if there is clear evidence that the corporation could not choose to deal with non-public sector clients because of the public sector influence, then public control is implied.
 - Control attached to borrowing from the government. Lenders often impose controls as conditions of making loans. If the government imposed controls through lending or issuing guarantees that are more than would be typical when a healthy private sector entity borrows from a bank, control may be indicated. Similarly, control may be implied if only the government was prepared to lend.
34. Totality of all indicators. Although a single indicator could be sufficient to establish control, in other cases, a number of separate indicators may collectively indicate control. A decision based on the totality of all indicators must necessarily be judgmental in nature. Of course, there has to be consistency in classification decisions for such judgments.

Market/non-market delineation: the notion of economically significant prices

35. Government units are public units whose output is mostly non-market. Non-market producers provide all or most of their output to others free of charges or at prices that are not economically significant. Economically

significant prices are prices which have a significant influence on the amounts the producers are willing to supply and on the amounts which purchasers wish to buy. It is the criterion that is used to classify output and producers as market or non-market, thus deciding whether an institutional unit set up by government, or in which government has controlling interest, is to be designated as non-market—therefore classified in the general government sector—or as market—therefore considered a public corporation.

36. It can be presumed that prices are economically significant when the producers are private corporations. When there is public control, however, the unit's prices may be modified for public policy purposes, which may cause difficulties in determining whether the prices are economically significant. Public corporations are often established to provide goods that the market would not produce in the desired quantities or prices. The sales of such corporations may cover a large portion of their costs, but one can expect that they respond to market forces quite differently than would private corporations.
37. It is likely that corporations receiving substantial government financial support or that enjoy other risk reducing factors such as government guarantees will act differently than corporations without such advantages because their budget constraints are softer. A non-market producer is a producer that faces a very soft budget constraint so that the producer is not likely to respond to changes in the economic conditions in the same way as real market producers.
38. The difference between a market and non-market producer that sells its output for a price, then, relates largely to the ways in which the producer responds to changes in market conditions. To decide this inherently difficult question, it is useful to consider a taxonomy that specifies which units are the consumers of the goods and services in question and whether the producer is the only supplier.

The output is sold primarily to corporations and households

39. Prices are economically significant if they cover the majority of the producer's costs (including consumption of fixed capital and a return to capital) and consumers are free to choose on the basis of the prices charged. Although there is no prescriptive numerical relationship between the value of output (excluding both taxes and subsidies on products) and the production costs, one would normally expect the value of goods and services sold (the sales) to average at least half of the production costs over a sustained multi-year period.³
40. Because economic circumstances vary considerably, it may be desirable to accept a different threshold to achieve consistent economic measurement over time, between branches and across countries. For the same reason, the distinction between market and non-market may be made for a group of entities undertaking similar activities rather than on a case-by-case basis. Examples may be higher educational institutions or transport systems. However, when compiling the general government sector accounts, this should never result in combining the accounts of market institutional units with those of non-market institutional units

The output is sold only to government

41. Some services are typically required by all units as ancillary services. These include activities such as transportation, purchasing, sales, marketing, computer services, communications, cleaning, and maintenance. A unit that provides this type of services exclusively to its parent unit or to other units in the same group of units may be described as an ancillary unit. Ancillary units provide all of their output to their owners for use as intermediate consumption.
42. If a public producer is the only supplier of its services, it is treated as a non-market unit unless it competes with a private producer in

³ No specific threshold carries full agreement as a rule at the international level.

tendering for a contract with government on normally accepted commercial terms.

43. If a public producer is one of several producers, it is considered a market producer if there is evidence that it competes with other producers in the market and its prices satisfy the general criteria of economically significant prices.

The output is sold to government and others

44. If a unit is the only supplier of its services, it is a market producer if its sales to non-government units are more than half of its total output or its sales to government satisfies the tender condition above.
45. If there are several suppliers, a public producer is a market producer if it competes with the other producers.

Mixed ownership

46. When there is mixed public and private ownership, the greater the degree of private control the greater the presumption that the output is market output, but this criterion is not definitive.

Definition of sales and of costs

47. In order to compare the output of a public unit selling goods and services with its production costs, as an assessment of economically significant prices and of market output, the output at basic prices of this unit is measured as equal to the total amount of goods and services sold (the “sales”), plus if necessary the change in inventories, excluding taxes on products and subsidies on products, except those subsidies that are also granted to all private producers for this type of activity. In all cases, subsidies or transfers to cover an overall deficit are excluded. Own-account production is not considered part of sales in this context.
48. Production costs are the sum of intermediate consumption, compensation of employees, capital services, and other taxes on production. Other subsidies on production are not deducted.

49. The case of units engaged in financial activities needs special consideration. Financial intermediation is usually considered a market activity, and financial intermediaries are classified in the financial corporations sector. However, an important characteristic is that a financial intermediary does not simply act as an agent for other institutional units but places itself at risk by incurring liabilities on its own account. In this context, if a public financial unit does not place itself at risk by incurring liabilities on its own account, it will not be considered a financial intermediary and the unit is to be classified in the general government sector rather than in the financial corporations sector.

3. THE COMPOSITION OF THE GENERAL GOVERNMENT SECTOR

50. Depending on the administrative and legal arrangements, there may be more than one level of government within a country. In the System, provision is made for three levels of government: central, state and local, with a sub-sector for each level. In addition to these levels of government, the existence of social security⁴ and its role in fiscal policy may require that statistics for all social security units be compiled as a fourth separate sub-sector of the general government sector. Not all countries will have all levels; some may have only a central government or a central government and one lower level. Other countries may have more than three levels. In that case, the various units should all be classified as one of the levels suggested above.
51. The requirements to classify general government units according to their level of government and whether there are social security units, can be accommodated in two alternative sets of sub-sectors. First, all social security units could be combined into a separate sub-sector and all other general government units could be classified according to their level. In that case, the central, state, and local government sub-sectors would consist of all government units other than social

⁴ The proposal was made to replace in the SNA the ambiguous denomination “social security funds” (usually unfunded) by “social security.” The editor of the SNA update will have the final word.

security. Second, all social security units could be classified according to the level of government that operates them and combined with other general government units at that level.

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

Sub-sectors of the general government sector

53. The **central government sub-sector** consists of all government units having a national sphere of competence (with the possible exception of social security units). The political authority of a country's central government extends over the entire territory of the country. The central government can impose taxes on all resident institutional units and on non-resident units engaged in economic activities within the country. The central government typically is responsible for providing collective services for the benefit of the community as a whole, such as national defence, relations with other countries, public order and safety, and the efficient operation of the social and economic system of the country. In addition, it may incur expenses on the provision of services, such as education or health, primarily for the benefit of individual households, and it may make transfers to other institutional units, including other levels of government.
54. The compilation of statistics for the central government is particularly important because of

the special role it plays in economic policy analysis. It is mainly through central government finances that fiscal policy impacts on inflationary or deflationary pressures within the economy. It is generally at the central government level that a decision-making body can formulate and carry out policies directed toward nationwide economic objectives. Other levels of government have not national economic policies as their objective.

55. The central government sub-sector is a large and complex sub-sector in most countries. It is generally composed of a central group of departments or ministries that make up a single institutional unit plus, in many countries, miscellaneous agencies operating under the control of the central government with a separate legal identity and enough autonomy to form additional central government units.
56. The **state government sub-sector** consists of all government units having a state sphere of competence (with the possible exception of social security units). A state is the largest geographical area into which the country as a whole may be divided for political or administrative purposes. These areas may be described by other terms, such as provinces, länder, cantons, republics, prefectures, or administrative regions. The legislative, judicial, and executive authority of a state government extends over the entire area of an individual state, which usually includes numerous localities, but does not extend over other states. In some countries, individual states and state governments may not exist. In other countries, especially those with federal constitutions, considerable powers and responsibilities may be assigned to state governments.
57. A state government usually has the fiscal authority to levy taxes on institutional units that are resident in or engage in economic activities in its area of competence. To be recognized as a government unit the entity must be able to own assets, raise funds, and incur liabilities on its own account, and it must also be entitled to spend or allocate at least some of the taxes or other income that it receives according to its own policies. The entity may, however, receive transfers from the central government that are tied to certain specified purposes. A state government should also be able to appoint its

own officers independently of external administrative control. If a government entity operating in a state is entirely dependent on funds from the central government, and if the central government also dictates the ways in which those funds are to be spent, then the entity should be treated as an agency of the central government.

58. The **local government sub-sector** consists of all government units having a local sphere of competence (with the possible exception of social security units). Local governments typically provide a wide range of services to local residents, some of which may be financed out of grants from higher levels of government. Statistics for local government may cover a wide variety of governmental units, such as counties, municipalities, cities, towns, townships, boroughs, school districts, and water or sanitation districts. Often local government units with different functional responsibilities have authority over the same geographic areas. For example, separate government units representing a town, a county, and a school district may have authority over the same area. In addition, two or more contiguous local governments may organize a government unit with regional authority that is accountable to the local governments. Such units should also be included in the local government sub-sector.
59. The legislative, judicial, and executive authority of local government units is restricted to the smallest geographic areas distinguished for administrative and political purposes. The scope of a local government's authority is generally much less than that of the central or a state government, and such governments may or may not be entitled to levy taxes on institutional units or economic activities taking place in their areas. They are often heavily dependent on grants from higher levels of government, and they may also act as agents of central or state governments to some extent. To be treated as institutional units, however, they must be entitled to own assets, raise funds, and incur liabilities by borrowing on their own account. They must also have some discretion over how such funds are spent, and they should be able to appoint their own officers independently of external administrative control.
60. The **social security sub-sector** consists of all social security units, regardless of the level of government that operates or manages the

schemes. If a social security scheme does not meet the requirements to be an institutional unit, it would be classified with its parent unit in one of the other sub-sectors of the general government sector.

Sub-sectors of the public sector

61. It is possible to construct sub-sectors of the public sector to meet analytical demands. Two methods of sub-sectoring the public sector immediately present themselves. First, the public sector could be divided into the general government sector as one sub-sector and the aggregate of all public corporations as a second sub-sector. The public corporations might be further divided into non-financial public corporations, financial public corporations other than the central bank, and the central bank.
62. Secondly, the public sector could be divided by level of government, just as the general government sector. In this case, the sub-sectors would be the central government public sector, the state government public sector, and the local government public sector. Each of these sub-sectors would consist of the corresponding sub-sector of the general government sector plus all public corporations controlled by a unit of that level of government. Social security units could form a separate sub-sector or could be combined with each level of government. It should be noted that autonomous government employee pension funds are excluded from government social security units.
63. Certain entities created by government units need some specific guidance on their sectorization. These include quasi-corporations, restructuring agencies, special purpose entities, joint ventures and supranational authorities.

Borderline with quasi-corporations

64. The general government sector comprises only non-market institutional units. If an institutional unit sells all or most of its output, then the definition of economically significant prices described in sub-section 1 above is used

to determine if the unit is a market or non-market producer. However, if a government establishment, or group of establishments engaged on the same kind of production under common management and they should be treated as a quasi-corporation if:

- charges prices for its outputs that are economically significant;
 - is operated and managed in a similar way to a corporation; and
 - a complete set of accounts exists that enable its operating balances, savings, assets and liabilities to be separately identified and measured, or it would be possible to construct a complete set of accounts.
65. Quasi-corporations are unincorporated enterprises that function as if they were corporations. Quasi-corporations are treated as if they were corporations: that is, as separate institutional units from the units to which they legally belong. Thus, quasi-corporations owned by government units are grouped with corporations in the non-financial or financial corporate sectors.
66. The intent behind the concept of a quasi-corporation is to separate from their owners those unincorporated enterprises which are sufficiently self-contained and independent that they behave in the same way as corporations. If they function like corporations, they must keep complete sets of accounts. Indeed, the existence or possibility to construct a complete set of accounts, including balance sheets, for the enterprise is a necessary condition for it to be treated as quasi-corporation. Otherwise, it would not be feasible from an accounting point of view to distinguish the quasi-corporation from its owner.
67. The amount of income withdrawn from a quasi-corporation during a given accounting period is decided by the owner, such a withdrawal being equivalent to the payment of a dividend by a corporation to its shareholder(s). Given the amount of the income withdrawn, the saving of the quasi-corporation (i.e., the amount of earnings retained within the quasi-corporation) is determined. The owner may invest more capital in the enterprise or withdraw capital from it by disposing of some of its assets, and such flows of capital must also be identifiable in the accounts whenever they occur. Investment flows in the quasi-corporation are recorded in the same way as investment flows in corporations (see section D.4 in this chapter). In particular, investment grants are recorded as capital transfers.
68. In order to be treated as a quasi-corporation the government must allow the management of the enterprise considerable discretion not only with respect to the management of the production process but also the use of funds. Government quasi-corporations must be able to maintain their own working balances and business credit and be able to finance some or all of their capital formation out of their own savings, depreciation reserves or borrowing. The ability to distinguish flows of income and capital between quasi-corporations and government implies that their operating and financing activities cannot be fully integrated with government revenue or finance statistics in practice, despite the fact that they are not separate legal entities. The net operating surplus of a government quasi-corporation is not a component of government revenue, and the accounts for government record only the flows of income and capital between the quasi-corporation and government.
69. The producer units that remain integrated with the government units that own them are those that cannot be treated as quasi-corporations. They are likely to consist largely of non-market producers, but it is perfectly possible for market establishments to exist within a non-market government unit or just some incidental sales at economically significant prices by a non-market establishment. As a result, a non-zero net operating surplus is possible for a government unit.

