

INTERNATIONAL MONETARY FUND



# Balance of Payments and International Investment Position Manual

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Sixth Edition (BPM6)



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# Foreword

The International Monetary Fund since its inception has had a compelling interest in developing and promulgating guidelines for the compilation of consistent, sound, and timely balance of payments statistics. This work underpins the IMF's other responsibilities, including conducting surveillance of countries' economic policies and providing financial assistance that enables countries to overcome short-term balance of payments difficulties. Such guidelines, which have evolved to meet changing circumstances, have been embodied in successive editions of the *Balance of Payments Manual* (the *Manual*) since the first edition was published in 1948.

I am pleased to introduce the sixth edition of the *Manual*, which addresses the many important developments that have occurred in the international economy since the fifth edition was released. The fifth edition of the *Manual*, released in 1993, for the first time addressed the important area of international investment position statistics. The sixth edition builds on the growing interest in examining vulnerabilities using balance sheet data, as reflected in the addition of international investment position to the title, and extensive elaboration of balance sheet components. The *Manual* also takes into account developments in globalization, for example, currency unions, cross-border production processes, complex international company structures, and issues associated with international labor mobility, such as remittances. In addition, it deals with developments in financial markets by including updated treatments and elaborations on a range of issues, such as securitization and special purpose entities.

Because of the important relationship between external and domestic economic developments, the *Manual* was revised in parallel with the update of the *System of National Accounts 2008*. To support consistency and interlinkages among different macroeconomic statistics, this edition of the *Manual* deepens the harmonization with the *System of National Accounts* and the IMF's manuals on government finance and on monetary and financial statistics.

The revised *Manual* has been prepared by the IMF's Statistics Department in close consultation with the IMF Committee on Balance of Payments Statistics, which includes experts from a range of member countries as well as international and regional organizations. In addition, input was received from specialized expert groups, and from member countries and international organizations during regional seminars and public comment periods on successive drafts of the *Manual*. In total, representatives from virtually all IMF member countries participated in one or more of these initiatives. The process underlying the revision of the *Manual* demonstrates the spirit of international collaboration and cooperation, and I would like to commend all of the national and international experts involved for their invaluable assistance.

I would like to recommend the *Manual* to compilers and users. I urge member countries to adopt the guidelines of the sixth edition as their basis for compiling balance of payments and international investment position statistics and for reporting this information to the IMF.

Dominique Strauss-Kahn  
*Managing Director*  
International Monetary Fund



# Preface

## Introduction

1. The release of the sixth edition of the *Balance of Payments and International Investment Position Manual (BPM6)* is the culmination of several years of work by the IMF Statistics Department and the IMF Committee on Balance of Payments Statistics (the Committee) in collaboration with compilers and other interested parties worldwide. It updates the fifth edition published in 1993, providing guidance to IMF member countries on the compilation of balance of payments and international investment position data.

2. When the Committee decided in 2001 to initiate an update of the manual, it considered that, while the overall framework of the fifth edition (*BPM5*) remained adequate, it needed to incorporate the numerous elaborations, clarifications, and improvements and updates in methodology that had been identified since 1993, and to strengthen the theoretical foundations and linkages to other macroeconomic statistics. The production of *BPM6* was conducted in parallel with the update of the *OECD Benchmark Definition of Foreign Direct Investment*, and the *System of National Accounts (SNA)* to maintain and enhance consistency among these manuals.

## Consultative process

3. The production of *BPM6* was characterized by extensive consultation. In addition to the Committee's oversight, there was significant outreach to the wider community.

### *Annotated outline*

4. In April 2004, the IMF released an *Annotated Outline* for the update of the manual. It included proposals and options for the style and content of the revised manual. Questions were posed on specific issues to gauge views. The outline was circulated to central banks and statistical agencies, and was posted on the IMF website. Input was invited from compilers and other interested parties worldwide. Altogether, 33 countries provided written comments.

### *Technical expert groups*

5. The Committee established four technical expert groups, with membership from member countries and international agencies, to undertake detailed consideration of issues and make recommendations on currency unions (Currency Union Technical Expert Group, or CUTEG), direct investment (Direct Investment Technical Expert Group, or DITEG), reserves (Reserve Assets Technical Expert Group, or RESTEG), and other issues (Balance of Payments Technical Expert Group, or BOPTTEG). DITEG was chaired jointly with the OECD and had common membership and meetings with the OECD's Benchmark Advisory Group (BAG) to bring about consistent treatments. The issue papers and outcome papers were posted on the IMF's website. Many of the issues discussed also were relevant

for the update of the *SNA*, thus ensuring coordination with the Advisory Expert Group on National Accounts (AEG), which had been created by the InterSecretariat Working Group on National Accounts as an advisory and consultative body for the update of the *SNA*.

6. In addition, other specialized groups provided input on such topics as trade in services, merchandise trade, tourism, remittances, debt statistics, and fiscal statistics. International organizations participated in all stages of the process directly and as members of specialized groups.

### *Worldwide review*

7. Draft versions of the *Manual* were published on the IMF website in March 2007 and March 2008. In each case, worldwide comment was invited within a deadline of three months. About 60 sets of comments were received on the 2007 version, and 20 on the 2008 version. In addition, other draft versions of selected chapters and of the whole document were circulated to Committee members, other departments of the IMF, and other interested parties.

8. Furthermore, an expert review of the draft version was undertaken in January 2008 by Mahinder Gill, a retired IMF staff member and former Assistant Director, who supervised the drafting of *BPM5*, to identify any inconsistencies or omissions in the document, and to check the consistency with the *SNA*.

9. During 2008, a series of nine regional outreach seminars was conducted on the *Manual* to explain the proposed changes and encourage comments on the content and drafting. Representatives from 173 IMF member economies, along with a number of international agencies, participated in these seminars and provided many useful suggestions.

10. Taking account of the written comments on the March 2008 draft, inputs from the regional seminars, and the finalization of Volume 1 of the *2008 SNA*, a new draft version was circulated to Committee members in July 2008. Following a further round of comments by Committee members and internal IMF review, the *BPM6* was adopted unanimously by the Committee in November 2008.

### *Major changes introduced*

11. The overall framework of the fifth edition is unchanged and *BPM6* has a high degree of continuity with *BPM5*. Some of the most significant changes from the last edition are as follows:

- Revised treatment of goods for processing and goods under merchanting;
- Changes in the measurement of financial services, including Financial Intermediation Services Indirectly Measured (FISIM), spreads on the purchase and sale of securities, and the measurement of insurance and pension services;
- Elaboration of direct investment (consistent with the *OECD Benchmark Definition of Foreign Direct Investment*, notably the recasting in terms of control and influence, treatment of chains of investment and fellow enterprises, and presentation on a gross asset and liability basis as well as according to the directional principle);
- The introduction of the concepts of reserve-related liabilities, standardized guarantees, and unallocated gold accounts;
- New concepts for the measurement of international remittances;
- Increased focus on balance sheets and balance sheet vulnerabilities (including a chapter on flows other than those arising from balance of payments transactions);

- Strengthened concordance with the *SNA* (such as the full articulation of the *SNA/Monetary and Financial Statistics Manual (MFSM)* financial instrument classification and the use of the same terminology such as primary and secondary income); and
- Extensive additions to the *Manual*, which is double the length of the original because of added detail and explanation, and new appendixes (such as currency unions, multinational enterprises, and remittances).

12. A detailed list of changes from *BPM5* is provided in Appendix 8 of the *Manual*.

## Acknowledgments

### *IMF staff*

13. The *BPM6* was produced under the direction of three Directors of the Statistics Department (STA): Carol Carson (2001-04), Robert W. Edwards (2004-08), and Adelheid Burgi-Schmelz (2008-). Lucie Laliberté was the responsible Deputy Director (2004-).

14. In the Balance of Payments Divisions, the editor of the *BPM6* throughout the project was Robert Dippelsman, Senior Economist, who provided the essential expert continuity. Robert Dippelsman and Manik Shrestha, a Senior Economist and coeditor, 2002-06, were primary drafters of both the *Annotated Outline* and *BPM6*. The project was supervised by Neil Patterson, Assistant Director (2001-06); Robert Heath, Division Chief (2003-08); and Ralph Kozlow, Division Chief (2007-).

15. Many staff of the Balance of Payments Divisions contributed to the project. John Joice, Senior Economist (2001-), was closely involved in various aspects of the project throughout. The following Senior Economist staff drafted Appendixes: Andrew Kitili (Appendixes 1 and 2), René Fiévet (Appendix 3), and Margaret Fitzgibbon (Appendix 4). Jens Reinke, Economist, drafted Appendix 5. Pedro Rodriguez, an Economist in the IMF's Strategy, Policy, and Review Department (SPR), contributed material for Chapter 14. In addition to staff mentioned above, the following members of the Balance of Payments Divisions conducted the nine regional seminars in 2008: He Qi and Emmanuel Kumah (Deputy Division Chiefs); and Paul Austin, Thomas Alexander, Antonio Galicia, John Motala, and Tamara Razin (Senior Economists). Within the staff of the Balance of Payments Divisions, Simon Quin (Deputy Division Chief); Colleen Cardillo, Jean Galand, Gillmore Hoefdraad, Natalia Ivanik, Eduardo Valdivia-Velarde, and Mark van Wersch (Senior Economists); and Sergei Dodzin, an Economist in SPR, made notable contributions to improving the overall quality of the *BPM6*.

16. Carmen Diaz-Zelaya and Marlene Pollard prepared the *BPM6* drafts for publication. In addition to these staff, Esther George, Elva Harris, and Patricia Poggi supported the preparation of papers for presentation at the Committee or technical expert group meetings.

