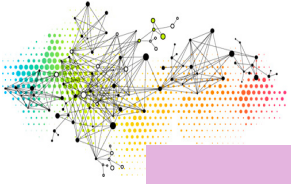


Primary Income Account (L11)

Course on External Sector Statistics

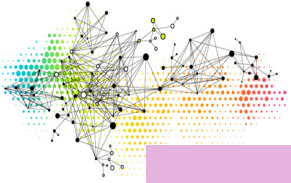
Nay Pyi Taw, Myanmar

January 19-23, 2015



Outline

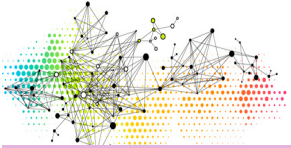
- What Is Income?
- Primary Income
 - Components of the Primary Account
 - Investment Income
 - Dividends, Reinvested Earnings, Interest
 - Recording
 - Direct Investment, Portfolio Investment, Other Investment, and Reserves
 - Other Primary Income



What Is Income?

- Primary Income
 - earnings arising from the provision of a factor of production: labor, Financial assets, land, and natural resources

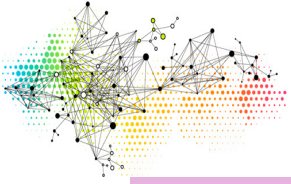
- Secondary Income
 - Redistribution of income through current transfers (e.g., by governments or charitable organizations)
 - *Discussed in subsequent lecture*



Primary Income

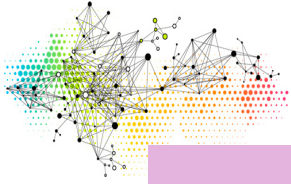
- Production process
 - From provision of labor = **compensation of employees**
 - From taxes and subsidies on products and production (e.g., sales tax or value added, but income tax) = **other primary income**

- Property income
 - From provision of financial assets = **investment income**
 - From renting natural resources (para 11.85) = **other primary income**



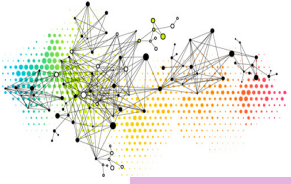
Components of Primary Income

1. Compensation of Employees (*This item will be discussed in one of the following sessions*)
2. Investment Income
3. Other Primary Income (new category)



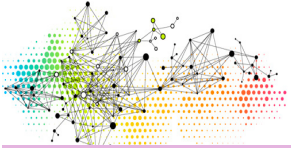
Investment Income

- **Definition:**
 - income accruing to an investor from the ownership of a financial asset
- **Included:**
 - Dividends
 - Reinvested earnings
 - Interest
 - Income attributable to policyholders of insurance, standardized guarantees, and pension funds
- **Excluded:**
 - Retained earnings on portfolio investment equity, *unless investment fund shares*
 - Capital gains and losses
 - financial derivatives and employee stock options
- **Recording:**
 - Investment income (other than dividends) should be recorded on an accrual basis



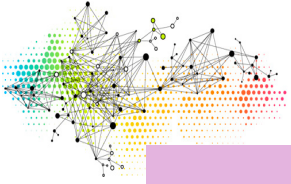
Dividends

- Dividends and withdrawals from income of quasi-corporations are payable on equity and investment fund shares, including other equity.
- Dividends should be recorded in the period when they go ex-dividend (excluded from the market price of shares).
 - however, difficult in practice – often when recorded when paid.



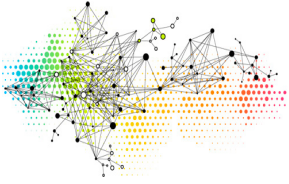
Reinvested Earnings

- Reinvested earnings are the direct investors' share of the retained earnings of the direct investment enterprise. Reinvested earnings also rise from investors' share of the retained earnings of the investment fund.
- Reinvested earnings are imputed as being reinvested in the direct investment enterprise or the investment fund.
 - Reinvestment of earnings may be negative, for example, when a direct investment enterprise or an investment fund has paid dividends out of earnings accrued over previous periods.