The case of restructuring agencies

70. Some public units are involved in the restructuring of corporations, either non-

financial or financial. These corporations may or may not be controlled by government. These restructuring agencies may be long-standing public units or agencies created for this special purpose. Government may fund the restructuring in various manners, either directly, through capital injections (capital transfer, loan or acquisition of equity) or indirectly, through granting guarantees. Regarding the sector classification of restructuring agencies used or set up by government, the major assessment to be performed concerns the market character of the main activity and the degree of risk assumed by the public agency. In many cases, the degree of risk taken by the restructuring agency is low due to the fact that it acts with strong public financial support and, *de jure* or *de facto*, on behalf of the government. Restructuring agencies have been observed in two different contexts.

71. The first type of restructuring agency concerns the reorganisation of the public sector and the indirect management of privatisation. Two cases may be considered:
- The restructuring unit is a genuine holding company controlling and managing a group of subsidiaries, and only a minor part of its activity is dedicated to channelling funds from one subsidiary the other on behalf of the government and for public policy purposes. The unit is classified as a corporation, and the transactions made on behalf of the government should be rerouted through the general government.
 - The restructuring unit, whatever its legal status, acts as a direct agent of the government and is not a market producer. Its main function is to redistribute national income and wealth, channelling funds from one unit to the other. The restructuring unit should be classified in the general government sector.
72. The second type of restructuring agency is mainly concerned with impaired assets, mainly in a context of banking or other financial crisis sometimes referred to as financial defeasance. Such a restructuring agency must be analysed

according to the degree of risk it assumes, considering the degree of financing of the government. Again, two cases may be considered:

- The restructuring agency borrows on the market at own risk to acquire financial and/or non-financial assets that it actively manages: the unit should be classified as a financial intermediary in the sector financial corporations.
- The restructuring agency deliberately purchases assets above market prices with the financial support of the government (directly or indirectly). It carries out non-market activities (redistribution of national income and wealth), does not place itself at risk, and therefore should be classified in the general government sector.

Special purpose entities

73. Government units are always considered resident because, by definition, the economic territory of a country consists of the geographic territory administered by a government, as well as some territorial enclaves in the rest of the world, used by the government for diplomatic, military, scientific, or other purposes, normally with the formal agreement of the government of the country in which they are physically located. These enclaves are part of the general government sector.
74. Some governments may set up special purpose entities (SPEs) for financial convenience, the SPE being involved in fiscal or quasi-fiscal activities (including securitisation of assets, borrowing etc.). Resident SPEs will not be treated as separate institutional units unless they satisfy all the criteria for qualifying as institutional units. These units should be classified according to the principal activity of the SPE, and therefore SPE's performing fiscal activities will be classified within the general government sector.
75. Non resident SPEs are always to be classified as separate institutional units. These entities

are deemed to be non-resident institutional units. When such entities are created, care must be taken to reflect faithfully the fiscal activities of the government. All flows and stock positions between the general government and the non-resident SPE should, of course, be recorded in the general government and SPE accounts when they occur.

76. When government creates a non-resident SPE to undertake government borrowing and/or incurs government outlays abroad with no economic flows between the government and the SPE related to these fiscal activities, transactions should be imputed in the accounts of both the government and the non-resident entity to reflect the fiscal activities of the government. The special case of securitisation units is discussed in section D.
77. If a non-resident SPE engages in a securitization operation based on a future stream of general government revenue, the operation should be treated as a borrowing transaction of the government and not as the sale of an asset. The economic substance of this transaction is best accounted for by imputing general government borrowing from the non-resident SPE for the same value and at the same time that the SPE incurs a liability to the foreign creditor. The SPE itself is termed a securitization vehicle and classified as a non-resident public corporation.

Joint ventures

Warning: The issue of the treatment of public-private partnerships, also treated in section D, may be subject to modifications according to the ISWGNA decisions on PPPs.

78. Many public units enter into arrangements with private entities or other public units to undertake a variety of activities jointly. The activities could result in market or non-market output. Joint operations can be structured broadly as one of three types: jointly controlled units, referred to here as joint ventures; jointly

controlled operations; and jointly controlled assets.

79. A joint venture involves the establishment of a corporation, partnership or other institutional unit in which each party has legally joint control over the activities of the unit. The units operate in the same way as other units except that a legal arrangement between the parties establishes joint control over the unit. As an institutional unit, the joint venture may enter into contracts in its own name and raise finance for its own purposes. A joint venture maintains its own accounting records.
80. The principal question to be considered here is whether the effective economic control of the joint venture establishes a public or a private unit. If it is a non-market unit, it will be a general government unit involved in non-market production, while it will be a public corporation if it is clear that it is a market producer.
81. The same indicators as described in subsection 1 above should be used to determine which unit controls the joint venture. Normally, the percentage of ownership will be sufficient to determine control. If each owner owns an equal percentage of the joint venture, the other indicators of control must be consulted.
82. Public units can also enter into joint operating arrangements that do not involve separate institutional units. In this case, there are no units requiring classification, but care must be taken to ensure that the proper ownership of assets is recorded and any sharing arrangements of revenues and expense are made in accordance with the provisions of the governing contract. For example, two units may agree to be responsible for different stages of a joint production process or one unit may own an asset or a complex of related assets but both units agree to share revenues and expenses.

Supranational authorities

83. Some countries may be part of an institutional agreement that recognise them as part of a supranational authority. Normally such an

arrangement implies monetary transfers from the member countries to this supranational authority and the reverse. The supranational authority will also engage in non-market production. In the national accounts of the member countries, the supranational authorities are non-resident institutional units that are part of the Rest of the World, and can be classified in a specific sub-sector of the Rest of the World.

84. Because the supranational authority is fulfilling the functions of a government level, it is possible to construct a set of accounts for the authority as if it were a resident unit of the member country. Such an additional account may be quite useful supplements for the analysis of the economic activities of the member countries.

C. THE GOVERNMENT FINANCE PRESENTATION OF STATISTICS

1. INTRODUCTION

85. The sequence of accounts for all institutional units and sectors is described in earlier chapters. The System allows for the statistics described in those chapters to be presented flexibly as they may serve various analytical needs. For the general government sector and in some cases the public sector, experience has shown that an alternative presentation, usually known as a government finance presentation, of those statistics is better suited to certain analytical requirements.

86. Very generally, the objective of the government finance presentation is to collect the resources and uses recorded in the various current accounts and the transactions in the capital account, rearrange them into a presentation appropriate for government finance, usually in a single account. In this framework, resources are usually rearranged to make a distinction between those that impact on net worth and those that are reflected in the changing the composition of the balance sheet of government. Similarly, the use of the resources will be presented to indicate those that impact on net worth of government separately from those that impact on the composition of the balance sheet.

87. The approach to the government finance presentation usually start with the concept of revenue as an aggregate of all resources that increase the net worth of government. These would include all resources acquired by

government as recorded in the current accounts, and capital transfers receivable as recorded in the capital account. In this approach, expense is an aggregate of all uses that reduce the net worth of government as recorded in current uses, and including capital transfers payable. The difference between revenue and expense is a new balancing item, the net operating balance. If the aggregate of acquisitions less disposals of non-financial assets is subtracted from this balancing item, net lending/net borrowing is the result. This approach is summarized in the following schematic.

Government Finance Presentation	
Revenue	
	Taxes
	Social contributions
	Grants
	Other revenue (current and capital)
Less: Expense	
	Production expenses ⁵
	Interest
	Subsidies
	Grants
	Social benefits
	Other expenses
Equals: Net Operating Balance	
Less: Acquisitions less disposals of non-financial assets	
Equals: Net lending/net borrowing	
Equals: Transactions in financial assets and liabilities (Financing)	

⁵ Including compensation of employees, use of goods and services and consumption of fixed capital.

88. In addition, it could be analytically useful to calculate expenditure as an aggregate of all uses, including capital transfers payable, and including the aggregate of acquisitions less disposals of non-financial assets. The difference between revenue and expenditure is net lending/net borrowing as indicated in the following schematic.

Government Finance Presentation	
Revenue	
Less: Expenditure	
Expense	
Acquisitions less disposals of non-financial assets	
Equals: Net lending/net borrowing	
Equals: Transactions in financial assets and liabilities (Financing)	

89. Additional accounts can be dedicated to, other economic flows, and balance sheets in full coherence with the sequence of accounts in the system. Again, there is flexibility for modified aggregations that might enhance the utility of the accounts for the analysis of government activities. It should also be noted that net lending/net borrowing can be derived from transactions in financial assets and liabilities.

90. The following section provides general information about the concepts involved in government finance. The annex to this chapter provides details about definitions and implementations of the government finance presentation.

2. REVENUE

91. A revenue transaction is one that increases net worth and improves net lending/borrowing. Government revenue is usually dominated by compulsory levies in the form of taxes and social contributions. For some levels of government, grants (transfers from other government units and international organizations) will be a major source of revenue. Other general category of revenue include property income, sales of goods and

services, and miscellaneous transfers other than grants.

92. Estimating taxes and social contributions can be quite difficult. The problems involved and the recommended solutions are described in section D of this chapter. Taxes are recorded in several of the accounts in the sequence of accounts. An advantage of the government finance presentation is that all taxes can be presented as one category of revenue, with sub-classifications according to the base on which the tax was levied. In particular, capital taxes are viewed as current transactions by governments and are, therefore, included in revenue of the SNA.

93. Government units are non-market producers, which means that most of their output consists of goods and services that are not sold at all or sold for prices that are not economically significant. The distribution of this output does not accord with the general notion of revenue as a transaction that increases net worth. As a result, only actual and certain imputed sales of goods and services are included in revenue. Variations in implementation result from decisions about the treatment of changes in inventories, own-account capital formation, and sales of goods purchased for resale without transformation, similar to a wholesale or retail trade enterprise.

94. Depending on the number of levels of government, transfers from one government unit to another, often from the central or a state government to a lower level of government, and from international organizations, can be quite important sources of government revenue. The government finance presentation allows all of these receipts to be collected into a separate category of revenue, usually labelled grants. Other transfers, including subsidies, amount to normally much less and are reported separately. Property income may or may not be an important source of revenue, but in either case it relates directly to the same category in the allocation of primary income account.

3. EXPENSE AND EXPENDITURE

95. An expense transaction is one that decreases net worth and worsens net lending/borrowing. The purchase of a non-financial asset is not an expense because it has no effect on net worth. Total expense consists of production related expenses (compensation of employees, intermediate consumption and capital services), property income payable (mainly interest), and various types of transfer payments (social benefits, current and capital grants to other governments, and miscellaneous other current and capital transfers).
96. Compensation of employees, intermediate consumption, and capital services all relate to the costs of production undertaken by government itself. Possible variations with the government finance presentation include payments made for the production of fixed assets on own account, expenses for goods intended for resale without being used in production, and changes in inventories of work in progress and finished goods.
97. Governments typically produce many services and some goods and then distribute them for free or at prices that are not economically significant. The cost of these goods and services is recorded as a use when they are produced and again as a social benefit or final consumption expenditure when they are distributed. To reduce unnecessary duplication, these costs are recorded only as production expenses in the government finance presentation.
98. In principle, retirement benefits paid to government employees are considered the liquidation of a liability rather than a payment of a current expense. However, in practice social benefits as reported in government accounts may include retirement benefits paid to government employees from non autonomous government employee pension schemes. To exclude these transactions of pension liabilities, the contributions must also be excluded from revenue, and the item adjustment for the change in net equity of households on pension funds is excluded from expense.
99. Expenditure is defined as expense plus the net acquisition of non-financial assets minus capital services. The net acquisition of non-financial assets is the sum of the gross capital formation and acquisitions, less disposals of non-produced non-financial assets, less capital services

4. BALANCING ITEMS

100. The net operating balance is defined as total revenue less total expense. It is the balance of all transactions that affect the net worth. It is equivalent to the changes in net worth due to saving and capital transfers (B.10.1) in the sequence of accounts. It provides a measure of the sustainability of government policies as it represents the resources acquired or consumed in the government's current operations.

101. Net lending/net borrowing can be calculated as the net operating balance less the net acquisition of non-financial assets plus capital services, or total revenue less total expenditure. It represents the amount the government has available to lend or must borrow to finance its non-financial operations.

102. Net lending/net borrowing is also the balancing item of the financial account, although in practice a statistical discrepancy could appear as a result of using different sources, and of possible errors and omissions.

5. THE RELATIONSHIP BETWEEN NET LENDING/BORROWING AND THE CHANGE IN DEBT

103. Net lending/net borrowing is the balancing item of the financial account and is determined by all the transactions in financial assets and liabilities. There is a close relationship between the level of net lending/net borrowing and the change in debt, with debt constituting a major share of the liabilities recorded on the balance sheet. Debt is defined in chapter XI in terms of the types of financial instruments.

104. For analytical purposes, there is often interest in the relationship between net lending/borrowing and debt. Attention to government debt usually centres on the amount owed to non-government units.