### *The Committee*

17. The *BPM6* was prepared under the auspices of the Committee. The *BPM6* benefited immensely from the expert advice of Committee members throughout the process; their contribution was crucial to the success of the project. The Statistics Department wishes to acknowledge, with thanks, the members and the representatives of international organizations on the Committee during 2001-08:

## PREFACE

### *Members*

<i>Australia</i>	Zia Abbasi Michael Davies Bronwyn Driscoll Ivan King	<i>Korea</i> <i>Russian Federation</i> <i>Saudi Arabia</i>	Jung-Ho Chung Sergei Shcherbakov Lidia Troshina Abdulrahman Al-Hamidy Sulieyman Al-Kholifey
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<i>China, Hong Kong SAR</i>	Lily Ou-Yang Fong	<i>United States</i>	Ralph Kozlow Obie Whichard
<i>France</i>	Philippe Mesny <sup>1</sup>		
<i>Germany</i>	Almut Steger		
<i>Hungary</i>	Antal Gyulavári		
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<i>Japan</i>	Satoru Hagino Joji Ishikawa Teruhide Kanada Makoto Kato Hideki Konno Takehiro Nobumori Toru Oshita Takuya Sawafuji Hidetoshi Takeda Takashi Yoshimura		

### *Representatives of International Organizations*

<i>Bank for International Settlements (BIS)</i>	Rainer Widera	<i>Organization for Economic Cooperation and Development</i>	Ayse Bertrand William Cave
<i>European Central Bank (ECB)</i>	Werner Bier Jean-Marc Israël Carlos Sánchez-Muñoz Pierre Sola	<i>United Nations Conference on Trade and Development</i>	Masataka Fujita
<i>Eurostat</i>	Elena Caprioli Maria-Helena Figueira Jean-Claude Roman Mark van Wersch	<i>United Nations Statistics Division</i>	Ivo C. Havinga

<sup>1</sup>From 2004 onward, Philippe Mesny represented the Bank for International Settlements.

*Technical expert groups*

18. As noted above, the Committee created four technical expert groups to advise it on specific issues. The Statistics Department is most grateful for the expert advice provided by the members of these technical expert groups.

***Balance of Payments Technical Expert Group (BOPTEG)***

Chair: Neil Patterson

Secretariat: Robert Dippelsman and Manik Shrestha

Zia Abbasi (Australia); Jamal Al-Masri (Jordan); Christopher Bach (United States); Stuart Brown (United Kingdom); Khady Beye Camara (Banque Centrale des États de l'Afrique de l'Ouest, BCEAO); Raymond Chaudron (the Netherlands); Teresa Cornejo (Chile); Michael Davies (Australia); Satoru Hagino (Japan); Han Hongmei (China); Januus Kroon (Estonia); Philippe Mesny (BIS); Pawel Michalik (Poland); Frank Oudekken (the Netherlands); Carlos Sánchez-Muñoz (ECB); Ipumbu Shiimi (Namibia); Almut Steger (Germany); Hidetoshi Takeda (Japan); Nuannute Thana-anekcharoen (Thailand); Charlie Thomas (United States); Mark van Wersch (Eurostat); Chris Wright (United Kingdom).

***Direct Investment Technical Expert Group (DITEG)***

Co-Chairs: Neil Patterson and Ralph Kozlow<sup>2</sup>

Secretariat: John Joice and Marie Montanjees (IMF), and Ayse Bertrand and Yesim Sisik (OECD)

Olga Aarsman (the Netherlands); Zia Abbasi (Australia); Roger de Boeck (Belgium); Lars Forss (Sweden); Christian Lajule (Canada); Mondher Laroui (Tunisia); Jeffrey Lowe (United States); Peter Neudorfer (ECB); George Ng (Hong Kong SAR); Frank Oudekken (the Netherlands); Paolo Passerini (Eurostat); Art Ridgeway (Canada); Carlos Sánchez-Muñoz (ECB); Bruno Terrien (France); Lidia Troshina (Russian Federation); Mark van Wersch (Eurostat); Carlos Varela (Colombia); Martin Vaughan (United Kingdom); Maiko Wada (Japan); Graeme Walker (United Kingdom); Stefaans Walters (South Africa); and Obie Whichard (United States).

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Chair: Robert Heath

Secretariat: René Fiévet and Samuele Rosa (IMF)

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***Reserve Assets Technical Expert Group (RESTEG)***

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Secretariat: Antonio Galicia and Gillmore Hoefdraad

Hamed Abu El Magd (Egypt); Koichiro Aritoshi (Japan); Kevin Chow (Hong Kong SAR); Allison Curtiss (United Kingdom); Mihály Durucskó (Hungary); Saher El-Sherbini (Egypt); Kelvin Fan (Hong Kong SAR); Fernando Augusto Ferreira Lemos (Brazil);

<sup>2</sup>DITEG was a joint task force with the OECD's Benchmark Advisory Group (BAG). Ralph Kozlow was chair of the Workshop of International Investment Statistics (the body overseeing the BAG) while Associate Director for International Economics at the Bureau of Economic Analysis, U.S. Department of Commerce, before joining the IMF's Statistics Department.

<sup>3</sup>Cochaired the second meeting of CUTEG held in Frankfurt.



Reiko Gonokami (Japan); Hideo Hashimoto (Japan); Yang Hoseok (Korea); Mohammed Abdulla A. Karim (Bahrain); Philippe Mesny (BIS); Jean Michel Monayong Nkoumou (BEAC); Linda Motsumi (South Africa); Christian Mulder (Monetary and Capital Markets Department, IMF); Joseph Ng (Singapore); Ng Yi Ping (Singapore); Carmen Picón Aguilar (ECB); Stephen Sabine (United Kingdom); Julio Santaella (Mexico); Dai Sato (Japan); Ursula Schipper (Germany); Jay Surti (Monetary and Capital Markets Department, IMF); Charlie Thomas (United States); Lidia Troshina (Russian Federation); and Yuji Yamashita (Japan).

### *Preparation of issues papers*

Issues papers for four technical expert groups were prepared by Olga Antropova, Ayse Bertrand, Stuart Brown, Richard Button, Robert Dippelsman, Remigio Echeverria, René Fiévet, Jean Galand, Antonio Galicia, Gillmore Hoefdraad, Ned G. Howenstine, Maurizio Iannaccone, John Joice, Andreas Karapappas, Andrew Kitili, Stephan Klinkum, Ralph Kozlow, Marie Montanjees, Frank Ouddeken, Paolo Passerini, Valeria Pellegrini, Art Ridgeway, Samuele Rosa, Carlos Sánchez-Muñoz, Manik Shrestha, Pierre Sola, Hidetoshi Takeda, Bruno Terrien, Lidia Troshina, Philip Turnbull, Martin Udy, Mark van Wersch, and Chris Wright.

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### *Other acknowledgments*

19. The *BPM6* also benefited from comments by national compilers, international agencies, and interested individuals from the private sector arising from the public comment periods on the March 2007 and March 2008 drafts. The IMF Statistics Department acknowledges, with gratitude, their contributions.

20. The IMF Statistics Department is grateful for the support and cooperation of the editor of the *SNA*, Anne Harrison.

Adelheid Burgi-Schmelz  
*Director, Statistics Department*  
International Monetary Fund

# List of Abbreviations

AEG	Advisory Expert Group on National Accounts
AMNE	Activities of Multinational Enterprises
BAG	Benchmark Advisory Group
BCEAO	Banque Centrale des États de l'Afrique de l'Ouest
BEAC	Banque des États de l'Afrique Centrale
BIS	Bank for International Settlements
BOOT	Build, own, operate, transfer
<i>BOPSY</i>	<i>Balance of Payments Statistics Yearbook</i>
BOPTeG	Balance of Payments Technical Expert Group
<i>BPM5</i>	<i>Balance of Payments Manual</i> , fifth edition (1993)
<i>BPM6</i>	<i>Balance of Payments and International Investment Position Manual</i> , sixth edition (2008)
CDIS	Coordinated Direct Investment Survey
CIF	Cost, insurance, and freight
CIRR	Commercial Interest Reference Rate
CMA	Common monetary area
The Committee	IMF Committee on Balance of Payments Statistics
CPC	Central Product Classification
CPIS	Coordinated Portfolio Investment Survey
CR.	Credit
CU	Currency union
CUCB	Currency union central bank
CUNCB	Currency union national central bank
CUTeG	Currency Unions Technical Expert Group
DI	Direct investment
DITeG	Direct Investment Technical Expert Group
DR.	Debit
EBOPS	Extended Balance of Payments Services (Classification)
ECB	European Central Bank
ECCB	Eastern Caribbean Central Bank
EcUn	Economic union
ESO	Employee stock option
FATS	Foreign Affiliates Statistics
FCA	Free carrier
FD	Financial derivatives (other than reserves) and employee stock options
FDIR	Framework for Direct Investment Relationships
FISIM	Financial intermediation services indirectly measured
FOB	Free on board
GAB	General Arrangements to Borrow
GATS	General Agreement on Trade in Services

## LIST OF ABBREVIATIONS

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GDP	Gross domestic product
<i>GFSM</i>	<i>Government Finance Statistics Manual</i>
GNDY	Gross national disposable income
GNI	Gross national income
HIPC	Heavily indebted poor country
HS	Harmonized Commodity Description and Coding System
IC	Insurance corporations
ICPF	Insurance corporations and pension funds
IIP	International investment position
IMF	International Monetary Fund
IMTS	International merchandise trade statistics
<i>ISIC</i>	<i>International Standard Industrial Classification of All Economic Activities</i>
ISWGNA	InterSecretariat Working Group on National Accounts
LIBOR	London interbank offered rate
<i>MFSM</i>	<i>Monetary and Financial Statistics Manual</i>
MMF	Money market fund
<i>MSITS</i>	<i>Manual on Statistics of International Trade in Services</i>
n.a.	not applicable
NAB	New Arrangements to Borrow
n.i.e.	not included elsewhere
NGO	Nongovernmental organization
NPISH	Nonprofit institution serving households
OECD	Organization for Economic Cooperation and Development
OFC	Other financial corporations
OI	Other investment
PF	Pension funds
PI	Portfolio investment
PRGF	Poverty Reduction and Growth Facility
RA	Reserve assets
RESTEG	Reserve Assets Technical Expert Group
RRL	Reserve-related liabilities
SDR	Special Drawing Right
<i>SNA</i>	<i>System of National Accounts</i>
SPE	Special purpose entity
SWF	Sovereign wealth fund

# I Introduction

## A. Purposes of the *Manual*

**1.1** The sixth edition of the *Balance of Payments and International Investment Position Manual (BPM6, the Manual)* serves as the standard framework for statistics on the transactions and positions between an economy and the rest of the world.

**1.2** The main objectives of this *Manual* are as follows:

- (a) To provide and explain concepts, definitions, classifications, and conventions for balance of payments and international investment position statistics;
- (b) To enhance international comparability of data through the promotion of guidelines adopted internationally;
- (c) To show the links of balance of payments and international investment position statistics to other macroeconomic statistics and promote consistency between different data sets; and
- (d) To provide a brief introduction to uses of data on balance of payments, other changes in financial assets and liabilities, and international investment position, as the international accounts of an economy.