Interest

- Investment income receivable by the owner of financial assets (e.g., deposits, debt securities, and loans) for putting the financial assets at the disposal of another institutional unit (para 11.48).
 - Fees on securities lending and gold loans are classified as interest (para 11.67) because they are payments for putting a financial asset at the disposal of another institutional unit

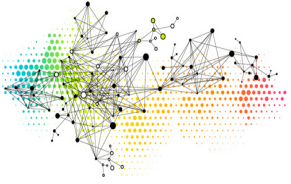


Recording Investment Income: Recording - Accrual Basis (1/2)

Income (other than dividends) should be recorded on accrual basis

- Reinvested earnings should be recorded in the periods, in which the underlying profits are earned.
- Interest
 - Interest accrues to the holder on a continuing basis (because of the continuous provision of capital) and not on cash basis.
 - Therefore, coupon payments are not the same as accrued interest.
 - If no interest or only partial interest payments are made, the price of the instrument rises as interest compounds.
 - the difference between the issue price and the contractual price at maturity (par) should be distributed over the maturity of the bond as assumed that the interest income is reinvested in the bond.
- However, Dividends should be recorded in the period when shares go ex-dividend (excluded from the market price of shares).

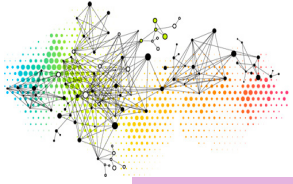
L10 Primary Income Account



Recording Investment Income: Recording - Accrual Basis (2/2)

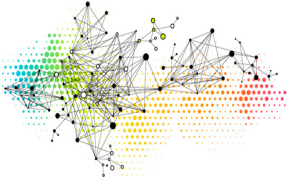
How to record it in BoP?

- Recording income on an accrual basis requires an entry in the financial account to offset any income, which is recorded in the current account, but is not actually paid (the reinvested part).
- This financial account entry is extinguished when the interest is actually paid;
- or in the case of securities issued at discount, such entries are extinguished when the securities are redeemed or sold.



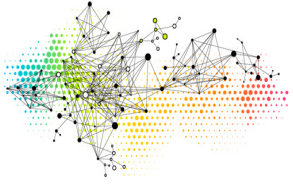
Investment Income and Functional Categories

- Investment Income
 - Direct Investment
 - Portfolio Investment
 - Other Investment
 - Reserves
- Structure is consistent with corresponding financial flows and positions.
- Facilitates the analysis of rates of return (but rate of return also includes other things, such as holding gains and losses)



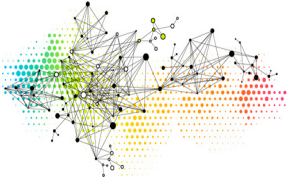
Direct Investment Income: Dividends and Interest

- Dividends and interest to/from non-residents should be on a gross basis (e.g., reverse investment and withholding taxes)
 - Exceptional dividends payments that are made out of accumulated reserves or sales of assets, 'superdividends', are considered withdrawals of equity, **NOT** primary income.



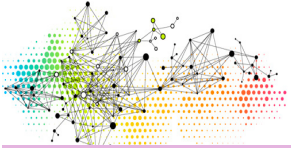
Direct Investment Income: Reinvested Earnings (1/2)

- Reinvested earnings is used as a term for all direct investment enterprises, so includes undistributed branch profits.
- Reinvested earnings of a direct investment enterprise are linked to the concept of **operational earnings** generated from production; and do not include any realized or unrealized holding gains or losses.



Direct Investment Income: Reinvested Earnings (2/2)

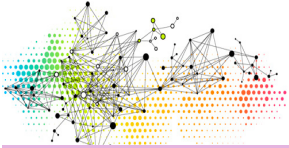
- Investment income attributed to the owners of investment fund shares also includes reinvested earnings (para 11.37).
- Earnings from investment funds can be viewed as being passed on to their shareholders as they are earned in the form of investment income on their equity (para 11.38).



Portfolio Investment Income

- **Income on equity and investment fund shares**
 - Dividends on equity other than investment fund shares
 - Investment income attributable to investment fund shareholders (if ownership is more than 10%, direct investment income)
 - Dividends on investment fund shares
 - Reinvested earnings on investment fund shares (new)

- **Interest**



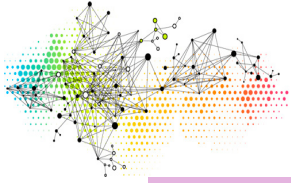
Other Investment and Reserves

Other investment

- Withdrawals from Income of quasi-corporations
- Interest
- Investment income attributable to policyholders in insurance, pension schemes, and standardized guarantee schemes

Reserve assets

- Income on equity and investment fund shares
- Interest



Other Primary Income

- Rent
- Taxes and subsidies on products and production