Depending on the existence of levels of government, there may be a substantial amount of debt issued by one government unit and held by a second government unit. If the statistics are consolidated, this debt would be eliminated. However, the debt of the general government sector, the central government sub-sector, or the public sector, separately identified could be analytically useful.

105. Although government debt is mainly the result of the financing of accumulated government deficits, the relationship includes several other flows. The change in debt is by definition equal to the change in debt from transactions in debt liabilities plus the change from other changes in the volume of assets plus the change from revaluations. It is also true by definition that the change in debt liabilities from transactions is equal to the change in financial assets from transactions minus net lending/ net borrowing minus the change in non-debt liabilities from transactions. Combining these equalities produces the following equation:

Increase in debt (at current market prices) is equal to the algebraic opposite of:

Net lending/borrowing
 - transactions in financial assets
 + transactions in liabilities other than debt
 - change in debt from revaluations
 - change in debt from other changes in the volume of debt liabilities

106. In fact, the term “net lending/net borrowing” is a sort of terminological shortcut. When the variable is positive, it should be called net lending, when it is negative, it should be called net borrowing. If it is negative, the increase in debt can then be expressed as the net borrowing plus the sum of the other four elements of the equation, which might be combined into a single deficit-debt adjustment (DDA). When the deficit and debt are separately measured, the DDA can be an indicator for the reliability and consistency of the accounts.

6. CONSOLIDATION

107. Consolidation is a method of presenting statistics for a set of units as if they constituted a single unit. It involves eliminating transactions and reciprocal stock positions among the units being consolidated. Consolidation may be undertaken for any group of units, but it can be particularly important for the general government sector and its sub-sectors. For example, assessing the overall impact of government operations on the total economy or the sustainability of government operations is more effective when the measure of government operations is a set of consolidated statistics. To relate government aggregates to the economy as a whole (as in revenue or expense to GDP ratios), it is better to eliminate the internal churning of funds and include only those transactions that actually cross the boundaries with other sectors or non-residents. This is of particular relevance for transactions like property income (in particular interest), current and capital transfers, and transactions in financial assets and liabilities.
108. Consolidation adjustments do not affect balancing items because the items consolidated are symmetric within each account. That is, two sides of the consolidation adjustment fall within the same account. For example, a grant (or transfer) from a central government to a local government unit is consolidated by eliminating the expense from central government and the revenue from the local government, thus leaving unchanged saving of the general government sector.
109. Conceptually, the nature of consolidation is to eliminate all flows among the consolidated units, but practicality should be kept in mind. For example, some argue that transactions in the production account, such as sales and purchases of goods and services, should not be consolidated. The decision about the level of detail employed in consolidation should be based on the policy usefulness of the consolidated data and the relative importance of the various types of transactions or stocks.

110. The major transactions considered for consolidation, in likely order of importance, are:

- Current and capital transfers, such as central governments grants to lower levels of government.
- Transactions in financial assets and liabilities, such as loans to other governments for policy purposes, acquisitions of government securities by social security units, and debt forgiveness.
- Interest income/expense on intergovernmental holdings of financial assets and liabilities.
- Acquisitions/disposals of non-financial assets, including intergovernmental transactions in land, buildings, and equipment.
- Taxes paid by one government unit or entity to another
- Purchases/sales of goods and services between government units.

111. Two types of transactions that appear to take place between two government units are never consolidated because they are rerouted in the System to other units. First, all employer social contributions, whether paid to social security or to government pension funds, are treated as being paid to the employee as part of compensation and then paid by the employee to the fund. Second, all taxes withheld by government units from the compensation of their employees, such as pay-as-you-earn (PAYE) taxes, and paid to other governments should be treated as being paid directly by the employees. The government employer is simply the collecting agent in this case for the second government unit. Taxes on gross payroll and workforce that are not earmarked as social contributions should, however, be consolidated when they are significant and can be identified.

112. Practical difficulties always arise with consolidation. For example, when a transaction to be consolidated is identified in the records of one unit, it is expected that the corresponding transaction will be found in the accounts of the counterparty, but it may not exist there, it may be recorded in a different period, it may have a different value, or it may be classified as a different type of transaction. These difficulties are inherent in the quadruple system of recording used in the System and could exist with any transaction, but they may be more obvious with inter-governmental transactions.

113. Consolidation should be undertaken only for the units within the sector or sub-sector for which the statistics are being compiled. That is, if statistics for each sub-sector of the general government sector are being separately compiled, then transactions and stocks between the sub-sectors should not be eliminated for the statistics of each sub-sector, but should be eliminated for statistics of the entire general government sector.

7. CLASSIFICATION OF FUNCTIONS OF GOVERNMENT

A classification of expense or expenditure transactions using the Classification of Functions of Government (COFOG) is integral to the government finance presentation. This classification, which is provided in annex (X), shows the purpose for which expense/expenditure transactions are undertaken. These purposes could differ significantly from the administrative arrangement of governments, i.e. an administrative unit responsible for health services could undertake some activities with a educational purpose, such as training of medical professionals. A cross classification of the transactions of government by both economic nature and according to functions is encouraged.

D. ACCOUNTING ISSUES RELATED TO THE GENERAL GOVERNMENT AND PUBLIC SECTORS

1. SELECTED TRANSACTIONS

114. Principles as embedded in the System should be applied to general government and public sectors in the same way that they apply to all other sectors of the economy. However, due to the economic nature of the activities of government units, in practice some additional guidance is required to assist with the treatment of selected transactions. This section provides additional guidance on the recognition and basis of recording of revenue and expense transactions, classification of non-financial assets and treatment of government specific debt transactions.

Tax revenue

115. Taxes are compulsory unrequited payments, in cash or in kind, made by institutional units to the general government exercising its sovereign powers. They usually constitute the major part of government revenue (up to 90% in some countries). Taxes are usually described as unrequited because, in most cases, the government provides nothing commensurate with the payment in exchange to the individual unit making the payment. However, there are cases where the government provides something to the individual unit against the payment in the form of the direct granting of a permit or authorisation. In this case, the payment is part of a mandatory process that ensures proper ownership recognition and performance of activities under the strict authorisation by the law. The delineation of such payments to be treated as a tax, or as the sale of a service, or the sale of an asset by the government requires additional guidance.

116. As quoted in SNA Chapter VII (§7.55), “The borderline between taxes and payments of fees for services rendered (by the

government) is not always clear cut in practice, however.” In the case of licences and permits delivered by the government, it is recommended to:

- Record as tax: when, against the payment of an amount legally defined, a licence or a permit is automatically granted by the government as a mandatory condition to perform an activity or acquire an asset (a good), and with the government unit performing little or no work—other than a minimum control of the legal capacity of the acquirer to do so (for instance, by not having been convicted of a crime). The payment of the licence in such a case will not be commensurate with the control function that the government exercised.
- Record as purchase of a service when a service is provided in return for the payment: for instance, if the issuance of the licence or permit implies a proper regulatory function of the government—exercising control on the activity, checking competence or qualifications of the persons concerned etc. In such a case, unless the payment is clearly in proportion to the costs of producing the service for all or any of the entities benefiting from the services.

Warning: The following has not been fully clarified. The ISWGNA will consider the matter further.

- Record as a sale of an intangible asset when the licence provides exclusive rights to perform an activity to one or to a small number of operators. This type of licence has the characteristics of an economic asset, making it “a store of value.” It implies the existence of an underlying asset (a produced asset or natural resource). One characteristic of the

licences to be recorded as a sale of assets is that their number is strictly limited. On the contrary, a usual feature of licences and permits recorded either as tax or as purchase of a service is that, in principle, there is no limit to the number of licences and permits to be granted.

Accrual recording of government transactions

117. “Accrual accounting records flows at the time economic value is created, transformed, exchanged, transferred or extinguished.” (SNA 1993, §3.94). It is different from cash recording, and in principle from due-for-payment recording, defined in §3.93 as the latest time payments can be made without additional charges or penalties. “The period of time (if any) between the moment a payment becomes due and the moment it is actually made is bridged by recording a receivable or a payable in the financial accounts” (SNA, §3.93). “The System recommends recording on an accrual basis throughout” (SNA, §3.91). However, it is recognised that for some transactions, like dividends or transfers (miscellaneous current transfers or capital transfers), the due for payment time is relevant.
118. Like all transactions in the system, government transactions should be recorded on an accrual basis. This is true on both revenue side (for example taxes and social contributions), and the expense side (for example, interest charge). The basic reason is that national accounts aim to be able to measure, at any moment, revenue and expense, transactions in non-financial assets, and claims and liabilities between economic agents, when economic value is created, transformed, exchanged, transferred or extinguished.
119. For the government, recording revenue and claims when the underlying event occurs is particularly difficult, since often government recordings—for tax in particular—are on a cash basis. Moreover, when accrued taxes are calculated from assessments of taxes due, there may be a risk of over recording the tax revenue, which is a crucial government

finance aggregate. This is the reason for clarifying the principles for accrual recording of various transactions.

120. As prescribed in chapter III for the definition of accrual recording (see §3.93), the period of time between the moment a tax—or any distributive transaction (social contributions, interest etc.)—is recorded as accruing (or due) in the non-financial accounts and the moment the payment is actually made is bridged by recording an account receivable in the financial account. In cases where a prepayment, covering two or more accounting periods, is made to government, an account payable—a financial advance—is recorded in the financial account of government for the amounts due in future periods. This liability is extinguished when recording the due amounts of the transaction in the future period(s). However, recording such a liability should occur only when the government could have, legally or by means of a constructive obligation, the obligation to make a refund to the payer for the pre-paid amounts.

Accrual recording of taxes

121. Taxes should be recorded when the activities, transactions or other events occur which create the liability to pay tax—in other words when the taxable events occur—and not when the payments are actually made. This time is usually when income is earned or when a transaction (such as the purchase of goods and services) generating the liability occurs, to the extent that the tax liability can reliably be measured. The different institutional arrangements for taxation (existence or not of assessments, like tax rolls for instance) may lead in practice to using different recording methods, according to the characteristic of the tax. Methods to record taxes on an accrual basis are two fold: first the amounts can be extracted from accounts using accrual principles (like company statements) or from assessments of the fiscal administration. Second, the method of “time-adjusted cash” can be used. This method is equivalent to estimating the average delay between the date of generating tax and the date of cash receipt

and to shifting the cash amounts based on this average delay.

122. However, concerning the amounts to be recorded, an important principle is that, in all cases, only amounts that government realistically expect to collect should be recorded. Uncollectible taxes should not be accounted for in the total revenue and in the net lending/net borrowing of the general government. This is one of the reasons to accept as an implementation of the accrual principle the time-adjusted cash method (estimated cash amounts of the period of the taxable event). In case where the amounts recorded are based on tax assessments, some uncollectible taxes—and taxes unlikely to be collected—may be accounted for in the total tax amounts. The right implementation of the accrual principle in this case is to record as total tax amounts only realistic assessments. If subsequently any amount recorded as taxes is discovered to be uncollectible, these amounts should be treated as a capital transfer.
123. In practice, when taxes are based on assessments, some flexibility is permitted concerning the time of recording in two cases where the measurement cannot be done in a reliable way before the time of assessment:
- Parallel economy: some activities escape temporarily the attention of the tax authorities, but it may then happen that government succeeds to collect some taxes based on these activities. It is then difficult to place the liability to pay tax in relation to the taxable event. In this case, an acceptable time of recording will be the time of the tax assessment (or payment).
 - Taxes on income: some tax systems may require the development of a roll or another form of tax assessment before the amounts of tax due will be known in a reliable way, taking into account the changes in tax rates and final settlements. This moment, which is the one where the economic behaviour of households is affected, is an acceptable time of recording. It is not necessarily the accounting period in which the payment is received.

Tax credits

124. Tax relief can take the form of a tax allowance, exemption, or deduction—which is subtracted from the tax base—or of a tax credit—which is subtracted directly from the tax liability otherwise due by the beneficiary household or corporation. Tax credits can sometimes be payable, in the sense that any amount of the credit that exceeds the tax liability (otherwise due) will be paid to the beneficiary. In contrast, some tax credits are non-payable and are limited to the size of the tax liability (otherwise due).
125. In national accounts, a tax relief that is embedded in the tax system should be recorded as reducing the tax liability and therefore as reducing government tax revenue. This is the case of tax allowances, exemptions, and deductions, as they enter directly into the calculation of the tax liability. This will also be the case for non-payable tax credits as their value to the taxpayer is limited to the size of their tax liability (otherwise due). In contrast, this should not be the case for *payable tax credits*, which by definition might concern non-taxpayers as well as taxpayers. As they are payable, this sort of tax credits should be considered as expense and recorded as such for their total amount. The government tax revenue will therefore be grossed up for the total amount of payable tax credits, as well as the government expense. This has no impact on the net borrowing/net lending of the general government, but of course has an impact on both the tax burden and the public expense or expenditure ratios (defined usually as total expense/GDP or total expenditure/GDP). However, the presentation of values should permit the derivation of tax credits on a net basis also.

Permits and licenses

Warning: The ISWGNA has not yet decided the treatment of the permits discussed in this section.