**1.3** Data collection and other compilation procedures and dissemination are not generally within the scope of a conceptual manual such as this one. Decisions on such issues should take into account circumstances, such as practical and legal constraints, and relative size, that need to be judged in each economy and that may explain departures from guidelines. The IMF's *Balance of Payments Compilation Guide* provides information on these issues.

**1.4** The *Manual* provides a framework that is applicable for a range of economies, from the smallest and least developed economies to the more advanced and complex economies. As a result, it is recognized that some items

may not be relevant in all cases. It is the responsibility of national compilers to apply international guidelines in a way appropriate to their own circumstances. In implementing this *Manual*, compilers are encouraged to assess the materiality and practicality of particular items according to their own circumstances and are further encouraged to revisit these decisions from time to time to see whether circumstances have changed. Such decisions necessarily rely on the professionalism and knowledge of the compilers.

**1.5** Factors to take into account when determining the items to be collected and the techniques used include whether or not exchange controls exist, the relative importance of particular types of economic activities, and the diversity of institutions and the range of instruments used in financial markets. In addition, data collection for some items in the framework may be impractical if the item is small and the data collection cost is high. Conversely, compilers may wish to identify other items of particular economic interest in their economy for which additional detail may be required by policymakers and analysts.

**1.6** This *Manual* is harmonized with the *System of National Accounts 2008 (2008 SNA)*, which was updated in parallel. Relevant elements of the *Monetary and Financial Statistics Manual 2000* and *Government Finance Statistics Manual 2001* will be revised to maintain their harmonization with the two updated manuals. Conceptual interlinkages mean that balance of payments and international investment position compilers should consult with other statisticians to ensure consistent definitions and provide data that can be reconciled where they overlap.

**1.7** The definitions and classifications in this *Manual* do not purport to give effect to, or interpret, various provisions (which pertain to the legal characterization of official action or inaction in relation to such transactions) of the Articles of Agreement of the International Monetary Fund.

## B. Structure of the *Manual*

**1.8** The *Manual* has 14 chapters and 9 appendixes. The introductory chapters deal with issues that cut across the accounts (Chapters 1-6) and are followed by chapters that cover respectively each main account (Chapters 7-13), closing with a chapter on analysis of data. The *Manual* states general principles that are intended to be applicable in a wide range of circumstances. As well, it applies the principles to some specific topics that have been identified as needing additional guidance. Definitions are given throughout the text, shown in italics.

**1.9** Consistent with this structure, different aspects of a topic are dealt with in different chapters to minimize repetition. For example, the classification of portfolio investment is a cross-cutting issue (Chapter 6), as are valuation and timing issues (Chapter 3). The position, transaction, other changes, and income aspects are dealt with in Chapters 7, 8, 9, and 11, respectively. Linkages are emphasized by extensive cross-references. In addition, for direct investment, insurance, and financial leases, appendixes have been included to allow the reader to see the linkages among the different accounts for that topic.

### 1. Introductory chapters

**1.10** The introductory chapters (Chapters 1-6) cover the following:

- (a) Chapter 1 gives background to the *Manual*.
- (b) Chapter 2 covers the accounting and dissemination frameworks.
- (c) Chapter 3 deals with accounting principles.
- (d) Chapters 4 deals with issues associated with units, sectors, and residence.
- (e) Chapter 5 deals with the classification of assets and liabilities.
- (f) Chapter 6 explains the functional categories.

### 2. Chapters for each account

**1.11** Chapters 7-13 deal with the accounts of the framework. Each account reflects a single economic process or phenomenon and has a single chapter. The order of chapters is a matter of convention; in this edition, the international investment position appears first to reflect the increased emphasis on its compilation and analysis since the release of the fifth edition (*BPM5*) and to explain financial assets and liability positions before dealing with the investment income they generate.

**1.12** Each chapter starts with a statement of general economic principles. A simplified table designed to give an overview of the account is also included in each chapter. The text provides general definitions of items in the account. Specific cases are given as examples of the application of the general definitions and to clear up ambiguities. A full understanding of each account also requires applying the wider principles that apply across several accounts, such as valuation, timing, residence, and classification, as covered in the introductory chapters.

### 3. Analysis

**1.13** Chapter 14 provides an introduction to the analysis of data, with particular reference to macroeconomic relationships as a whole.

### 4. Appendixes

**1.14** Appendixes provide more details on specific issues that go across several accounts, including changes from *BPM5*, currency unions, exceptional financing, debt reorganization, and a listing of standard components.

### 5. Standard components and memorandum items

**1.15** A list of standard items for presenting and reporting the balance of payments and international investment position is given in Appendix 9. Standard items consist of standard components and memorandum items.

- (a) *Standard components are items that are fully part of the framework and contribute to the totals and balancing items.*
- (b) *Memorandum items are part of the standard presentation, but are not used in deriving totals and balancing items.* For example, whereas nominal value is used for loans in the standard components, memorandum items provide additional information on loans at fair value, as discussed in paragraphs 7.45-7.46.

In addition,

- (c) *Supplementary items are outside the standard presentation, but are compiled depending on circumstances in the particular economy, taking into account the interests of policymakers and analysts as well as resource costs (see the items in italics in Appendix 9).*

**1.16** The list of standard items should not inhibit compilers from publishing additional data of importance to their economy. IMF requests for information will not be limited to standard items when further details are required to understand the circumstances of particular economies or to analyze new developments. IMF staff occasionally will consult with authorities to decide on the reporting of additional details. Few economies are likely to have significant information to report for every standard item. Furthermore, data for several components may be available only in combination, or a minor component may be grouped with one that is more significant. The standard items should nevertheless be reported to the IMF as completely and accurately as possible in accordance with the compilation framework. Compilers are in better positions than IMF staff to make estimates and adjustments for items that do not exactly correspond to the basic series of the compiling economy.

### C. History of the *Manual*

**1.17** Each new edition of the *Manual* is introduced in response to economic and financial developments, changes in analytical interests, and accumulation of experience by compilers.

**1.18** The IMF showed early interest in statistical methodology with its publication of the first edition of the *Balance of Payments Manual* in January 1948. The major objective of that first *Manual* was to provide a basis for regular, internationally standardized reporting to the IMF. The *Manual* was a continuation of work started by the League of Nations to develop guidelines for balance of payments statistics. Economists and other specialists from many countries contributed to the *Manual*, and representatives of some 30 countries and international organizations met in Washington, D.C., in September 1947 to finalize the first draft of the *Manual*.

**1.19** The first edition of the *Manual* consisted primarily of tables for reporting data and brief instructions for completing them. No general discussion of balance of payments concepts or compilation methods was included, so it can be said that the *Manual* grew out of the listing of standard components.

**1.20** The second edition was published in 1950, greatly expanding the material describing the concepts of the system.

**1.21** The third edition was issued in 1961. It moved beyond the previous editions by providing both a basis for reporting to the IMF and a complete set of balance

of payments principles that could be used by countries to serve their own needs.

**1.22** The fourth edition was published in 1977. It responded to the important changes in the way in which international transactions were carried out and to changes in the international financial system. Much fuller treatments of the underlying principles of residence, valuation, and other accounting principles were provided. The *Manual* also introduced flexibility in the use of the standard components to construct various balances, with no single presentation preferred.

**1.23** The fifth edition was published in September 1993, following a long period of development that included expert group meetings convened by the IMF in 1987 and 1992 as well as two working parties covering the current and financial accounts. This edition was marked by harmonization with the *System of National Accounts 1993 (1993 SNA)*, which was developed at the same time. The decision to harmonize the guidelines was a result of increasing interest in linking different macroeconomic data sets and avoiding data inconsistencies. *BPM5* brought about a number of changes in definitions, terminology, and the structure of the accounts, including removing capital transfers and non-produced assets from the current account to a newly designated capital account, the renaming of the capital account as the financial account, and splitting services from primary income (which previously had been called factor services). Additionally, *BPM5* introduced microfoundations of units and sectors, consistent with the *SNA*, rather than treating the economy as a single unit. In addition, the *Manual* was extended beyond balance of payments statistics to include the international investment position.

**1.24** The IMF subsequently published the *Monetary and Financial Statistics Manual 2000* and *Government Financial Statistics Manual 2001*. These manuals also brought about further harmonization of the statistical guidelines, reflecting increasing concerns about the ability to link different statistical data, minimizing data inconsistency, and enhancing analytical potential.

**1.25** In 1992, the IMF established the IMF Committee on Balance of Payments Statistics (the Committee), as a continuing body for consultation with national compilers and international organizations. A procedure was established for partial revisions of statistical guidelines between major revisions, as was done in the late 1990s for financial derivatives and aspects of direct investment. (The procedures for partial revisions are set out in Section E.)

**1.26** A number of related publications have been developed since the 1993 edition. *The Balance of Payments Compilation Guide* was published in 1995. The *Guide* complemented the *Manual* by providing practical advice on the collection and compilation of statistics. The *Balance of Payments Textbook* was released in 1996. It has a teaching orientation, for instance, giving numerical examples to illustrate general principles.

**1.27** Some aspects of international accounts statistics with particular interest were covered in specialized guides. Those guides are *Coordinated Direct Investment Survey Guide* (2008), *Coordinated Portfolio Investment Survey Guide* (1996 and 2001), *International Reserves and Foreign Currency Liquidity: Guidelines for a Data Template* (2000), *Manual on Statistics of International Trade in Services* (2002), *External Debt Statistics: A Guide for Compilers and Users* (2003), *Bank for International Settlements Guide to the International Banking Statistics* (2003), *International Transactions in Remittances: Guide for Compilers and Users*, and the *OECD Benchmark Definition of Foreign Direct Investment* (2008).

#### D. The 2008 Revision

**1.28** At its 2001 meeting, the Committee decided to initiate an update of the *Manual* by around 2008. It was considered that although the overall framework of the fifth edition did not need to change, a new *Manual* should incorporate the numerous elaborations and clarifications that had been identified since 1993. Also, the sixth edition should strengthen the theoretical foundations and linkages to other macroeconomic statistics.

**1.29** The Committee also decided to conduct the update in parallel with the update of the 1993 *SNA* and *OECD Benchmark Definition of Foreign Direct Investment*.

**1.30** The IMF released, through the Committee, an *Annotated Outline* for the update of the *Manual* in April 2004. It included proposals and options for the style and content of the revised *Manual*. It was circulated to central banks and statistical agencies, as well as being made available on the Internet. Input was invited from compilers and others on a global basis. The Committee established technical expert groups to undertake detailed consideration of issues and make recommendations on currency unions, direct investment, reserves, and other issues, respectively. Draft versions of the *Manual* were published

on the IMF website in March 2007 and March 2008, with invitations for worldwide comment. In addition, other editions of selected chapters and the whole document were circulated to Committee members and other interested parties. A series of regional outreach seminars was conducted between January and September 2008 to explain the changes in the *Manual* and gain comments on the content. This process led to a revised version submitted to the Committee in November 2008.

**1.31** Three major themes that have emerged from the revision are globalization, increasing elaboration of balance sheet issues, and financial innovation.

**1.32 Globalization** has brought several issues to greater prominence. An increasing number of individuals and companies have connections to two or more economies and economies increasingly enter into economic arrangements. In particular, there has been increasing interest in the residence concept and in information on migrant workers and their associated remittance flows. Additionally, globalized production processes have become more important, so treatments have been developed to provide a fuller and more coherent picture of outsourced physical processes (i.e., goods for processing) and sales and management of manufacturing that do not involve physical possession (i.e., merchanting). Guidance is provided on the residence and activities of special purpose entities and other legal structures that are used for holding assets and that have little or no physical presence. The results of work on international trade in services and remittances are included. Furthermore, for the first time, specific guidance on the treatment of currency unions is included.

**1.33** The *Manual* reflects increased interest in **balance sheet** analysis for understanding international economic developments, particularly vulnerability and sustainability. Greater emphasis and elaboration of the financial instrument classification in the *SNA* and *Monetary and Financial Statistics Manual* are designed to facilitate linkages and consistency. The *Manual* provides considerably more detailed guidance on the international investment position. It also provides much greater discussion of revaluations and other volume changes and their impact on the values of assets and liabilities. The results of detailed work over the past decade on international investment position, direct investment, external debt, portfolio investment, financial derivatives, and reserve assets are incorporated into the new *Manual*. The move to an integrated view of transactions, other changes, and

positions has been recognized in the amended title as *Balance of Payments and International Investment Position Manual*, with the acronym *BPM6* used to highlight the historical evolution from previous editions of the *Manual*, which were known as *BPM5*, *BPM4*, and so on.

1.34 **Financial innovation** is the emergence and growth of new financial instruments and arrangements among institutional units. Examples of instruments covered include financial derivatives, securitization, index-linked securities, and gold accounts. An example of institutional arrangements are special purpose entities and complex, multieconomy corporate structures. Enhanced guidelines cover direct investment in cases of long and complex chains of ownership, revised in conjunction with the revised *OECD Benchmark Definition of Foreign Direct Investment*. Revised treatments of insurance and other financial services are adopted. The *Manual* also provides expanded treatment on the issues of loan impairments, debt reorganization, guarantees, and write-offs.

1.35 In addition, the *Manual* incorporates changes arising from other statistical manuals, particularly the *2008 SNA*. The harmonization with other macroeconomic statistics is strengthened in terms of presentation by more details on the underlying economic concepts and their associated links with the equivalent parts of the *SNA* and other manuals. Other changes were made in response to requests to provide clarification or further detail on particular topics.

1.36 The overall structure of the accounts and broad definitions are largely unchanged in this edition, so the changes are less structural than those made for the fifth edition. Rather, economic and financial developments and evolution of economic policy concerns are taken into account, and clarification and elaboration of these developments are provided. A list of changes made in this edition of the *Manual* is included as Appendix 8.

## E. Revisions between Editions of the *Manual*

1.37 The IMF and the Committee have developed procedures for updating the *Manual* on an ongoing basis between major revisions. Under these procedures, updates can be divided into four types:

- (a) editorial amendments;
- (b) clarifications beyond dispute;
- (c) interpretations; and

(d) changes.

Each of these types of updates has a different set of steps that are to be followed in the consultation process.

1.38 **Editorial amendments** refer to wording errors, apparent contradictions, and, for non-English versions of the *Manual*, translation errors. These corrections affect neither concepts nor the structure of the system. IMF staff will draft these amendments, which will be brought to the Committee for advice. An errata sheet will then be produced, and the amendments will be publicized on the website.

1.39 A **clarification beyond dispute** arises when a new economic situation emerges or when a situation that was negligible when the *Manual* was produced has become considerably more important, but for which the appropriate treatment under existing standards is straightforward. IMF staff will draft these clarifications, based on existing recommendations, and after advice from the Committee, they will be publicized on the website and by other means.

1.40 An **interpretation** arises when an economic situation arises for which the treatment under the *Manual* may not be clear. Several solutions on how to treat the situation may be proposed, because it is possible to have different interpretations of the *Manual*. In this case, IMF staff, in consultation with the Committee, will draft preliminary text that will be sent to panels of experts, and to the InterSecretariat Working Group on National Accounts (ISWGNA) (if also relevant to the *SNA*). IMF staff will propose a final decision, in consultation with the Committee. Interpretations will be publicized on the website and by other means.

1.41 A **change** to the framework arises when an economic situation occurs in which it becomes apparent that the concepts and definitions of the framework are not relevant or are misleading and will require change. In such a situation, parts of the *Manual* may need to be substantially rewritten to reflect the needed changes. In such a case, IMF staff, in consultation with the Committee, will prepare proposals that will be disseminated widely to panels of experts, the ISWGNA (if also relevant to the *SNA*), and all IMF member countries. The Committee will advise how such changes should be incorporated into the framework, whether promulgated immediately through a booklet detailing the amendments to the *Manual* or by issuing a new *Manual*. Information will be produced and provided to all countries with changes also publicized on the IMF website and by other means.



1.42 The IMF website will provide a consolidated list of these decisions.

**1.43** A research agenda has been identified for possible future work. It includes the following:

- (a) ultimate investing economy and ultimate host economy in direct investment (see paragraph 4.156);
- (b) whether direct investment relationships can be achieved other than by economic ownership of equity (e.g., through warrants or repos) (see paragraph 6.19);
- (c) pass-through funds (see paragraphs 6.33-6.34);
- (d) reverse transactions (including short positions and investment income that is receivable/payable while a security is on-lent) (see paragraphs 5.52-5.55, 7.28, 7.58-7.61, and 11.69);
- (e) extended use of fair values of loans (see paragraphs 7.48-7.49);
- (f) how the risk and maturity structure of the financial assets and liabilities should be taken into account in the reference rate for calculations of financial services indirectly measured (see paragraphs 10.126-10.136);
- (g) investment income, in particular the different treatments of retained income for different investment types and the borderline between dividends and withdrawal of equity (see Chapter 11, Primary Income Account);
- (h) debt concessionality, in particular whether the transfer element should be recognized and, if so, how it should be recorded (see paragraphs 12.51 and 13.33); and
- (i) emissions permits (see paragraph 13.14).

# Overview of the Framework

## A. Introduction

**2.1** This chapter first describes and illustrates how the international accounts are an integral conceptual part of the broader system of national accounts. It then covers important aspects of statistics such as time series.

## B. Structure of the Accounts

References:

*2008 SNA*, Chapter 2, Overview, and Chapter 16, Summarizing and Integrating the Accounts.

IMF, *The System of Macroeconomic Accounts Statistics: An Overview*, Pamphlet Series No. 56.

### I. Overall framework

**2.2** The international accounts for an economy summarize the economic relationships between residents of that economy and nonresidents. They comprise the following:

- (a) the international investment position (IIP)—a statement that shows at a point in time the value of: financial assets of residents of an economy that are claims on nonresidents or are gold bullion held as reserve assets; and the liabilities of residents of an economy to nonresidents;
- (b) the balance of payments—a statement that summarizes economic transactions between residents and nonresidents during a specific time period; and
- (c) the other changes in financial assets and liabilities accounts—a statement that shows other flows, such as valuation changes, that reconciles the balance of payments and IIP for a specific period, by showing changes due to economic events other than transactions between residents and nonresidents.

**2.3** The international accounts provide an integrated framework for the analysis of an economy's international economic relationships, including its international economic performance, exchange rate policy, reserves management, and external vulnerability. A detailed study of the use of international accounts data is provided in Chapter 14, Selected Issues in Balance of Payments and International Investment Position Analysis.

**2.4** The framework provides a sequence of accounts, each one encompassing a separate economic process or phenomenon, and shows the linkages between them. While each account has a balancing item, the account also gives a full view of its components.

**2.5** The concepts of the international accounts are harmonized with the *System of National Accounts (SNA)*, so they can be compared or aggregated with other macroeconomic statistics. The framework for macroeconomic statistics used in the *SNA* and international accounts is shown in Figure 2.1.

**2.6** The international accounts framework is the same as the *SNA* framework. However, some accounts, which are shaded in Figure 2.1, are not applicable.

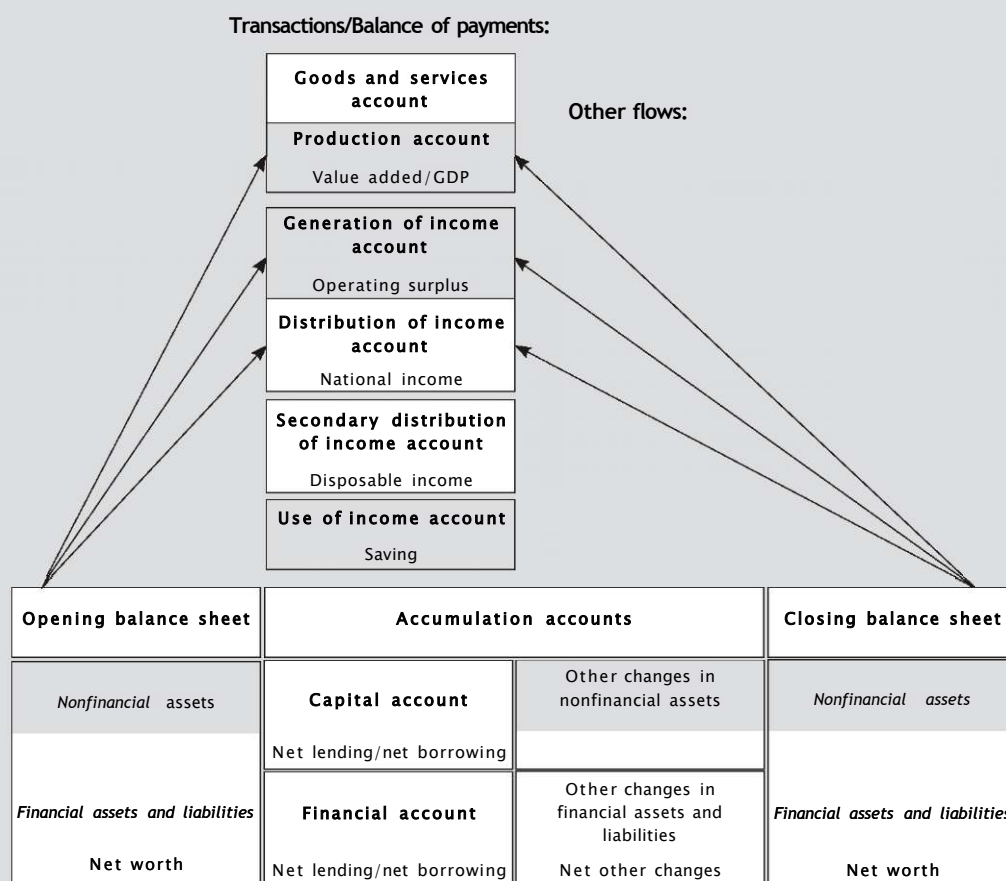
**2.7** The framework is designed so that the core concepts can be used to develop additional data sets, as discussed in Annex 2.1 to this chapter.