126. One of the regulatory functions of governments is to forbid the ownership or use

of certain goods or the pursuit of certain activities unless specific permission is granted by issuing a permit, licence or other certificate, for which a fee normally is demanded. Some permits or licences grant permission to use an existing government asset, such as a produced asset or natural resources (the “underlying asset”, *see also* §111). When these licences are issued on a restricted basis—the number of beneficiaries is strictly limited—they can be viewed as intangible assets. Other treatments are possible.

127. This section considers the treatment of government permits and licenses that do not grant the purchaser the use of an existing government-owned asset (the “underlying asset”). There are three general possibilities:

- Some permits are granted automatically on payment of the amounts due and the issue of the permit involves little or no work on the part of government. These transactions are classified as taxes receivable by government, either other taxes on production or miscellaneous current taxes within current taxes on income, wealth, etc. depending on the unit purchasing the permit and the reason for purchasing it.
- Some permits are granted automatically on payment of the amounts due, but the government uses the requirement to obtain a permit to exercise some proper regulatory function—for example, checking the competence or qualifications of the person concerned, checking the efficient and safe functioning of the equipment in question, or carrying out some other form of control that it would otherwise not be obliged to do. These transactions should be treated as the sale of a service by the government. Even in this case, however, the transactions should be treated as a tax if the amount of the payment is clearly out of all proportion to the cost of providing the service.
- Other permits (without an underlying asset) are granted on a restricted basis rather than automatically on payment of the amounts due, where restricted means the number of permits is limited and the

permit holder enjoys some degree of exclusivity in undertaking the permitted activity. In this case the permit holder can expect to earn above-normal profits when the profits are calculated without taking into account the cost of the permit. Depending on the degree of exclusivity and the demand for the activity, the potential profits may be quite large and, as a result, the permits can be sold for correspondingly large amounts. The price of the permit in this case is a means for the government to appropriate most of the anticipated above-normal profits that will be created by the government’s restrictions. These transactions are to be recorded as taxes receivable by government in the same way as unrestricted permits.⁶

128. Some permits treated as a tax are valid for more than one year. If the terms of the permit are such that the issuing government is not liable, either legally or by means of a constructive obligation, to make a refund to the permit holder if the permit were to be rescinded by government or surrendered by the holder, then the entire payment is treated as a tax when the permit is acquired.

Interest (including fungible bonds, index-linked securities, zero-coupon bonds, derivatives)

129. Interest is an expense incurred by a debtor for the use of another unit’s funds (see also SNA93, §7.93-94-95). In the SNA 1993, interest is classified as property income (D.41, interest). Differently to dividends (D.42), interest may entitle the holder/the lender to a fixed and predetermined income (or according to an agreed reference in the case of a floating interest rate). In the case of the general government sector, interest is a major expense item, most of governments being structurally borrowers in the market.

⁶ It is assumed that the price of restricted permits will be out of all proportion to the cost of providing any services that may accompany the permits so that the permits would be classified as taxes rather than sales of services.

130. In the System—in the same spirit as in commercial and in financial accounting—interest is recorded on an accrual basis, i.e., interest is recorded as accruing continuously over time to the creditor on the amount of principal outstanding” (§7.94). It is recorded according to the debtor approach (or original cost of borrowing principle), based on the rate prevailing—or agreed on—at the time of creation of the financial instrument.

131. ***Warning to the editor: it is proposed here to record accrued interest with the underlying instrument and not to leave the choice to record it under receivable/payable.*** Recording interest as accruing continuously has the consequence, on a security for instance, that the accrued interest charge will be recorded starting at the time the security has been issued, not awaiting for the time of the first coupon payment (usually in the following year, in the classical case of a security with a yearly coupon payment). It means also that accrued interest on securities becomes a liability as soon as the first day it is issued, an element of the debt and that, in the logic of accrual accounting, interest is reinvested under the financial asset bearing it.⁷ As a result, accrued interest is always to be added to the value of the principal of the underlying instrument, and, subsequently, interest payments reduce the debtor’s liability. This basic principle should cover all financial instruments bearing interest.

132. The method of determining the interest payable on some specific instruments issued by government units is indicated in the following paragraphs.

133. Fungible bonds: in many countries, government long-term bonds are issued in fungible tranches, over several years, with the same conditions concerning the nominal rate

Warning: paragraph to be checked following discussion in last TFHPSA meeting.

⁷ By contrast, in some other definitions of debt (for instance the Maastricht debt in the European Union, measured at face value), accrued interest is not reinvested under the debt instrument.

of interest. The rate of interest agreed on at issuing the bond is used for calculating interest on all of these bonds.

134. Index-linked securities. Index-linked securities are financial instruments, usually long-term bonds, for which the amounts of the periodic payments and/or the principal are linked to a price index or an exchange rate index. Any additional payments to creditors due to changes in the index are considered as interest, including the uplift of the principal (if any, due to the index), to be recorded as accruing continuously. When the value of the principal is index linked, the difference between the eventual redemption price and the issue price is treated as interest accruing over the life of the asset, in addition to any interest due in that period.

135. Deep-discounted and zero-coupon bonds. Zero-coupon bonds are instruments such that the debtor has no obligation to make any payments to the creditor until the redemption of the bond. The amount of the principal borrowed is lower than the value of the bond that will be repaid by the debtor. In effect, the debtor’s liability is discharged by a single payment at maturity covering both the amounts of the principal and the interest accrued over the life of the instrument. In the System, the difference between the amount repaid at the end of the contract and the amount initially borrowed is interest that must be allocated over the accounting periods between the beginning and the end of the contract. The interest accruing each period is treated as being paid by the debtor and then reinvested as an additional amount of the same liability. Interest expense and increase in the liability are thus recorded each period. The same principle applies to deep-discounted bonds, which is a slightly different case to the extent that there are actual periodic low interest payments in the contract. In this case, the interest expense to be recorded is the amount of accrued interest (corresponding to the contract) plus the amount accruing each period attributable to the difference between the redemption price and the issue price.

136. Financial derivatives. Settlements on swap transactions are no longer considered as property income in the System. The settlements related to financial derivatives are financial transactions, to be recorded at the time of the effective exchange of financial instrument.

Rate of return on government assets/capital services

137. Non-market output other than output for own final use, which includes most output by units of the general government sector, is to be measured by the sum of the costs of production, which is the sum of intermediate consumption, compensation of employees, capital services of non-financial assets, and other taxes (less subsidies) on production. Output for own final use should, if possible, be valued at basic prices, but if reliable basic prices cannot be calculated, then this output should also be measured by the sum of the costs of production.

138. Capital services should be calculated for all fixed assets used by non-market producers, including infrastructure assets. By convention, no return to capital will be applied to other classes of assets. In particular, no return to capital should be calculated for open land and in principle, for land under buildings.

139. As described in Chapter VI, the complete formula for calculating capital services comprises four principal terms:

- i) a return to capital equal to the real interest rate multiplied by the value of the asset at the beginning of the period
- ii) *less* the anticipated real holding gain or loss of owning an asset
- iii) *plus* consumption of fixed capital
- iv) *all multiplied by* a discount factor that takes account of the fact that the three other terms are in the future.

140. For most assets the anticipated real holding gain will be close to zero and the second term in the formula can be ignored. For some assets, however, the anticipated real holding gains/losses can be significant. For example,

an owner of a computer would normally expect its price to fall in real terms over and above that due to depreciation given past experience of falling real prices.

141. The real interest rate usually is small, in which case the fourth term in the formula also can be ignored. In this case, a reasonable approximation of the user cost of capital is the return to capital plus depreciation.

142. The real interest rate used to determine the return to capital should reflect the cost of borrowing money. It is recommended to take a representative average of the implicit rates on all government bonds outstanding, to average the term structure, and smooth the effects of changes in rates over time. Because the real interest rate is used, no adjustment is necessary for countries experiencing high inflation.

143. Consumption of fixed capital is the decline, during the course of the accounting period, in the current value of the stock of fixed assets owned and used by a producer as a result of physical deterioration, normal obsolescence or normal accidental damage. It is parallel to the accounting practice of depreciation. It is a component of the value of capital services, but it is also required to estimate the change in the value of fixed assets over time.

144. Consumption of fixed capital is generally estimated for the government as for other sectors using the perpetual inventory method.⁸ Accounts of the government can be used if these accounts follow SNA guidelines (market price and economic asset life).

145. Consumption of fixed capital must be calculated for all fixed assets, including infrastructure and military fixed assets.

Military expense and transactions in military fixed assets

146. Items such as bullets, bombs, grenades and torpedoes, which are designed for a single use, should be recorded as expense of

⁸ See SNA93, §6.188 and following. See also "Measuring Capital," *OECD Manual* (2001).

government because it is not considered as being used continuously in production. In contrast, military weapon systems provide an on-going service of deterrence against aggressors and, being used continuously in production of the service—for more than one year and therefore meet the general criteria to be classified as fixed assets. This should include armoured vehicles, warships, fighter and bomber aircraft, and ballistic missiles.

147. As a result, the acquisition of weapons systems is to be recorded as gross fixed capital formation, whilst the acquisition of ammunition is to be recorded as an expense that would result in a change in inventories. Treating weapons systems as fixed assets implies the need to estimate their expected service lives, and capital services. It is recommended that gross fixed capital formation for defence equipment be presented separately from other types of gross fixed capital formation. If weapon systems classified as fixed assets are destroyed in combat, their disappearance should be recorded in the “other changes in volume of assets account,” in the same manner as other fixed assets destroyed in war. When the single-use items classified as inventories are expended, whether in combat or in training exercises, their use is an intermediate consumption of government, with an offsetting reduction in inventories.

Transactions with international and supranational organisations

148. These transactions occur between resident units and either international or supranational organisations classified in the Rest of the World (see also §76. It has to be emphasised that some of these transactions that might be channelled in practice through government units (like taxes and subsidies) will be in national accounts directly earmarked to the final beneficiary every time the government unit is only a collecting intermediary.⁹ Six

⁹ See SNA chapter III, “Recognising the principal party to a transaction”, and in particular paragraph 3.33 (collecting taxes or subsidies on behalf of another).

major types of transactions have to be considered in this context:

- Taxes: Some taxes on products, such as import duties, excises, and value added taxes, might be paid to a supranational organisation (for example, the European Union). If they are considered to be levied directly by the supranational organisation (it is usually the case in the European Union), they are recorded as being paid by the total economy to the Rest of the World and do not appear in the accounts of the general government sector. If they are considered to be levied by the national government and paid to the supranational organization, the taxes would be receivable by the central government with a subsequent transfer payment from the government to the supranational organization.
- Subsidies: Any subsidies paid by a supranational organisation directly to a resident producer is recorded in the same manner as other subsidies except that they are payable by the supranational organisation rather than a resident government unit. However, subsidies payable to resident producers and channelled through the resident government unit will give rise to a payable in the accounts of the resident government unit.
- Current international cooperation: most current transfers (except taxes and subsidies, *see above*), in cash or in kind, between the government and non-resident units including international organisations are classified as current international cooperation. This includes current aid to developing countries, wages paid to teachers and to other government agents in activity abroad etc. One characteristic of the current international cooperation is that it consists of transfers made on a voluntary basis.

- Miscellaneous current transfers: for example, payments of the so-called “fourth resource” to the European Union by its members are based on the gross national income of each member. These payments are considered to be compulsory, but not taxes. They are recorded as a miscellaneous current transfer.
- Capital transfers: Both investment grants, in cash or in kind; and other capital transfers, especially as the counterpart transaction of debt cancellation or assumption can be paid to or received from an international or supranational organisation.
- Financial transactions: Some financial transactions, usually loans, may be recorded when granted by international organisations (World Bank and International Monetary Fund).

149. The payment of membership dues and subscription fees by central governments to international organisations are either a transfer payment (current international cooperation) if there is no possibility of repayment or the acquisition of a financial asset if there is a possibility of repayment, even if unlikely.

Development assistance

150. Governments provide assistance to other countries is by lending funds at an interest rate that is intentionally less than the market interest rate for a loan with comparable risk (concessional loans as described in section 2), or grants in cash and in kind.
151. Recording the international assistance through grants in kind, such as deliveries of food stocks, often creates difficulty. The prices of the goods or services being delivered in kind, such as the food stocks, in the receiving country might be quite different from the prices in the donor country. As general principle, the value of the donation to the recipient should be regarded as equal to the cost of providing the assistance to the

recipient. It follows that the prices of the donor country should be used as a basis for the calculation of the value of the donation. In addition to the goods or services themselves, all supplemental costs identifiable with the delivery of the goods or services should be included, such as transportation to the foreign country, delivery within that country, the compensation of government employees of the donating country to prepare the shipments or oversee their delivery, insurance, and so forth.

2. DEBT AND RELATED OPERATIONS

Debt operations

152. Debt is a commonly used concept, defined in terms of types of financial instruments. All debt instruments are liabilities, but some liabilities such as shares and equity are not debt.

153. Debt operations can be particularly important for the general government sector as they often serve as a means for government to provide economic aid to other units. The recording of these operations is covered in Chapter XI, but it is worth summarising the following recommendations here. The general principle for any cancellation or assumption of debt of a unit by another unit (made by mutual agreement), is—unless an effective financial asset is given in exchange—to consider that there is a voluntary transfer of wealth between the two units (“something for nothing”). This means that the counterpart transaction of the liability assumed or of the claim cancelled is a capital transfer. No flow of money being usually observed, this may be analysed as a capital transfer in kind.