### 2. International investment position

**2.8** *The IIP is a statistical statement that shows at a point in time the value of: financial assets of residents of an economy that are claims on nonresidents or are gold bullion held as reserve assets; and the liabilities of residents of an economy to nonresidents.* The difference between the assets and liabilities is the net position in the IIP and represents either a net claim on or a net liability to the rest of the world.

**2.9** The IIP represents a subset of the assets and liabilities included in the national balance sheet. In

**Figure 2.1. Overview of the System of National Accounts as a Framework for Macroeconomic Statistics Including International Accounts**



**Key:**

<b>Name of account</b>
SNA Balancing item

Shaded accounts do not appear in the international accounts.

The arrows represent the contributions of assets to production and income generation (e.g., using nonfinancial assets as an input to production, using financial assets to generate interest and dividends).

addition to the IIP, the national balance sheet incorporates nonfinancial assets as well as financial assets and liability positions between residents. This statement is described further in Chapter 7.

2.10 Whereas the IIP relates to a point in time, the integrated IIP statement relates to different points in time, and it has an opening value (as at the beginning of the period) and a closing value (as at the end of the period). The integrated IIP statement reconciles the

opening and closing values of the IIP through the financial account (flows arising from transactions) and the other changes in financial assets and liabilities account (other volume changes and revaluation). So, the values in the IIP at the end of the period result from transactions and other flows in the current and previous periods. The integrated IIP statement consists of the accounts explained in Chapters 7-9 (i.e., the IIP, the financial account, and the other changes in financial assets and liabilities account, respectively).

**2.11** The highest level of classification used in the IIP, financial account, and other changes in assets and liabilities account is the functional classification, which is covered in Chapter 6. The functional categories group together financial instruments based on economic motivations and patterns of behavior to assist in the analysis of cross-border transactions and positions. These categories are direct investment, portfolio investment, financial derivatives (other than reserves) and employee stock options, other investment, and reserve assets. The *SNA* does not have such categories, preferring to record financial account activity by type of instrument alone (although direct investment is a memorandum item to the *SNA* instrument classification). Chapter 5 covers the classification of financial instruments.

### 3. Balance of payments

**2.12** *The balance of payments is a statistical statement that summarizes transactions between residents and nonresidents during a period. It consists of the goods and services account, the primary income account, the secondary income account, the capital account, and the financial account.* Under the double-entry accounting system that underlies the balance of payments, each transaction is recorded as consisting of two entries and the sum of the credit entries and the sum of the debit entries is the same. (See Box 2.1 for further elaboration on the double-entry accounting system.)

**2.13** The different accounts within the balance of payments are distinguished according to the nature of the economic resources provided and received.

#### Current account

**2.14** *The current account shows flows of goods, services, primary income, and secondary income between residents and nonresidents.* The current account is an important grouping of accounts within the balance of payments. Its components are dealt with in the following chapters:

- Chapter 10 discusses the goods and services account. This account shows transactions in goods and services.
- Chapter 11 discusses the primary income account. This account shows amounts payable and receivable in return for providing temporary use to another entity of labor, financial resources, or nonproduced nonfinancial assets.<sup>1</sup>

<sup>1</sup>Allowing another entity to use produced assets gives rise to a service (see paragraph 10.153). In contrast, allowing another entity

- Chapter 12 discusses the secondary income account. This account shows redistribution of income, that is, when resources for current purposes are provided by one party without anything of economic value being supplied as a direct return to that party. Examples include personal transfers and current international assistance.

**2.15** The balance on these accounts is known as the current account balance. The current account balance shows the difference between the sum of exports and income receivable and the sum of imports and income payable (exports and imports refer to both goods and services, while income refers to both primary and secondary income). As shown in Chapter 14, Selected Issues in Balance of Payments and International Investment Position Analysis, the value of the current account balance equals the saving-investment gap for the economy. Thus, the current account balance is related to understanding domestic transactions.

#### Capital account

**2.16** The capital account shows credit and debit entries for nonproduced nonfinancial assets and capital transfers between residents and nonresidents. It records acquisitions and disposals of nonproduced nonfinancial assets, such as land sold to embassies and sales of leases and licenses, as well as capital transfers, that is, the provision of resources for capital purposes by one party without anything of economic value being supplied as a direct return to that party. This account is described further in Chapter 13.

#### Financial account

**2.17** The financial account shows net acquisition and disposal of financial assets and liabilities. This account is described in Chapter 8. Financial account transactions appear in the balance of payments and, because of their effect on the stock of assets and liabilities, also in the integrated IIP statement.

**2.18** The sum of the balances on the current and capital accounts represents the net lending (surplus) or net borrowing (deficit) by the economy with the rest of the world. This is conceptually equal to the net balance of the financial account. In other words, the financial account measures how the net lending to or borrowing

to use nonproduced nonfinancial assets gives rise to rent (paragraph 11.86) and allowing another entity to use financial assets gives rise to investment income, such as interest, dividends, and retained earnings (see paragraph 11.3).

### Box 2.1. Double-Entry Basis of Balance of Payments Statistics

#### Recording for individual transactions

The recording of debits and credits underlies the accounting system at the level of individual transactions. Each transaction in the balance of payments is recorded as consisting of two equal and opposite entries, reflecting the inflow and outflow element to each exchange. For each transaction, each party records a matching credit and debit entry:

- Credit (CR.)—exports of goods and services, income receivable, reduction in assets, or increase in liabilities.
- Debit (DR.)—imports of goods and services, income payable, increase in assets, or reduction in liabilities.

#### Examples

A simple example is for sale of goods to a nonresident for 100 in currency. For the seller:

Exports	100 (CR.)
Currency	100 (DR.—Increase in financial assets)

(The transaction involves the provision of physical resources to nonresidents and a compensating receipt of financial resources from nonresidents.)

An example of a transaction involving only financial asset entries is the sale of shares for 50 in currency. For the seller:

Shares and other equity	50 (CR.—Reduction in financial assets)
Currency	50 (DR.—Increase in financial assets)

(The selling party provides shares and receives currency in return.)

An example involving the exchange of an asset for the creation of a liability is where a borrower receives a loan of 70 in cash. For the borrower:

Loan	70 (CR.—Increase in liabilities)
Currency	70 (DR.—Increase in financial assets)

(There are some more complex cases when three or more parties are involved, e.g., the case of debt assumption shown in Box 8.1.)

#### Aggregate recording

In balance of payments aggregates, the current and capital account entries are totals, while financial account entries are net values for each category/instrument for each of assets and liabilities (as explained in paragraph 3.31). Chapter 3, Accounting Principles, Part C provides further information on the accounting system used in balance of payments statistics.

As a result of the two-entry nature of each transaction, the difference between the sum of credit entries and the sum of debit entries is conceptually zero in the national balance of payments, that is, in concept, the accounts as a whole are in balance. As discussed in paragraphs 2.24-2.26, measurement problems cause discrepancies in practice.

The two-entry nature of the balance of payments can be presented in aggregate data in different ways. A presentation where the nature of the entries is conveyed by the column headings (namely, credits, debits, net acquisition of financial assets, and net incurrence of liabilities) is adopted in Table 2.1. This presentation is considered to be easily understood by users. Another presentation is where credit entries are shown as positive and debit entries as negative. This presentation is useful for calculating balances, but requires more explanation for users (e.g., increases in assets are shown as a negative value).

In the *SNA* presentation, a credit entry for the compiling economy in the balance of payments current account is called a use by the rest of the world sector (e.g., exports are used by the rest of the world). Similarly, a debit entry for the compiling economy is called provision of "resources" in the *SNA* (e.g., imports are a resource provided by the rest of the world). Because the *SNA* rest of the world accounts use the point of view of the nonresidents, assets of the compiling economy in the international accounts are shown as liabilities of the rest of the world sector in the *SNA*.

from nonresidents is financed. The financial account plus the other changes account explain the change in the IIP between beginning- and end-periods.

#### Cross and net recording

2.19 The current and capital accounts show transactions in gross terms. In contrast, the financial account shows transactions in net terms, which are shown separately for financial assets and liabilities (i.e., net transactions in financial assets shows acquisition of assets less reduction in assets, not assets net of liabilities). For resources that enter and leave an economy (such as re-exported goods, and funds in transit), it may be

analytically useful to present net flows as well. Each of the accounts and the borderlines between them are discussed in more detail in the specific chapters.

#### 4. Accumulation accounts

2.20 *The accumulation accounts comprise the capital account, financial account, and other changes in financial assets and liabilities accounts.* They show the accumulation (i.e., acquisition and disposal) of assets and liabilities, their financing, and other changes that affect them. Accordingly, they explain changes between the opening and closing IIP/balance sheets. Whereas the current account is concerned with resource flows

oriented to the current period, the accumulation accounts deal with the provision and financing of assets and liabilities, which are items that will affect future periods.

**2.21** The financial account shows the net acquisition of financial assets and net incurrence of liabilities during the specified period. In contrast, the other changes in financial assets and liabilities account shows flows that do not result from balance of payments transactions. The other changes in financial assets and liabilities account covers changes in volume, other than balance of payments transactions; revaluation due to exchange rate changes; and other revaluation. This account is described further in Chapter 9.

## 5. Integrated recording of positions and transactions

**2.22** As highlighted in the previous sections, the international accounts, inclusive of the IIP and balance of payments, consist of a set of accounts that are integrated at two levels. First, while the accounts represent a great mass of detailed information on interaction between the different economic agents, their recording is based on the double-entry system of accounting, as set out in Box 2.1.