154. Debt assumption occurs when a unit assumes responsibility for another unit’s outstanding liability to a creditor, which happens most frequently when a government guaranteed a debt of another unit and the guarantee is called (or activated). (The treatment of the guarantee itself is described in the following section.) When a government assumes a debt, in most instances the counterpart transaction of the new government liability is a capital

transfer in favour of the defaulting debtor. However, if the government acquires an effective legal claim against the defaulting unit and there is a realistic probability that the claim will be paid, the government may record, as the counterpart transaction of its new liability, the acquisition of a financial asset equal to the present value of the amount expected to be received. If this amount is equal to the liability assumed, no further entries are required, but if the amount expected to be recovered is less than the liability assumed, the government records a capital transfer for the difference between the liability incurred and any asset acquired. If a government has its debt assumed by another government, then it records a capital transfer receivable, a new debt to the assuming government unit, or both.

155. Debt payments on behalf of others are similar to debt assumptions, but the unit making the payments does not assume the entire debt. The transactions recorded are similar.
156. Debt forgiveness (or debt cancellation) is the extinction or reduction of a debt by contractual agreement between the creditor and the debtor. The forgiving unit records a capital transfer payable for the amount forgiven and the other unit records a capital transfer receivable.
157. Debt restructuring is an agreement to alter the terms and conditions for servicing an existing debt, usually on more favourable terms for the debtor. The debt instrument that is being restructured is considered to be extinguished and replaced by a new debt instrument with the new terms and conditions. If there is a difference in value between the extinguished debt instrument and the new debt instrument, it is a type of debt forgiveness and a capital transfer is necessary to account for the difference.
158. A debt-for-equity swap occurs when a creditor agrees to replace a debt owed to it by an equity security. For example, the government may agree with a public enterprise owned by it to accept an increase in the government's equity stake in the public enterprises in place of a loan. Any difference
- in the value of the debt instrument being extinguished and the replacement equity is a capital transfer if the agreement had an explicit debt forgiveness element, otherwise the difference should be recorded as a revaluation.
159. Debt write-offs refer to unilateral reductions by a creditor in the amount owed to it, usually when a creditor concludes that a debt obligation has no value or a reduced value because the debt is not going to be paid (in full or in part): the debtor is bankrupt or has disappeared. An other change in the volume of assets is used to record the write off. Thus, contrary to debt assumption (§145) and debt forgiveness (§147), no capital transfer is recorded and, therefore, there is no impact on net lending/borrowing of government.
160. Debt arrears occur when a debtor misses an interest or principal payment. The debt instrument will not normally change, but knowing the amount of debts in arrears can provide important information. When feasible and important, therefore, each category of debt should be divided into those instruments that are in arrears and those not in arrears.
161. Debt defeasance occurs when a debtor matches debt instruments with financial assets having the same or greater debt service inflows. Even when the defeased instruments have been transferred to a separate entity, the gross position should still be recorded by treating the new entity as an ancillary unit and consolidating it with the defeasing unit. If the ancillary unit is non-resident, it is treated as a special purpose entity and the transactions of government with this unit should be treated as described in section B.
162. Debt issued on concessional terms. There is no precise definition of concessional loans, but it is generally accepted that they occur when units of the general government sector or public sector lend to other units and the contractual interest rate is intentionally set below the market interest rate that otherwise would apply. The degree of concessionality can be enhanced with grace periods, frequencies of payments, and a maturity period favourable to the debtor. Because the

terms of a concessional loan are more favourable to the debtor than market conditions would otherwise permit, concessional loans effectively include a transfer from the creditor to the debtor.

Warning: A final decision about the treatment of concessional loans was not yet available. The following text may need revision.

163. In the system, concessional loans are recorded at their nominal value just as other loans, but a capital transfer should be recorded as a memorandum item at the point of loan origination equal to the difference between the nominal value of the debt and its present value using a relevant market discount rate. There is no single market interest rate that should be used to measure the capital transfer. The Commercial Interest Reference Rate published by the OECD may be applicable when the loan is issued by one of its member countries.

Bailouts

164. A bailout is a loosely defined term meaning a rescue from financial distress. It is often used when a government unit provides short-term financial assistance to a corporation to help it survive a period of financial difficulty or a more permanent injection of financial resources to help recapitalize the corporation. Bailouts of financial institutions are particularly noteworthy, and are often referred to as financial defeasance. Bailouts are likely to involve highly publicized one-time transactions with large values and, therefore, be easy to identify.

165. Intervention of general government may take various forms. For instance:

- A government may guarantee certain liabilities of the enterprise to be assisted.
- A government might provide equity financing on exceptionally favourable terms.
- A government might purchase assets from the enterprise to be assisted for

prices greater than their true market value.

- A government might create a special purpose entity or other type of public body to finance and/or to manage the sales of assets or liabilities of the enterprise to be assisted.

166. Government guarantees during a bailout are treated in the same manner as other guarantees. In this case, they would be treated as one-off guarantees, which will normally lead to a capital transfer if the guarantee is called.

167. If the government buys assets from the enterprise to be assisted, the amount paid will normally be more than the true market price of the assets. The purchase should be recorded at the actual market price and a capital transfer should be recorded for the difference between the market price and the total amount paid.

168. Governments often buy loans from financial institutions during a bailout for their nominal value rather than their market value. Given that loans are valued at nominal prices in the System, there may not be justification for recording a capital transfer even though there clearly has been a transfer. If there is reliable information that some loans are irrecoverable (fully or for nearly their total amount), these loans should be accounted for at zero and a capital transfer should be recorded for their former nominal value.

169. If a public institutional unit is created by government with its only task being to assume management of the bailout, the unit should be classified in the general government sector. If the new unit is intended to be an on-going concern with the bailout a temporary task, its classification as a government unit or a public corporation is made following the general rules as described in the section on restructuring agencies above. Units that purchase financial assets from distressed financial corporations with the objective of selling them in an orderly manner cannot be considered financial intermediaries because

they do not place themselves at risk. They must be classified in the general government sector.

Debt guarantees

Warning: Further distinction between standardized guarantees and one-off guarantees is being considered by the ISWGNA.

170. A debt guarantee is an arrangement in which a guarantor agrees to pay a creditor if a debtor defaults. For general government, giving a guarantee is a way to support economic activities without a need for an immediate cash outlay. Guarantees have a significant impact on the behaviour of economic agents by modifying the lending and borrowing conditions on financial markets.
171. For each guarantee, there are three parties involved—the lender, the borrower, and the guarantor. Stocks and flows of the credit relationship are recorded between the lender and the borrower, while stocks and flows of the guarantee relationship are recorded between the lender and the guarantor. The activation of guarantees involves the recording of flows and changes in the balance sheets of the debtor, the creditor, and the guarantor.
172. There are three main types of guarantees: (i) guarantees that meet the definition of a financial derivative; (ii) standardised guarantees; and (iii) one-off guarantees.
173. Guarantees that meet the definition of financial derivatives are those that are actively traded on financial markets, such as credit default swaps. The derivative would be based on the risk of default of a reference instrument and so not actually linked to an individual loan or bond.
174. When such a guarantee is initiated, the purchaser pays a fee to the financial institution creating the derivative. This is recorded as a transaction in financial derivatives. Changes to the value of the derivative are recorded as revaluations. If the reference instrument defaults, the guarantor pays the purchaser for its theoretical loss on the reference bond. This is also recorded as a transaction in financial derivatives.
175. Guarantees for which the probability of default can be established but do not meet the definition of a financial derivative, and hence are related to an actual financial arrangement between lender and borrower, are treated as standardized guarantees. These guarantees cover similar types of credit risk for a large number of cases. It is not possible to estimate precisely the risk of any one loan being in default but it is possible to estimate many out of a large number of such loans will default. As a result, it is possible for the guarantor to determine suitable fees: working on the same principle as an insurance corporation with the fees received in respect of many loans covering the losses from the few defaulting loans. Governments have been observed helping borrowers by charging fees that are less than cost. Classic examples are export credit guarantees or student loan guarantees.
176. These guarantees are to be recorded like insurance. When fees cover costs, part of the fee is recorded as output by the guarantor and consumption of the unit paying the fee; and the other part is the incurrence of a liability by the guarantor and the purchase of a financial asset (the guarantee) by the creditor. These assets and liabilities are classified as insurance technical reserves.
177. The value of the output and consumption is determined in a manner similar to that of insurance corporations and equals the difference between premiums received and the net present value of the estimated cost of future claims.
178. The initial value of the financial asset and liability is equal to net present value of the estimated cost of future claims. This value is a probability-weighted calculation. The amount would be recorded as a provision in public accounts compiled on an accruals basis.
179. For guarantees that last no more than one year, the expected cost of calls would be recorded in D.71 (insurance premium).

Similarly for guarantees that last more than one year, the expected cost of calls would be spread over the future years in accordance with the risk in each year and recorded in D.71 each year. In effect this accrues part of the premium (the part used to fund claims rather than output) over the life of the guarantee. The counterpart to this payment is a transaction in F.63 reducing the F.63 asset and liability.

180. Claims would be recorded in insurance claims D.72, with a counterpart in the cash or accounts payable.
181. Property income is imputed for the unwinding of the discount component in the estimated cost of future claims. This property income is deemed to be reinvested in an additional amount of the guarantee.
182. Other changes in the financial asset and liability, such as from a changed perception of the risk due would be recorded as other changes in the volume of assets.
183. Actual payment may be made by the creditor or the debtor, but the asset is always recorded in the balance sheet of the entity that holds the right to make a claim on, and receive funds from, the guarantor. Rerouting transactions are needed when the entity that pays the premium is not the one that holds the asset. The precise details of the rerouting would depend on the actual circumstances.
184. If a publicly controlled market guarantor sells guarantees for premiums that do not cover the costs fully, a subsidy from the government to the guarantor should be imputed for the amount relating to the administration costs and a capital transfer for amounts relating to the expected costs of calls. If a government unit provides the guarantee to a creditor without a fee, a capital transfer should be imputed from the government to the creditor, which then purchases the guarantee.
185. One-off guarantees exist where the conditions of the loan or the security are so particular that it is not possible for the degree of risk associated with the loan to be calculated with any degree of accuracy. In most cases, the granting of a one-off guarantee is considered a

contingency and is not recorded as a financial asset/liability for the guarantor. As an exception, one-off guarantees granted by governments to corporations in certain well-defined financially distressed situations and with a very high likelihood to be called might be treated as if these guarantees were called at inception.

186. The activation of a one-off guarantee is treated in the same way as a debt assumption. The original debt is liquidated and a new debt is created between the guarantor and the creditor. In most instances, the guarantor is deemed to make a capital transfer to the original debtor, unless he would acquire an effective claim on the creditor, in which case it would lead to the recognition of a financial asset (a liability of the debtor).
187. The activation of a guarantee may or may not require repayment of debt at once. The accrual principle for time of recording suggests that the total amount of debt assumed should be recorded at the time the guarantee is activated and the debt assumed. Principal repayments by the guarantor (the new debtor) and interest accruals on the assumed debt should be recorded when these flows occur.

Securitisation

188. Securitisation occurs when a unit, named the originator, conveys the ownership rights over financial or non-financial assets and/or the right to receive specific future flows, to another unit, named the securitisation unit, and the securitisation unit pays an amount to the originator from its own source of financing. The securitisation unit is often a special purpose entity. The securitisation unit obtains its own financing by issuing securities using the assets and/or rights to future flows transferred by the originator as collateral. Government units have made widespread use of this source of finance.
189. The first case involving government to be considered is when the securitisation comprises the sale (or the transfer) of an asset. The key-question for recording the transaction properly is to determine whether the transfer

of the asset is a sale of an existing asset to the securitisation unit or a way to borrow using possible future flows of revenues as collateral. In principle, to be treated as a sale, the asset must pre-exist in the SNA balance sheet of the government and there must be a full change of ownership to the securitisation unit as evidenced by the transfer of the risks and rewards linked to the asset. The following factors must also be considered:

- The purchase price should equal the current market price to be a sale.
- **Warning: This section is currently in the process of being checked by Eurostat.** In some cases, the amount paid to the originator by the securitisation unit is less than the current market price of the asset, but there is provision for an additional payment if the securitisation unit receives more from its use or disposition of the asset than is necessary to repay any debts incurred. For such an arrangement to be considered a sale, the initial price must be a large percentage of the current market price and the likelihood of additional payments must be considered virtually certain.
- If the government, as the originator, guarantees repayment of any debt incurred by the securitisation unit related to the asset, it is unlikely that all of the risks associated with the asset have been transferred.

190. The second case involving government is the securitisation of future revenue flows. In most of these cases, it is not the rights to the income that are used as collateral, but the obligation of the government to use a sufficient amount of the future income to repay the borrowing in full. If more income is earned than is needed to repay the borrowing, the excess is retained by the government. Because receipts of future income are uncertain, usually “rights” to considerably more income than is necessary to repay the borrowing of the securitisation unit is used as collateral. The amount received by the

government as the originator is treated as borrowing, usually in the form of a loan.

Pension obligations

191. The treatment of pensions for government employees is identical to the general treatment of pension described elsewhere, primarily in Chapters IV, VI, VII, VIII, XI, and XIII. Government pensions are particularly important because they are often operated on an unfunded basis. Among the issues for pensions are the output of pension funds, the existence and valuation of pension liabilities, and property income attributed to the owners of pension assets.

192. Employers’ pension schemes are arrangements set up to provide retirement benefits to participants, based on a contractual employer-employee relationship. They include funded, unfunded, and partly funded schemes. They can be autonomous or non-autonomous. Autonomous schemes are included in the pension funds sub-sector of the financial corporations sector. Non-autonomous schemes are included in the sector of the sponsor.

193. Output should be recorded for all autonomous pension funds. In principle, output of non-autonomous pension funds should be also recorded, when possible. It should be measured at cost, including the full management cost of any insurance company managing the fund on behalf of an employer. The cost of managing non-autonomous pension schemes should be classified as individual final consumption; output should be recorded as consumed by the beneficiaries of the funds (i.e., households); for non-autonomous defined benefit schemes, an income should be imputed to the policyholders equal to the property income due to the reduction in the discount period plus the imputed service charge.

194. All pension liabilities of employers, therefore also for the government as an employer, should be recognized, irrespective of the degree to which the pension schemes are funded. However, there can be problems in

drawing a distinction between pension schemes for government employees and social security. Additional criteria such as the nature of the liability—whether it is a contingent claim, a constructive obligation, or an actual liability—have to be taken into account. The System recommends the creation of a special supplementary table where social security schemes would be accounted for as if they had pension liabilities. When their nature is close to social security, pension obligations of government employer schemes can be recorded in these supplementary accounts, alongside social security. In addition, as the flows associated with unfunded pension schemes can involve large imputations, it is recommended that the imputed components of flows and stocks be separately identified.

A paragraph is to be drafted here to explain these supplementary accounts once the ISWGNA has agreed to include them and how they are to be structured.

195. The value of property income imputed to the beneficiaries (and recorded as supplementary pension contributions) for defined benefit schemes should represent the expected return on the accumulated value of benefits, due to the unwinding of the discount factor applied to the value of these benefits plus the imputed service charge.
196. The accumulated value of benefits included in the balance sheet of defined benefit schemes, and the increase in that value due to service provided in the current period, should be calculated only on service to date and using current wage and salary levels. An alternative method of estimating benefits is to use the wage and salary levels projected to retirement date. Such estimates should be included as a memorandum item.
197. An acceptable discount rate for a government pension scheme would be the interest rate on government bonds and with the terms to maturity consistent with the time horizon of the pension liability.
198. Social security schemes are generally unfunded. Some, however, are funded. In general these amounts are “buffer funds”, allocated to the scheme to smooth its cash flow management. These financial assets are not considered in the System as the property of the beneficiaries, and the contributions to and payments of benefits by these schemes should be treated as current transfer schemes. However, there may be also mixed schemes, where part of what is labelled as a social security scheme functions in fact as a funded pension scheme. In this case, it is recommended to separate this part from the rest, and either classify it as a pension fund, outside the general government sector or classify it as a government unit but treating the scheme as a saving scheme.
199. On occasion, large one-off transactions may occur between a government and another unit, usually a public corporation, linked to pension reforms or to privatizations of public corporations. The goal sometimes can be to make a public corporation competitive, and financially more attractive, by eliminating existing pension obligations. This goal is achieved by the government assuming the liability in question in exchange for a cash payment with the same value, that are both financial transactions. In case the cash payment do not have the same value as the liability incurred, a capital transfer is recorded for the difference.
200. As an equal exchange of cash for the incurrence of a liability, the transaction should not affect the net worth or any other balancing item of the either unit. In some cases, however, the pension liability may not be on the balance sheet of one—or both—of the units. For example, when transferred to the government, the pension obligations may be merged with a social security scheme for which no liability is recognized.
201. In this case, a pension scheme controlled by the government should be created in the national accounts. The rationale is that the pension obligation becomes a full liability because its value has been determined by a transaction. This recognition is similar to recognising goodwill as an asset because a transaction occurs where by the goodwill that was known to exist can now be valued. Other

accounting treatments than creating a pension scheme are possible as long as they have the same absence of impact on the net lending/net borrowing.

3. OUTPUT OF THE GENERAL GOVERNMENT SECTOR IN CURRENT AND CONSTANT PRICES

202. By convention, the output of non-market services by government units is measured in current prices as the sum of the production costs. At constant prices, however, it is desirable to measure the output of these services in volume terms rather than as the sum of deflated production costs. Subject to the availability of data, this is likely to be possible for the majority of individual services and for some collective services.
203. This output method is based on quality-adjusted quantity indicators, combined using weights which reflect the cost of the activity covered by the indicator. The quantity indicators should be defined in sufficient detail to ensure that the activities being covered are reasonably homogeneous. If the available indicators cover only part of the relevant function of government, the remaining part should be taken account of in one of two ways: When the activities not covered by the indicators are very similar to those which are covered, then the volume can be assumed to change in the same way. If the activities not covered by the indicators are not similar, it will be more appropriate to measure the uncovered activities based on their costs of production.
204. When doing these calculations, it is important to ensure that the indicators are measuring outputs which can be attributed to government, and not outcomes. In some cases, outcome measures may be useable as indicators of the quality of the output, but they need to be clearly used in that way and not as output indicators. In some cases, particularly for collective government services, it may not be possible to identify any output indicators. In those cases, a second best default approach is to estimate the constant price output as the sum of constant price inputs. A limitation of this approach however is that it is then

assumed by the methodology that productivity is constant.

4. RELATIONS OF GENERAL GOVERNMENT WITH CORPORATIONS

Earnings from equity investment

205. Any government unit will have a close relationship with any public corporation or quasi-corporation that it controls. Despite this close relationship, flows between a government unit and its controlled corporation related to the equity investment are treated in the same way as flows between any corporation and its owners. An equity investment is the action by economic agents of placing funds at the disposal of corporations in exchange for specific financial assets. The amounts invested—the equity capital—are part of the own funds of the corporation and the corporation has a large degree of freedom in the way of using them. In return, the owners receive in shares or some other form of equity securities. These financial assets represent property rights on corporations and quasi-corporations and entitle the holders to:
- a share of any dividends (or withdrawals of income from quasi-corporations) paid at the choice of the corporation but not to a fixed and predetermined income, and
 - A share in the net assets of the corporation in the event of its liquidation.
206. It is important to distinguish between the return of the equity investment by the corporation to its owner and the payment of income in the form of dividends. Only regular distributions from the entrepreneurial income are recorded as dividends or withdrawals of income from quasi-corporations. Large and irregular payments to the owner should be recorded as a withdrawal of equity.
207. An alternative way to record the distribution of a wholly owned public corporation's earnings is part of the research agenda of the SNA but may be usefully summarized here as it can help to explain what is meant as regular

distributions from entrepreneurial income in the above paragraph. This approach is similar to the treatment of reinvested earnings on foreign direct investment described in chapter VII. If the approach were to be adopted:

- The distributable earnings of the corporation, whether distributed or not, would be accrued to the government owner as property income. The amount would then be shown as reinvested in additional equity of the corporation. The amount of distributable earnings is equal to the operating surplus of the enterprise (B2) plus any property incomes or current transfers receivable minus any property incomes or current transfers payable..
- All payments to the owners, including dividends, would be recorded as financial transactions.
- All capital injections into the public corporation by the government unit, including debt assumptions and debt cancellations, would be recorded as financial transactions.

208. This approach corresponds to a consolidation of net saving between government and wholly owned corporations. An advantage is that the problem of making subjective assessments when analysing large and irregular payments to owners would be avoided.

Taxes versus withdrawal of equity

209. Taxes normally have a strong legal basis and are under the control of well-established legislative procedure. These transactions, which are treated by convention as being made by mutual agreement, constitute the main revenue of the general government.

210. However, it may happen, on an exceptional basis, that a transaction described as a tax in legal documents should not be recorded as such in the System. One example is the case of an indirect privatisation. If a public holding corporation sells its equity ownership in another public corporation and remits some of

the proceeds to the government in the form of a tax, such as a capital gains tax, the payment should nevertheless be recorded as a financial transaction.

Dividends versus withdrawal of equity

211. The earnings from equity investment in public corporations may be recorded as a distributive transaction (usually dividends) or, in some cases, as a purely financial transaction. Dividends are property income. The resource available for distribution of dividends is the entrepreneurial income of the corporation. In principle, the resources from which dividends are paid should neither include the proceeds of sales of assets nor the revaluation gains. The same basic principles apply to withdrawals from income of quasi-corporations. However, in order to smooth the amounts of dividend payments, some public corporations may allocate a part of their profits in a special reserve, dedicated to further distribution of dividends. Smoothed dividends in this context are still recorded as property income in national accounts. Different is the case of large and irregular payments, based on accumulated reserves or sale of assets: these payments are to be recorded as a withdrawal of equity.

Acquisition of equity, capital transfers, and subsidies

212. Subsidies are current transfers, usually made on a regular basis, from government, or exceptionally from the rest of the world, to corporations designed to influence their levels of production, the prices at which their outputs are sold or the remuneration of the corporations. Payments to public corporations on a large and irregular basis (often called “capital injections“ in the media) are not subsidies. They are a capital transfer or an acquisition of equity:

- Payments to cover accumulated losses provided for public policy purposes should be recorded as a capital transfer.

- However, a payment made in a commercial or competitive context can be treated as an acquisition of equity. This should be limited to cases where the government is acting similarly to a private shareholder in that it has a valid expectation of a cash return in the form of a property income. In this case, the corporation likely will issue new shares, and enjoy a large degree of freedom in the way of investing the funds provided.

213. It is expected that in many cases, payments made by government units to public corporations intend to compensate losses. Treatment as an acquisition of equity should depend on evidence of the corporation's profitability and its ability to pay dividends.

Privatization and nationalization, including holding corporations

214. The classical case of privatisation—a sale of shares in a public corporation, directly made by the government—is straightforward: this is a financial transaction, recorded in the financial account. This flow corresponds to a reshuffling of assets (AF.5 against AF.2) in the balance sheet of the government. Any purchase of financial services to achieve this process should, however, be recorded as intermediate consumption. A sale of non-financial assets, such as buildings and land, rather than an entire corporation would be recorded in the capital account as disposals of fixed assets or non-produced non-financial assets.

215. Privatisation might be organised in more complicated institutional arrangements. For instance, if some or all of the assets of a public corporation are sold by a public holding company, or other public agency, controlled by a government, and all or part of the proceeds paid to the government. In all cases, the payment to the government of the proceeds of the sale of assets in this manner is to be recorded as a financial transaction, with a simultaneous decrease in shares and other equities corresponding to the partial liquidation of assets of the holding company.

216. It may also happen that the public holding company, or other public agency, acts as a “restructuring agency.” In such a context, the proceeds of the sale will not be paid to the government but kept by the restructuring agency to inject capital in other enterprises. Two main possibilities of treatment are:

- The restructuring unit, whatever its legal status, acts as a direct agent of government and is not a market producer or a financial intermediary. Its main function is rather to restructure and change the ownership status of public corporations and to channel funds from one unit to the other. The unit should be classified in the general government sector.

- The restructuring unit is a genuine holding company controlling a group of subsidiaries, and only a minor part of its activity is dedicated to channelling funds in the way described above, on behalf of government and for public policy purposes. The public holding company is classified in one of the corporations sectors according to its main activity. The recommended treatment in this context is to reroute the transactions made on behalf of government through the government unit.

217. Nationalisation means the taking of control by a government of specific assets or an entire corporation, usually by acquiring the majority or the whole stake in the corporation. The recording of flows differs according to the way the taking of control is operated by government:

- Appropriation/confiscation: the change in ownership of assets is not the result of a transaction made by mutual agreement. There is no payment to the owners (or the compensation is far from the fair value of assets). The difference between the market value of the assets acquired and any compensation provided is recorded as an uncompensated seizure in the other changes in the volume of assets account.

- Purchase of shares: the government buys all or part of the shares in the corporation at market price—or at a price sufficiently close, considering usual market practices with regard to valuation of corporations in the same branch of activity. There is usually a legal context for the transaction which ensures that it is made by mutual agreement, even though the former owner may have little choice to accept or not the offer, or to negotiate the price. The purchase of shares is a financial transaction to be recorded in the financial account.

Restructures, mergers, and reclassifications

218. When a public corporation is restructured, financial assets and liabilities may appear or disappear reflecting new financial relationships. These changes are recorded as changes in sector classification and structure in the other changes in the volume of assets account. An example of such a restructuring is when a corporation is split into two or more institutional units and new financial assets and liabilities are created.
219. The purchase of shares and other equity of a corporation as part of a merger, on the other hand, is to be recorded as a financial transaction between the purchasing corporation and the previous owner.
220. Any change in the classification of assets and liabilities not related to restructuring or changes in sector classification, such as the monetisation or demonetisation of gold is recorded as a change in the classification of assets or liabilities in the other changes in the volume of assets account.

Transactions with the central bank

221. It is assumed that, in the general case, the central bank is a public financial corporation. It is a financial intermediary, whose activity is subject to specific legal provisions, and which is placed under a certain type of control of the central government (which is supposed to represent the national interest), even though it is commonly agreed that the central bank

enjoys a large degree of autonomy or independence with respect to exercising its main activity. The key issue here is more the recognition of the central bank's main function and activity—to manage the nation's reserve assets, to issue the national currency and to conduct the monetary policy—rather than its legal status. Therefore, in this general case, ownership of the central government over the central bank—or, at least, over the reserve assets managed by the central bank—will be recognised in national accounts, as an economic ownership if not as a legal one.