**2.23** Second, the system calls for consistent reporting by the two parties to each financial claim, transaction, and other flow. In the case of the international accounts, this consistency helps to promote comparability across economies as well as the use of counterpart data as data sources or for data validation.

## 6. Net errors and omissions

**2.24** Although the balance of payments accounts are, in principle, balanced, imbalances result in practice from imperfections in source data and compilation. This imbalance, a usual feature of balance of payments data, is labeled net errors and omissions and should be identified separately in published data. It should not be included indistinguishably in other items. Net errors and omissions are derived residually as net lending/net borrowing and can be derived from the financial account minus the same item derived from the current and capital accounts.<sup>2</sup> Therefore, a positive value of net errors and omissions indicates an overall tendency that:

- (a) the value of credits in the current and capital accounts is too low; and/or
- (b) the value of debits in the current and capital accounts is too high; and/or
- (c) the value of net increases in assets in the financial account is too high; and/or
- (d) the value of net increases in liabilities in the financial account is too low.

(For a negative value of net errors and omissions, these tendencies are reversed.)

**2.25** The values of net errors and omissions should be analyzed by compilers. The size and trends may help identify data problems, such as coverage or misreporting. Patterns in net errors and omissions may provide useful information on data problems. For example, a consistent sign indicates a bias in one or more components. A persistent positive value of net errors and omissions suggests that credit entries have been understated or omitted or debit entries have been overstated. In contrast, a volatile pattern may suggest timing problems. However, although net errors and omissions can help point to some problems, it is an incomplete measure because errors and omissions in opposite directions offset each other. The term net errors and omissions should not be interpreted as meaning errors on the part of compilers; it is far more common that this discrepancy is caused by other factors, such as incomplete data sources and poor quality reporting.

**2.26** A large or volatile value of net errors and omissions hampers interpretation of the results. While it is not possible to give guidelines on an acceptable size of net errors and omissions, it can be assessed (where possible) by compilers in relation to other items, such as GDP, positions data, and gross flows. Statistical discrepancies also can arise in the IIP statement. Closing values are by definition equal to the opening values plus net transactions plus net other changes during the period. However, if these components are independently measured, discrepancies may arise because of data imperfections.

## 7. Linkages within the international accounts

**2.27** Some of the important linkages within the international accounts are as follows:

- (a) The end of period values of the IIP are the sum of the beginning of period values, transactions, and other flows.
- (b) The current, capital, and financial account entries are in balance, in principle.

<sup>2</sup>For example, if net lending/net borrowing measured from the current and capital accounts is 29, while net lending/net borrowing measured from the financial account is 31, then net errors and omissions is +2.

- (c) Consequent to (b), the balance on the sum of the current and capital accounts is equal to the balance on the financial account. This balance is called net lending/net borrowing, whichever way it is derived.
- (d) Consequent to (b), the current account balance is equal to the balance on the financial account less the balance on the capital account.
- (e) Financial assets and liabilities generally give rise to investment income. Table 5.2 shows the link between financial instruments and their corresponding income. The rate of return is derived as the ratio of income to the corresponding stock of assets or liabilities. (Rates of return might also take into account holding gains or losses for some analysis.)

**2.28** Because of the harmonization of macroeconomic statistical guidelines, it is also possible to look at residents' transactions and positions with nonresidents in relation to the transactions and positions between residents. For example:

- (a) the international financing can be compared with domestic lending and borrowing; and
- (b) the IIP can be compared with the national balance sheet and with monetary and financial statistics.

Chapter 14, Selected Issues in Balance of Payments and International Investment Position Analysis, has a wider discussion of interrelationships between the international accounts and other macroeconomic data.

## 8. Linkages and consistency with other data sets

**2.29** Placing the international accounts in the *SNA* framework shown in Figure 2.1 helps identify linkages among macroeconomic data sets. Specific aspects of the international accounts are provided, for instance, in reporting statements on merchandise trade, trade in services, direct investment, external debt, and international reserves. Additionally, items involving flows and positions between residents and nonresidents that appear in the national accounts, monetary and financial statistics, and government finance statistics correspond exactly to international accounts items.

**2.30** The following paragraphs list data items that should be consistent with the international accounts. Data compilers should reconcile these overlapping items, with a view toward eliminating or explaining any

differences. Data consistency is particularly important for comprehensive macroeconomic analysis, in order to allow the different datasets to be combined coherently. For example, if data are consistent, it is possible to understand how a government is financing a deficit from external and domestic sources, or show how the saving-investment balances of individual sectors contribute to the national current account balance.

### *National accounts*

**2.31** The international accounts correspond to the rest of the world accounts of the *SNA*. They differ in that the balance of payments is from the perspective of the resident sectors, whereas national accounts data for the rest of the world are from the perspective of nonresidents. The *SNA* items that are equivalent to balance of payments items include exports and imports of goods and services, primary income, secondary income, current external balance, balance on the capital account, and net lending/net borrowing.

### *Monetary and financial statistics*

**2.32** Balance sheets for deposit-taking and other financial corporations can be compared with the relevant parts of the IIP. In particular:

- foreign assets and liabilities of the central bank; and
- foreign assets and liabilities of other deposit-taking corporations

should be consistent with the corresponding international accounts items. Because the IIP data are organized primarily on a functional category basis, the instrument and sector data from different functional categories need to be combined if they are to be linked with monetary and financial statistics. Direct investment, if any, of the central bank and other deposit-taking corporations is needed to derive aggregates consistent with monetary and financial statistics, and thus is shown as a supplementary item where relevant. Other adjustments may be needed for any deposit-taking corporations whose liabilities are excluded from broad money (e.g., offshore banks in some cases) or for other types of corporations included in broad money (such as money market funds) and thus are included with the deposit-taking corporations subsector in monetary statistics.

**2.33** In cases in which monetary statistics also include flows, they can be compared with the balance of payments. Balance of payments transactions for a

period may differ from the transactions in foreign assets and liabilities in the monetary statistics to the extent that balance of payments statistics exclude transactions in foreign assets and liabilities between residents. See also paragraphs 14.20-14.22 on the possibility of linking these transactions through the monetary presentation of the balance of payments.

#### *Government finance statistics*

2.34 The following items that appear in government finance statistics should be consistent with their international accounts equivalents:

- interest payable on general government external debt;
- grants by general government to nonresidents;
- grants to general government from nonresidents;
- net external financing; and
- external assets and liabilities.

(Direct investment of general government, if any, is needed to derive aggregates consistent with govern-

ment finance statistics. Thus, it is shown as a supplementary item where relevant.)

#### **9. Numerical example**

2.35 Table 2.1 provides a numerical overview of the international accounts, using data drawn from the *SNA* framework presented in Annex 2.2. (The numerical example helps show interrelationships between items.)

2.36 The international accounts data have the same scope as the rest of the world sector in the *SNA*. However, the international accounts are expressed from the perspective of the resident units, but in the *SNA*, the data for the rest of world sector are expressed from the perspective of the nonresident units. So, the current account surplus of 13 in Table 2.1 is presented as a current external balance for the rest of the world sector of -13 in the table in Annex 2.2. Similarly, closing assets of 1,346 in the IIP are shown as the liabilities of 1,346 of the rest of the world sector in the *SNA*.



## BALANCE OF PAYMENTS AND INTERNATIONAL INVESTMENT POSITION MANUAL

**Table 2.1. Overview of International Accounts**

(Consistent with Data in Annex 2.2)<sup>1</sup>

Balance of payments	Credits	Debits	Balance		
<b>Current account</b>					
Goods and services	540	499	41		
Goods	462	392	70		
Services	78	107	-29		
Primary income	50	40	10		
Compensation of employees	6	2			
Interest	13	21			
Distributed income of corporations	17	17			
Reinvested earnings	14	0			
Rent	0	0			
Secondary income	17	55	-38		
Current taxes on income, wealth, etc.	1	0			
Net nonlife insurance premiums	2	11			
Nonlife insurance claims	12	3			
Current international cooperation	1	31			
Miscellaneous current transfers	1	10			
Adjustment for change in pension entitlements					
Current account balance			13		
<b>Capital account</b>					
Acquisitions/disposals of nonproduced nonfinancial assets	0	0			
Capital transfers	1	4			
Capital account balance			-3		
<b>Net lending (+)/net borrowing (-) (from current and capital accounts)</b>			<b>10</b>		
<b>Financial account (by functional category)</b>					
	Net acquisition of financial assets	Net incurrence of liabilities	Balance		
Direct investment	8	11			
Portfolio investment	18	14			
Financial derivatives (other than reserves) and ESOs	3	0			
Other investment	20	22			
Reserve assets	8				
Total changes in assets/liabilities	57	47			
<b>Net lending (+)/net borrowing (-) (from financial account)</b>			<b>10</b>		
<b>Net errors and omissions</b>			<b>0</b>		
<b>International investment position:</b>	<b>Opening position</b>	<b>Transactions (fin. acc.)</b>	<b>Other changes in volume</b>	<b>Revaluation</b>	<b>Closing position</b>
<b>Assets (by functional category)</b>					
Direct investment	78	8	0	1	87
Portfolio investment	190	18	0	2	210
Financial derivatives (other than reserves) and ESOs	7	3	0	0	10
Other investment	166	20	0	0	186
Reserve assets	833	8	0	12	853
<b>Total assets</b>	<b>1,274</b>	<b>57</b>	<b>0</b>	<b>15</b>	<b>1,346</b>
<b>Liabilities (by functional category)</b>					
Direct investment	210	11	0	2	223
Portfolio investment	300	14	0	5	319
Financial derivatives (other than reserves) and ESOs	0	0	0	0	0
Other investment	295	22	0	0	317
<b>Total liabilities</b>	<b>805</b>	<b>47</b>	<b>0</b>	<b>7</b>	<b>859</b>
<b>Net IIP</b>	<b>469</b>	<b>10</b>	<b>0</b>	<b>8</b>	<b>487</b>

Note: ESO = employee stock option.

<sup>1</sup>The SMA tables in Annex 2.2 use instruments rather than functional categories. At the end of Annex 2.2, international accounts data are presented in terms of instruments and the derivation of functional category data from instrument data is shown.

## Box 2.2. Data Quality Assessment Framework

This table shows the two-digit level of the IMF's data quality assessment framework, as at the time of publication. More detail of the framework on the specific aspects

for balance of payments is available on the IMF website. New versions will be posted on the IMF website as they are developed.