222. Two types of payments by the central bank to the government will be observed in practice:

- Payments made on a regular basis, usually in the form of dividends, based on the current activity of the central bank (like managing foreign exchange reserves). These payments are recorded as dividends as long as they are not higher than the sum of net interest and net commissions receivable by the bank in the same year. Amounts in excess of this sum are to be recorded as a decrease in equity.
- Exceptional payments following sales or revaluation of reserve assets. These payments should be recorded as a withdrawal of equity. The rationale is that these assets are being managed as the economic property of the nation and not of the bank itself. Their valuation affects the equity liability of the central bank and the equity assets of the government. Holding gains on the reserve assets (assets of the central bank) will have a counterpart in the equity liability of the central bank and the equity assets of the central government.

Quasi-fiscal operations

223. Fiscal operations are carried out by the government and financed through the budget under the usual budgetary procedures. However, some operations originated by government units may require the intervention of entities which are not ruled by the legal

government framework, including public corporations. Though they will not be reported in the budget, and might escape the usual control procedures, they may have significant impact on government revenue and expenditure: they are sometimes called quasi-fiscal operations. The following might be considered quasi-fiscal operations: operations related to privatisation and restructuring public corporations, securitisation of assets, using the intervention of special purpose entities, including abroad, as well as of restructuring units.

Public-private partnerships

Warning: The ISWGNA is still deciding how to treat this subject. One possibility is as a separate annex that can be updated when the treatment becomes clearer.

224. Public-private partnerships (PPPs)¹⁰ are complex, long-term contracts between two units, one of which is normally a private, for-profit enterprise and the other normally is a government unit.¹¹ PPPs normally involve a collection of expensive fixed assets being acquired by the private unit, which then operates and manages the assets to produce and deliver services either to the public unit or to the general public on behalf of the public unit. At the end of the contract, the public unit often acquires legal ownership of the fixed assets, sometimes without payment or for a payment that clearly is less than the market value. The fixed assets are often referred to as infrastructure assets because many of the large projects undertaken by means of PPPs involve the provision of transportation, communications, utilities, or other services typically described as infrastructure services.

225. Governments engage in PPPs for a variety of reasons, including the hope that private

management may lead to more efficient production and that access to a broader range of financial sources can be obtained. PPP contracts frequently generate difficult accounting decisions because legal ownership of the assets may differ from operational control, there may be an advance agreement for the transfer of legal ownership part way through the service lives of the assets, observed monetary transactions may take place at prices that are not market prices, and actual transactions may have to be rearranged to reveal their true economic character.

226. PPPs vary greatly. A general description that includes the most common accounting problems is as follows: A private enterprise agrees to acquire a complex of fixed assets and then to use those assets together with other production inputs to produce services. Those services may be delivered to the government, either for use as an input to its own production (for example, motor vehicle maintenance services) or for distribution to the public without payment (for example, education services), in which case the government will make periodic payments during the contract period and the private enterprise expects to recover its costs and earn an adequate rate of return on its investment from those payments. Alternatively, the private enterprise may sell the services to the public (for example, a toll road), with the price regulated by the government but set at a level that the private enterprise expects will permit it to recover its costs and earn an adequate rate of return on its investment. At the end of the contract period, the government may gain legal ownership and operational control of the assets, possibly without payment. There can be many variations in PPP contracts regarding the disposition of the assets at the end of the contract, the required operation and maintenance of the assets during the contract, the price, quality, and volume of services produced, and so forth.

227. The private enterprise acquires the fixed assets and is the legal owner of the assets during the contract period, although the acquisition is often aided by the implicit backing of the government. The contract may

¹⁰ This use of PPP should not be confused with the use of PPP to represent purchasing power parities (see chapter XVI).

¹¹ It is also possible for a public corporation to occupy the role of either unit and for a private non-profit institution to occupy the role of the government unit.

require, however, that the assets meet the design, quality, and capacity specified by the government, be used in the manner specified by the government to produce the services required by the contract, and be maintained in accordance with standards specified by the government. Furthermore, the assets typically have service lives much longer than the contract period so that the government will control the assets, bear the risks, and receive the rewards for a major portion of the assets' service lives. Thus, it frequently is not obvious whether the private enterprise or the government controls the assets over their service lives and/or will bear the majority of the risks and reap the majority of the rewards.

228. As with leases, the economic owner of the assets related to a PPP is determined by assessing which unit bears the majority of the risks and which unit is expected to receive a majority of the rewards of the assets. Some of the factors that might be considered in making this assessment are

- The degree to which the government controls the design, quality, size, and maintenance of the assets.
- The degree to which the government is able to control the services produced, the units to which the services are provided, and the prices of the services produced.
- Construction risk, which includes the possibility of additional costs resulting from late delivery, not meeting specifications or building codes, and environmental and other risks requiring payments to third parties.
- Availability risk, which includes the possibility of additional costs or the incurrence of penalties because the volume and/or quality of the services do not meet the standards specified in the contract.
- Demand risk, which includes the possibility that the demand for the services is higher or lower than expected.

- Residual value and obsolescence risk, which includes the risk that the asset will be less than their expected value at the end of the contract and the degree to which the government has an option to acquire the assets.
- The presence, if any, of third party revenues—the greater the reliance on sales to the public, the more the private enterprise should be assessed to be the economic owner,

229. The relative importance of each factor is likely to vary with each PPP. It is not possible to state prescriptive rules that will be applicable to every situation in a satisfactory way. The provisions of each PPP will have to be evaluated in order to decide which unit is the economic owner.

230. Likewise, the complexity and variety of PPP contracts precludes the enumeration of detailed rules governing the transactions to be recorded concerning the control and use of the assets. Instead, all of the facts and circumstances of each contract should be considered, and then an accounting treatment should be selected that best brings out the underlying economic relationships. There are, however, a few common difficulties.

231. If the private enterprise is assessed as being the economic owner and if—as is common—the government obtains legal and economic ownership at the end of the contract without an explicit payment, a transaction must be recorded for the government's acquisition of the assets. One general approach is for the government gradually to build up a financial claim and the private unit gradually to accrue a corresponding liability such that the value of both will equal the expected residual value of the assets at the end of the contract period. Implementing this approach requires existing monetary transactions to be rearranged or new transactions to be constructed using assumptions about expected asset values and interest rates. An alternative approach is to record the change of legal and economic ownership as a capital transfer. The capital transfer approach does not reflect the

underlying economic reality as well, but data limitations, uncertainty about the expected residual value of the assets, and contract provisions allowing various options to be exercised by either party could make using a capital transfer prudent.

232. Another important problem arises when the government is assessed as being the economic owner of the assets but does not make any explicit payment at the beginning of the contract. A transaction must be constructed to accomplish the acquisition. The most common suggestion is that the acquisition be made with an imputed financial lease because of the similarity with actual financial leases. The implementation of that choice, however, depends on the specific contract provisions, how they are interpreted, and possibly other factors. For example, a loan could be imputed and actual government payments to the private unit, if they exist, could be rearranged so that a portion of each payment represents repayment of the loan. If there are no actual government payments, then non-monetary transactions could be constructed for the loan payments. Other means of payment by the government for the asset could be an operating lease prepayment if an operating lease is imputed or an intangible asset for

right of the private unit to access the assets for the production of services.

233. A third important problem concerns the measurement of production. Whatever decisions are made about which unit is the economic owner of the assets during the contract period and how the government eventually acquires them, care should be taken that production is correctly measured. Again, there are options and their desirability varies with the exact situation and the availability of data. The difficulty arises when the government is assessed as being the economic owner of the assets but the assets are used by the private unit to produce services. It is desirable to show the value of the capital services as a cost of production of the private unit, but that may require the imputation of an operating lease, which in turn may require a rearrangement of actual transactions or a construction of non-monetary transactions to identify the lease payments. An alternative is to show the cost of capital services in the production account of the general government sector but to classify the output of the government in the same way as the classification of the output of the private unit so that the total output in the economy is correctly classified.

E. THE PUBLIC SECTOR PRESENTATION OF STATISTICS

234. As described in section B, the public sector includes all resident institutional units controlled directly or indirectly by resident government units. In other words, the public sector consists of all units of the general government sector plus all resident public corporations.

235. Statistics for the public sector can be presented both within the sequence of accounts for institutional units and sectors or within the same government finance framework as described in Section C of this chapter, depending on the use to be made of the statistics.

236. With either method of presentation, it will be useful to show both sub-sectors of the public

sector and the entire public sector, with the total public sector statistics shown both unconsolidated and consolidated. For example, one column might have the statistics for the general government sector, a second column for the aggregate of all public corporations, and a third column would have the unconsolidated totals for the entire public sector. Depending on the flows involved, a fourth column could show the amounts to be eliminated by consolidation and a fifth column could show the consolidated totals for the entire public sector.

237. Not all flows need to be consolidated for the public sector. Because the public sector is a mixture of market and non-market producers,

most components of revenue and expense will have limited economic meaning for the public sector. Elements of the financial account and the balance sheet are the most likely candidates to be consolidated.

238. The same balancing items as stressed for the general government sector are likely to be important for the public sector. The public sector net operating balance (or saving in the sequence of accounts) will indicate trends in net worth resulting from the public sector's current operations. This might be particularly useful if there are public corporations operating at significant losses.
239. Net lending/borrowing becomes the public sector borrowing requirement when calculated for the total public sector. This value will indicate the net financing obtained by the public sector from the rest of the economy, or supplied to the rest of the economy if positive. As with any other unit or sector, it can be calculated as revenue less expenditure or as the balancing item of the financial account.
240. The balance sheet will provide information of net worth, determined as total assets less total liabilities, and financial net worth, determined as the difference between the total financial assets and the total liabilities. The later is often cited because of the public sector's influence on the financial system and because it is often difficult to value government-unique non-financial assets.

ANNEX ON THE GENERAL GOVERNMENT AND PUBLIC SECTORS

A. PUBLIC FINANCE AGGREGATES

241. A number of formulations have been proposed to adapt the traditional SNA sequence of accounts for analysis of public finance statistics. This annex provides a detailed correspondence between the SNA framework and transactions codes and the public finance aggregates (see also section C, §77 and following).

242. The total general government revenue of an accounting period is calculated through the following equation (summing transactions which are *receivable*):

Total revenue = total taxes (D.2 + D.5 + D.91) + total social contributions (D.61) + total sales of goods and services + other current revenue (D.39 + D.4 + D.7) + other capital revenue (D.92 + D.99).

Of which:

Total taxes = taxes on production and imports (D.2) + current taxes on income and wealth etc. (D.5) + capital taxes (D.91)

Total social contributions = actual social contributions (D.611) + imputed social contributions (D.612)

Total sales of goods and services = market output (P.11) + output for own final use (P.12) + payments for non-market output (P.131)

Other current revenue = property income (D.4 = interest, D.41 + dividends, D.42) + other subsidies on production (D.39) + other current transfers (D.7)

Other capital revenue = investment grants (D.92) + other capital transfers (D.99)

NB: Grants are defined in the *GFSM 2001* as “non compulsory transfers received from other governments or from international organisations.” Their amount is equivalent to the sum of the following receivable transfers in the SNA: D.74 + D.92.

243. The total government expenditure of an accounting period is calculated through the

following equation (summing transactions which are *payable*):

Total expenditure = intermediate consumption (P.2) + compensation of employees (D.1) + interest (D.41) + Social benefits (D.62) and social transfers in kind via market producers (D.6311+D.63121+D.63131) + subsidies (D.3) + other current expenditure (D.29+D.5+D.7+D.8) + capital expenditure (P.5+K.2+D.92+D.99)

Of which:

Social transfers in kind via market producers (D.6311+D.63121+D.63131): these are government expenditure financing goods and services provided to households (for individual final consumption) by market producers (SNA, §9.76 and 9.79). Typical examples concern the health care, and goods and services provided by doctors and pharmacists, financed—or reimbursed—by government units (such as social security schemes).

Other current expenditure = other taxes on production (D.29) + current taxes on income and wealth etc. (D.5) + other current transfers (D.7) + adjustment for the net equity of households in pension funds (D.8)

Capital expenditure = Gross capital formation (P.5 = gross fixed capital formation, P.51 + changes in inventories and acquisitions of valuables, P.52 + P.53) + Acquisitions less disposals of non-produced non-financial assets (K.2) + investment grants (D.92) + other capital transfers (D.99)

Total expense = intermediate consumption (P.2) + compensation of employees (D.1) + interest (D.41) + Social benefits (D.62) and social transfers in kind via market producers (D.6311+D.63121+D.63131) + subsidies (D.3) + other current expenditure (D.29+D.5+D.7+D.8+D.92+D.99)

NB: In the calculation of Total expense, and differently from Total expenditure, current

expenditure will include investment grants (D.92) and other capital transfers (D.99)

Balancing items:

- Net operating balance = Total revenue - total expense
- Net borrowing/net lending = Total revenue - total expenditure

The public finance presentation of statistics will also include a financial account whose balancing item will be named Net financial transactions.