Quality dimensions	Elements
0. Prerequisites of quality	0.1 Legal and institutional environment—The environment is supportive of statistics. 0.2 Resources—Resources are commensurate with needs of statistical programs. 0.3 Relevance—Statistics cover relevant information on the subject field. 0.4 Other quality management—Quality is a cornerstone of statistical work.
1. Assurances of integrity <i>The principle of objectivity in the collection, processing, and dissemination of statistics is firmly adhered to.</i>	1.1 Professionalism—Statistical policies and practices are guided by professional principles. 1.2 Transparency—Statistical policies and practices are transparent. 1.3 Ethical standards—Policies and practices are guided by ethical standards.
2. Methodological soundness <i>The methodological basis for the statistics follows internationally accepted standards, guidelines, or good practices.</i>	2.1 Concepts and definitions—Concepts and definitions used are in accord with internationally accepted statistical frameworks. 2.2 Scope—The scope is in accord with internationally accepted standards, guidelines, or good practices. 2.3 Classification/sectorizations—Classification and sectorization systems are in accord with internationally accepted standards, guidelines, or good practices. 2.4 Basis for recording—Flows and stocks are valued and recorded according to internationally accepted standards, guidelines, or good practices.
3. Accuracy and reliability <i>Source data and statistical techniques are sound and statistical outputs sufficiently portray reality.</i>	3.1 Source data—Source data available provide an adequate basis to compile statistics. 3.2 Assessment of source data—Source data are regularly assessed. 3.3 Statistical techniques—Statistical techniques employed conform to sound statistical procedures. 3.4 Assessment and validation of intermediate data and statistical outputs—Intermediate results and statistical outputs are regularly assessed and validated. 3.5 Revision studies—Revisions, as a gauge of reliability, are tracked and mined for the information they may provide.
4. Serviceability <i>Statistics, with adequate periodicity and timeliness, are consistent and follow a predictable revisions policy.</i>	4.1 Periodicity and timeliness—Periodicity and timeliness follow internationally accepted dissemination standards. 4.2 Consistency—Statistics are consistent within the data set, over time, and with major data sets. 4.3 Revision policy and practice—Data revisions follow a regular and publicized procedure.
5. Accessibility <i>Data and metadata are easily available and assistance to users is adequate.</i>	5.1 Data accessibility—Statistics are presented in a clear and understandable manner, forms of dissemination are adequate, and statistics are made available on an impartial basis. 5.2 Metadata accessibility—Up-to-date and pertinent metadata are made available. 5.3 Assistance to users—Prompt and knowledgeable support service is available.

## C. Metadata, Dissemination Standards, Data Quality, and Time Series

References:

IMF, *Dissemination Standards Bulletin Board* at [www.imf.org](http://www.imf.org).

IMF, *The General Data Dissemination System: Guide for Participants and Users*.

IMF, *Special Data Dissemination Standard*.

### 1. Metadata, dissemination standards, and data quality

**2.37** Metadata are systematic, descriptive information about data content and organization. They provide information on the concepts, sources, and methods underlying the data and therefore help users to understand and assess the characteristics of the data. Statistical compilers should provide metadata to their users because metadata are an integral part of the publication of statistics.

**2.38** Good dissemination practices are essential in addition to good data compilation. As well as provision of metadata, aspects of good dissemination practices include predictable release schedule, availability of publications, and identification of internal government access to statistics before public release. In recent years, international guidelines have been developed on good data dissemination practices, namely, the IMF's General Data Dissemination System and Special Data Dissemination Standard.

**2.39** The IMF's Data Quality Assessment Framework identifies aspects of data quality, including the definitions and sources of data as well as the dissemination and institutional aspects. Box 2.2 shows the broadest headings of the framework.

### 2. Time series

Reference:

IMF, *Quarterly National Accounts Manual*, Chapter VIII, Seasonal Adjustment and Estimation of Trend-Cycles, and Chapter XI, Revision Policy and the Compilation and Release Schedule.

**2.40** While the tables included in the *Manual* have been designed to highlight classifications and interrelationships, tabulations for users will generally use time series. Good practices in the compilation of international accounts for time series analysis include the following:

- (a) Consistency over time in concepts and compilation practices to minimize "breaks" and "steps" in the series—where changes in definitions and techniques are implemented, they should be clearly identified to data users and the effect should be quantified, where practical, preferably with an overlapping period;
- (b) A transparent way of handling of revisions—revisions to data are necessary to account for revised methods and more recent information. The revision of data should be dealt with through a predictable and documented policy. The causes and sizes of significant individual revisions should be identified. Revision studies should be made to identify the size and any bias of past revisions. This will help to refine preliminary data and to define the optimum revision cycle that is largely driven by the availability of major data sources; and
- (c) Consistency of available annual, quarterly, and monthly data—the monthly values should sum to the corresponding quarterly values, which should sum to the corresponding annual values.

**2.41** Seasonal adjustment of monthly and quarterly data is potentially useful for time series data in both analysis and compilation. However, some international accounts items, especially in the financial account, may not be suitable for seasonal adjustment because of the high degree of irregularity associated with large, one-time transactions.

## Annex 2.1

### Satellite Accounts and Other Supplemental Presentations

Reference:

2005 *SNA*, Chapter 29, Satellite Accounts and Other Extensions.

**2.42** This *Manual* shows a standard presentation, which is designed to be used flexibly and to support many kinds of analysis. However, it is recognized that no single framework can meet all the different analytical interests. Thus, satellite accounts and other supplemental presentations are encouraged. Such presentations would be based on the circumstances in each economy and are not included in the standard components or memorandum items. They may include data from other sources that are not necessarily obtained from the international accounts compilation system.

**2.43** *Satellite accounts provide a framework linked to the central accounts and that enable attention to be focused on a certain field or aspect of economic and social life.* Common examples of satellite accounts for the national accounts include the environment, tourism, and nonprofit institutions. International accounts have more detailed presentations for direct investment, portfolio investment, external debt, remittances, tourism, and reserves. The analytic and monetary presentations are discussed in Chapter 14. Statistics on activities of multinational enterprises (as discussed in Appendix 4) are also a related data set. These presentations use the basic framework as a starting point

but differ by adding detail or other information, or by rearranging information, to meet particular needs. Use of the basic framework as a starting point increases the ability to relate the topic to other aspects of the economy while maintaining international comparability. Specific manuals and guides are produced on some of these topics. While the term satellite accounts suggests a major set of data, other supplemental presentations are encouraged. This *Manual* refers to supplementary items as possible additional data on a smaller scale than a full satellite account. The range of supplementary data is wide and can be developed according to national circumstances.

## Annex 2.2

## Overview of Integrated Economic Accounts

Table 2.2. Overview of Integrated Economic Accounts (from 2008 SNA)

<b>Production account</b>									
Uses									
Transactions and balancing items	Nonfinancial corporations	Financial corporations	General government	Households	NPISHs	Total economy	Rest of the world	Goods and services	Total
Imports of goods and services								499	499
Imports of goods								392	392
Imports of services								107	107
Exports of goods and services							540		540
Exports of goods							462		462
Exports of services							78		78
Output								3,604	3,604
Intermediate consumption	1,477	52	222	115	17	1,883			1,883
Taxes on products								141	141
Subsidies on products (-)								-8	-8
Value added, gross/Gross domestic product	1,331	94	126	155	15	1,854			1,854
Consumption of fixed capital	157	12	27	23	3	222			222
Value added, net/Net domestic product	1,174	82	99	132	12	1,632			1,632
<b>Generation of income account</b>									
Uses									
Compensation of employees	986	44	98	11	11	1,150			1,150
Wages and salaries	841	29	63	11	6	950			950
Employers' social contributions	145	15	35	0	5	200			200
Taxes on production and imports						235			235
Taxes on products						141			141
Other taxes on production	88	4	1	0	1	94			94
Subsidies						-44			-44
Subsidies on products						-8			-8
Other subsidies on production	-35	0	0	-1	0	-36			-36
Operating surplus, net	135	34	0	69	0	238			238
Mixed income, net				53		53			53
<b>Allocation of primary income account</b>									
Uses									
Compensation of employees							6		6
Wages and salaries							6		6
Employers' social contributions							0		0
Taxes on production and imports									0
Taxes on products									0
Other taxes on production									0
Subsidies									0
Subsidies on products									0
Other subsidies on production									0
Property income	134	168	42	41	6	391	44		435
Interest	56	106	35	14	6	217	13		230
Distributed income of corporations	47	15				62	17		79
Reinvested earnings on foreign									
direct investment	0	0				0	14		14
Other investment income		47				47	0		47
Rent	31	0	7	27	0	65			65
Balance of primary income, net / National income, net	97	15	171	1,358	1	1,642			1,642

Table 2.2 (concluded)

<b>Production account</b>							<b>Resources</b>		
Transactions and balancing items	Nonfinancial corporations	Financial corporations	General government	Households	NPISHs	Total economy	Rest of the world	Goods and services	Total
Imports of goods and services							499		499
Imports of goods							392		392
Imports of services							107		107
Exports of goods and services								540	540
Exports of goods								462	462
Exports of services								78	78
Output	2,808	146	348	270	32	3,604			3,604
Intermediate consumption								1,883	1,883
Taxes on products						141			141
Subsidies on products (-)						-8			-8
<b>Generation of income account</b>							<b>Resources</b>		
<i>Value added, net of taxes on domestic product</i>	1,174	82	99	132	12	1,632			1,632
Compensation of employees									
Wages and salaries									
Employers' social contributions									
Taxes on production and imports									
Taxes on products									
Other taxes on production									
Subsidies									
Subsidies on products									
Other subsidies on production									
<b>Allocation of primary income account</b>							<b>Resources</b>		
<i>Operating surplus, net</i>	135	34	0	69	0	238			238
<i>Mixed income, net</i>				53		53			53
Compensation of employees				1,154		1,154	2		1,156
Wages and salaries				954		954	2		956
Employers' social contributions				200		200	0		200
Taxes on production and imports				235		235			235
Taxes on products				141		141			141
Other taxes on production				94		94			94
Subsidies				-44		-44			-44
Subsidies on products				-8		-8			-8
Other subsidies on production				-36		-36			-36
Property income	96	149	22	123	7	397	38		435
Interest	33	106	14	49	7	209	21		230
Distributed income of corporations	10	25	7	20	0	62	17		79
Reinvested earnings on foreign direct investment	4	7	0	3	0	14	0		14
Other investment income	8	8	1	30	0	47	0		47
Rent	41	3	0	21	0	65			65

Table 2.2 (continued)