- Net financial transactions = Net acquisition of financial assets – net incurrence of liabilities.

Finally, the net worth is equal to the balancing item (B.90) of the balance sheet.

- Net worth = Total assets – Total liabilities

In case the net worth of the general government sector cannot be calculated—due to the lack of information for measuring the stock of non-financial assets, it is recommended to calculate the financial net worth, as the difference between the total financial assets and the total liabilities.

Financial account

244. The financial account of the government records the transactions on financial assets and liabilities of the government in a similar way to the one described in chapter XI for all institutional sectors. In most countries, monetary gold and SDRs are managed by the central bank. In cases where they are managed by the government, they would be recorded in the financial account of the government, on the asset and liability side.

245. Transactions in policy-related financial assets are particularly important for fiscal analysis. It is suggested that a sub-category be created for these assets whenever possible. These assets will be found primarily in shares and other equity, loans, securities other than shares, and currency and deposits. Governments are encouraged to report statistics international reserves. Either a sub-category can be created or a memorandum item can be added.

246. Arrears are important for some governments. A subcategory of each type of liability involving arrears is encouraged.

Other changes in assets accounts

247. Both the other changes in volume of assets account and the revaluation account are virtually identical to the parallel accounts described in chapter XII. All changes in assets and changes in liabilities from non-transaction sources are recorded in one of these accounts.

248. Revaluations will be the same as in the account described in chapter XII, but with the possibility of additional relevant information as memoranda items. For example, revaluations in the equity of public corporations held by government units are likely to be particularly important and, at the same time, difficult to measure because it is unlikely that there will be any market prices.

Balance sheets

249. The same definition of an economic asset is used in the general government accounts as in the System. Hence, the total value of assets and liabilities should be identical and the classification of each should be identical. The importance of public debt, however, may suggest a slightly different presentation to indicate clearly which liabilities are considered debt and the total value of the outstanding debt.

250. In addition to the classification of assets described in chapter XIII, it may be useful to classify general government assets as being general-purpose assets, which are assets that are used much like any other unit might use them; heritage assets, such as historic monuments; and infrastructure assets, such as roads and communications facilities. Also, the identification of policy-related financial assets and international reserves may be appropriate.

B. RELATIONSHIP BETWEEN THE SEQUENCE OF ACCOUNTS AND PUBLIC FINANCE ACCOUNTS

1. *Government Finance Statistics Manual 2001*

Background

251. The IMF published a revised version of its *Government Finance Statistics Manual* in 2001 (*GFSM 2001*) in order to harmonize it as fully as possible with the SNA. It is intended to be a comprehensive, integrated system of macroeconomic statistics reflecting the flows and stocks of governments.
252. The coverage of the system is primarily the general government sector as it is defined in the SNA, but allows for expansion to the public sector.
253. The manual is written from the viewpoint of the government and with the understanding that the statistics would be compiled using almost exclusively the financial accounting records of the governments involved. By compiling statistics conforming as much as possible to the concepts, definitions, classifications, and accounting rules as the SNA, the resulting statistics can be expected to serve as the primary input for the compilation of statistics for the general government sectors of the national accounts by the national statistics office.
254. Because of the assumptions underlying the *Government Finance Statistics Manual 2001*, a comparison of that statistical system with the SNA should focus on the adjustments that need to be made to its statistics in order to make them compatible with the SNA. The following sections provide a brief summary of these adjustments.

Revenue in *GFSM 2001*

255. Revenue in *GFSM 2001* is classified as taxes, social contributions, grants, and other revenue, where other revenue consists of

property income, sales of goods and services, and miscellaneous other items. The various items in the *GFSM 2001* classification can be rearranged to the various accounts in the SNA, mostly resources in the current accounts, and then adjustments can be made to convert them to SNA values.

256. Sales of goods and services are related to output in the production account. As non-market producers, most of the output of the general government sector will not be represented by sales. The total value of the non-market output can, however, be determined by the cost of production as described in chapter VI. That total can then be divided between output for own final use, in this case own-account capital formation, and other non-market output.
257. The value of own-account capital formation is not considered revenue in *GFSM 2001* because it does not improve net worth. It must be added as part of the estimate of non-market output.
258. Sales differ from output by changes in inventories of work in progress and finished goods. While such changes in inventories are likely to be small for non-market producers that produce mainly services, the sales of market output would have to be adjusted for any changes in inventories.
259. Sales data might include the value of goods purchased for resale, such as souvenir items in a government museum gift shop. The value of any such goods is not part of output and need to be deducted.
260. Sales data might also include the value of sales of goods that were previously treated as consumption expenditure when acquired. Any such sales are considered negative consumption in the period sold and are not part of output.
261. Market output includes the value of goods and services produced and exchanged as compensation of employees, barter, or other payments in kind. This value needs to be added to market output.

262. The following adjustments need to be made to sales of goods and services as recorded in *GFSM 2001* to convert them to values of output:

Sales of goods and services
 Plus: output for own final use
 Plus: Other non-market output
 Plus: Value of goods and services produced and exchanged as payment for compensation of employees, barter, or other payments in kind.
 Minus: Sales at prices that are not economically significant
 Minus: Sales of used consumption goods
 Minus: Sales of goods purchased for resale
 Plus of minus: Changes in inventories of goods and services sold for economically significant prices
 Equals: Output

263. Subsidies received by government units are likely to be rare, but all subsidies that might be received are revenue in *GFSM 2001*. Subsidies on production are recorded in the generation of income account as a negative use. Subsidies on products are recorded only in the production account as an entry for the total economy.

264. The total value of taxes in *GFSM 2001* is identical to the value in SNA, but different classifications are used. It should be possible to allocate the various tax categories in *GFSM 2001* the equivalent categories in the SNA, taxes on production and imports, current taxes on income, wealth, etc. and capital taxes without difficulty.

265. Property income in *GFSM 2001* does not include reinvested earnings of direct foreign investment and interest revenue is not adjusted for FISIM because that adjustment is made globally for the total economy.

266. Social contributions in *GFSM 2001* include only those contributions that are not related to pensions or other retirement benefits. Receipts of those contributions are treated

as the incurrence of a liability to provide those benefits.

267. Grants in *GFSM 2001* consists of transfers other than subsidies received by one government unit from a second government unit or an international organization. Current grants are part of other current transfers in the secondary distribution of income account, and capital grants are capital transfers.

268. The miscellaneous other revenue items in *GFSM 2001* are all transfers, both current and capital and are allocated as appropriate, similar to grants.

Expense in *GFSM 2001*

269. Expense in *GFSM 2001* is classified as compensation of employees, use of goods and services, consumption of fixed capital, interest, subsidies, grants, social benefits, other property income, and miscellaneous other expense. As with revenue, the various expense items in the *GFSM 2001* classification can be rearranged to the various accounts in the SNA, mostly uses in the current accounts, and then adjustments can be made to convert them to SNA values.

Use of goods and services
 Plus: goods and services used in own-account capital formation
 Plus: FISIM and insurance services indirectly measured
 Minus: Goods purchased for resale
 Plus of minus: Changes in inventories of goods and services sold for economically significant prices
 Equals: Intermediate consumption

270. Compensation of employees is the same as in the SNA except that compensation with respect to own-account capital formation is recorded as a separate memorandum item. This separation is done to avoid recording the cost of producing fixed assets on own

account as an expense and as the acquisition of an asset.

271. Use of goods and services is similar to intermediate consumption in the SNA, but adjustments have to be made that are similar to the adjustments to convert sales to output, as described in the following tabulation.
272. Consumption of fixed capital is the same as in the SNA except for the amount associated with own-account capital formation recorded as a memorandum in *GFSM 2001*.
273. All taxes on production and imports are recorded as expense in *GFSM 2001*. In the SNA, only other taxes on production are recorded as a use in the generation of income account. Subsidies as an expense in *GFSM 2001* is identical to subsidies recorded as uses in the SNA.
274. Interest expense is not adjusted for FISIM in *GFSM 2001*, just as interest revenue is not adjusted, because the adjustment must be made globally for the total economy.
275. Social benefits, like social contributions, exclude pensions and other retirement benefits in *GFSM 2001* but include those benefits in the SNA.
276. The SNA includes an adjustment for the change in net equity of households on pension funds as a use in the use of disposable income account. It is equal to social benefits paid as pensions or other retirement benefits less social contributions received for pensions or other retirement benefits. Because these items are not recorded as revenue or expense in *GFSM*

2. ESA95 Manual of government deficit and debt

281. Text to be added.

3. OECD Revenue statistics

282. Background

The OECD Revenue Statistics has been in existence for a long time, in harmonisation with

2001, there is no need for this adjustment item.

277. Grants and miscellaneous other expense items are all transfer payments, either other current transfers in the secondary distribution of income account or capital transfers in the capital account.

Other flows and stocks in *GFSM 2001*

278. As mentioned above, it is likely that a large amount will have to be added to sales of goods and services to replicate total output of the general government sector in the SNA. The parallel to that large adjustment is adding equal amounts to social benefits other than social transfers in kind or to final consumption expenditure.
279. Taxes on products paid and subsidies on products received are recorded as expenses and revenues, respectively, in *GFSM 2001* but not as uses or resources in the SNA. They need to be added or subtracted as appropriate when estimating final consumption expenditure. Also, sales of used consumption goods are recorded as revenue in *GFSM 2001* but not as a resource in the SNA. These sales need to be subtracted with estimating final consumption expenditure.
280. All other flows and stocks in *GFSM 2001* are identical to their counterparts in the SNA. These flows include as acquisitions less disposals of non-financial assets, transactions in financial assets and liabilities, other changes in the volume of assets, and revaluation. Stocks include all assets and liabilities on the balance sheet.

the IMF Government finance statistics (for the revenue side), and to a certain extent with the SNA (for the definition of the general government). This standard has focussed on tax revenue. It has allowed the OECD to analyse the

tax levels and tax structures, and in particular to promote the notion of “tax burden”, relevant for international comparisons, also called in the OECD the “Total tax revenue” (to be related to the Gross Domestic Product). In this framework, compulsory social contributions were always included in the total tax revenue.

In addition to the tax revenue, information is also provided on non-tax revenue (current non-tax revenue, capital revenue and grants), usually based on GFS information.

Until the 2003 edition of Revenue Statistics, this standard had the same basic characteristics as *GFSM 1986*: flows were recorded on a cash basis, the main source of information being the ministries of Finance in several member countries. Along with the new GFS standard (*GFSM 2001*), Revenue statistics has started presenting data on tax on an accrual basis starting from its 2004 edition¹². This move has amounted to bring Revenue Statistics closer to the SNA revenue of the general government sector, at least for recent years.

283. Differences with SNA

a) Presentation of tax revenue (see bridge table in annex)

Revenue Statistics present the data by country in one single table for six major categories of taxes (including social security contributions):

- 1000: Taxes on income, profits and capital gains
- 2000: Social security contributions
- 3000: Taxes on payroll and workforce
- 4000: Taxes on property
- 5000: Taxes on goods and services
- 6000: Other taxes

SNA presents taxes and social contributions in three different accounts, in its usual sequence of accounts:

¹² However, about one fifth of OECD countries still report taxes on a cash basis in Revenue statistics.

- D.2: Taxes on production and imports, in the Allocation of primary income account
Of which: D.21: Taxes on products
D.29: Other taxes on production
- D.5: Current taxes on income and wealth, etc., in the Secondary distribution of income account
Of which: D.51: Taxes on income
D.59: Other current taxes
- D.91: Capital taxes, in the Capital account
- D.61: Social contributions, in the Secondary distribution of income account.

b) Other classification or conceptual differences

Some conceptual differences are a source of discrepancies between the measurement of taxes in Revenue statistics and in the SNA framework:

- Social contributions: Revenue statistics do not recognise *imputed* social contributions (from employers’ schemes). In addition, *voluntary* social contributions are not normally included in Revenue Statistics.

- Accrual gross recording of taxes: in national accounts, some countries record taxes and social contributions on an accruals basis by using assessments of amounts due, using in principle realistic assessments, on a gross basis. A correction is then necessary for taxes and social contributions unlikely to be collected using a capital transfer (D.995). This adjustment is to be deducted in national accounts to obtain a comparable Total tax revenue. It is included in Revenue Statistics for the comparison of tax revenues as a percentage of GDP.

- Coverage of taxes: in some exceptional cases, it may happen that a payment called tax in the public accounts is not recorded as such in national accounts. In such cases, the payment to government can be analysed as:

1. A sale of service by the government, accounted for in the market output or as a payment for non-market output (in the production account)

2. A sale of asset: case of government permits to undertake an activity, allocated on

a restricted basis (recorded in the capital account)

3. A financial transaction: the payment is part of the proceeds of sale of assets, in the context of a privatisation for instance (recorded in the financial account).

- Tax credits: in principle, tax credits reduce the tax revenue in Revenue Statistics. In the case of payable tax credits, only the part used to reduce taxes otherwise payable reduces the tax revenue. The part actually paid to the beneficiary—in excess of its tax liability—is treated as government expenditure. However, information is provided to allow the user to adjust the tax revenue figures to alternative treatments of payable tax credits. In the national accounts framework, some countries favour a gross recording of tax revenue, and record payable tax credits entirely as government expenditure. This is the adopted recommendation for payable tax credits in the SNA update.