**Secondary distribution of income account**

## Uses

Transactions and balancing items	Nonfinancial corporations	Financial corporations	General government	Households	NPISHs	Total economy	Rest of the world	Goods and services	Total
Current transfers	98	277	248	582	7	1,212	17		1,229
Current taxes on income, wealth, etc.	24	10	0	178	0	212	1		213
Net social contributions				333		333	0		333
Social benefits other than social transfers in kind	62	205	112	0	5	384	0		384
Other current transfers	12	62	136	71	2	283	16		299
<i>Disposable income, net</i>	71	13	290	1,196	34	1,604			1,604

**Use of disposable income account**

## Uses

Final consumption expenditure			352	1,015	32	1,399			1,399
Adjustment for the change in pension entitlements	0	11	0		0	11	0		11
<i>Current external balance</i>							-13		-13

**Capital account**

## Changes in assets

Gross capital formation	308	8	38	55	5	414			414
Consumption of fixed capital	-157	-12	-27	-23	-3	-222			-222
Changes in inventories	26	0	0	2	0	28			28
Acquisitions less disposals of valuables	2	0	3	5	0	10			10
Acquisitions less disposals of nonproduced assets	-7	0	2	4	1	0			0
Capital transfers, receivable									
Capital transfers, payable									
<i>Net lending (+) 1 net borrowing (-)</i>	-56	-1	-103	174	-4	10	-10		0

**Financial account**

## Changes in assets

Net acquisition of financial assets	83	172	-10	189	2	436	47		483
Monetary gold and SDRs		-1				-1	1		0
Monetary gold		0				0	0		0
SDRs		-1				-1	1		0
Currency and deposits	39	10	-26	64	2	89	11		100
Debt securities	7	66	4	10	-1	86	9		95
Loans	19	53	3	3	0	78	4		82
Equity and investment fund shares	10	28	3	66	0	107	12		119
Insurance, pension, and standardized guarantee schemes	1	7	1	39	0	48	0		48
Financial derivatives and employee stock options	3	8	0	3	0	14	0		14
Other accounts receivable/payable	4	1	5	4	1	15	10		25

Table 2.2 (continued)

Secondary distribution of income account							Resources		
Transactions and balancing items	Nonfinancial corporations	Financial corporations	General government	Households	NPISHs	Total economy	Rest of the world	Goods and services	Total
<i>Balance of primary income, net / National income, net</i>	97	15	171	1,358	1	1,642			1,642
Current transfers	72	275	367	420	40	1,174	55		1,229
Current taxes on income, wealth, etc.			213			213	0		213
Net social contributions	66	213	50	0	4	333	0		333
Social benefits other than social transfers in kind				384		384	0		384
Other current transfers	6	62	104	36	36	244	55		299
<b>Use of disposable income account</b>							Resources		
<i>Disposable income, net</i>	71	13	290	1196	34	1,604			1,604
Final consumption expenditure								1,399	1,399
Adjustment for the change in pension entitlements				11		11	0		11
<b>Capital account</b>							Changes in liabilities and net worth		
<i>Saving, net</i>	71	2	-62	192	2	205			205
<i>Current external balance</i>							-13		-13
Gross capital formation								414	414
Consumption of fixed capital								-222	-222
Changes in inventories								28	28
Acquisitions less disposals of valuables								10	10
Acquisitions less disposals of nonproduced assets								0	0
Capital transfers, receivable	33	0	6	23	0	62	4		66
Capital transfers, payable	-16	-7	-34	-5	-3	-65	-1		-66
<i>Changes in net worth due to saving and capital transfers</i>	88	-5	-90	210	-1	202	-10		192
<b>Financial account</b>							Changes in liabilities and net worth		
<i>Net lending (+) / net borrowing (-)</i>	-56	-1	-103	174	-4	10	-10		0
Net acquisition of liabilities	139	173	93	15	6	426	57		483
Monetary gold and SDRs									0
Monetary gold									
SDRs									0
Currency and deposits		65	37			102	-2		100
Debt securities	6	30	38	0	0	74	21		95
Loans	21	0	9	11	6	47	35		82
Equity and investment fund shares	83	22				105	14		119
Insurance, pension, and standardized guarantee schemes		48	0			48	0		48
Financial derivatives and employee stock options	3	0	0	0	0	11	3		14
Other accounts receivable/payable	26	0	9	4		39	-14		25



Table 2.2 (continued)

**Other changes in the volume of assets account**

## Changes in assets

Other flows	Nonfinancial corporations	Financial corporations	General government	Households	NPISHs	Total economy	Rest of the world	Goods and services	Total
Economic appearance of assets	26	0	7	0	0	33			33
Produced nonfinancial assets			3			3			3
Nonproduced nonfinancial assets	26	0	4	0	0	30			30
Economic disappearance of nonproduced nonfinancial assets	-9	0	-2	0	0	-11			-11
Other economic disappearance of nonproduced nonfinancial assets	-3	0	0	0	0	-3			-3
Catastrophic losses	-5	0	-6	0	0	-11			-11
Uncompensated seizures	-5	0	5	0	0	0			0
Other changes in volume n.e.c.	1	1	0	0	0	2			2
Changes in classification		6	-2	-4	0	0			0
Changes in sector classification and structure	6		0	-4	0	2			2
Changes in classification of assets and liabilities	0	-2	0	0	0	-2			-2
Total other changes in volume	14	-1	0	0	0	13			13
Produced nonfinancial assets	-2	-2	-3	0	0	-7			-7
Nonproduced nonfinancial assets	14	0	3	0	0	17			17
Financial assets	2	1	0	0	0	3			3
Monetary gold and SDRs						0			0
Currency and deposits						0			0
Debt securities						0			0
Loans						0			0
Equity and investment fund shares/units	2					2			2
Insurance, pension, and standardized guarantee schemes		1				1			1
Financial derivatives and employee stock options						0			0
Other accounts receivable/payable						0			0

**Revaluation account**

## Changes in assets

Nonfinancial assets	144	4	44	80	8	280			280
Produced nonfinancial assets	63	2	21	35	5	126			126
Nonproduced nonfinancial assets	81	2	23	45	3	154			154
Financial assets/liabilities	8	57	1	16	2	84	7		91
Monetary gold and SDRs		11	1			12			12
Currency and deposits						0			0
Debt securities	3	30		6	1	40	4		44
Loans						0			0
Equity and investment fund shares/units	5	16		10	1	32	3		35
Insurance, pension, and standardized guarantee schemes						0			0
Financial derivatives and employee stock options						0			0
Other accounts receivable/payable						0			0

Table 2.2 (concluded)

Other changes in the volume of assets account							Changes in liabilities and net worth		
	Nonfinancial corporations	Financial corporations	General government	Households	NPISHs	Total economy	Rest of the world	Goods and services	Total
Other flows									
Economic appearance of assets									
Produced nonfinancial assets									
Nonproduced nonfinancial assets									
Economic disappearance of nonproduced nonfinancial assets									
Other economic disappearance of nonproduced nonfinancial assets									
Catastrophic losses									
Uncompensated seizures									
Other changes in volume n.e.c.	0	0	0	1	0	1			1
Changes in classification	0	0	2	0	0	2			2
Changes in sector classification and structure	0	0	2	0	0	2			2
Changes in classification of assets and liabilities	0	0	0	0	0	0			0
Total other changes in volume	0	0	2	1	0	3			3
Produced nonfinancial assets									
Nonproduced nonfinancial assets									
Financial assets	0	0	2	1	0	3			3
Monetary gold and SDRs									
Currency and deposits									
Debt securities									
Loans						0			0
Equity and investment fund shares/units			2			2			2
Insurance, pension, and standardized guarantee schemes				1		1			1
Financial derivatives and employee stock options									
Other accounts receivable/payable									
<i>Changes in net worth due to other changes in volume of assets</i>	14	-1	-2	-1	0	10			
<b>Revaluation account</b>	<b>Changes in liabilities and net worth</b>								
Nonfinancial assets									
Produced nonfinancial assets									
Nonproduced nonfinancial assets									
Financial assets/liabilities	18	51	7	0	0	76	15		91
Monetary gold and SDRs							12		12
Currency and deposits									
Debt securities	1	34	7			42	2		44
Loans									
Equity and investment fund shares/units	17	17				34	1		35
Insurance, pension, and standardized guarantee schemes									
Financial derivatives and employee stock options									
Other accounts receivable/payable									
<i>Changes in net worth due to nominal holding gains/losses</i>	134	10	38	96	10	288	-8		280

## BALANCE OF PAYMENTS AND INTERNATIONAL INVESTMENT POSITION MANUAL

Table 2.2 (continued)

Stocks and changes in assets	Nonfinancial corporations	Financial corporations	General government	Households	NPISHs	Total economy	Rest of the world account	Goods and services account	Total
<b>Opening balance sheet</b>									
Nonfinancial assets	2,151	93	789	1,429	159	4,621			4,621
Produced nonfinancial assets	1,274	67	497	856	124	2,818			2,818
Nonproduced nonfinancial assets	877	26	292	573	35	1,803			1,803
Financial assets/liabilities	982	3,421	396	3,260	172	8,231	805		9,036
Monetary gold and SDRs		690	80			770			770
Currency and deposits	382		150	840	110	1,482	105		1,587
Debt securities	90	950		198	25	1,263	125		1,388
Loans	50	1,187	115	24	8	1,384	70		1,454
Equity and investment fund shares/units	280	551	12	1,749	22	2,614	345		2,959
Insurance, pension, and standardized guarantee schemes	25	30	20	391	4	470	26		496
Financial derivatives and employee stock options	5	13	0	3	0	21	0		21
Other accounts receivable/payable	150		19	55	3	227	134		361
<b>Total changes</b>									
Nonfinancial assets	300	-2	57	116	11	482			482
Produced nonfinancial assets	195	-4	29	67	7	294			294
Nonproduced nonfinancial assets	105	2	28	49	4	188			188
Financial assets/liabilities	93	230	-9	205	4	523	54		577
Monetary gold and SDRs	0	10	1	0	0	11	1		12
Currency and deposits	39	10	-26	64	2	89	11		100
Debt securities	10	96	4	16	0	126	13		139
Loans	19	53	3	3	0	78	4		82
Equity and investment fund shares/units	17	44	3	76	1	141	15		156
Insurance, pension, and standardized guarantee schemes	1	8	1	39	0	49	0		49
Financial derivatives and employee stock options	3	8	0	3	0	14	0		14
Other accounts receivable/payable	4	1	5	4	1	15	10		25
<b>Closing balance sheet</b>									
Nonfinancial assets	2,451	91	846	1,545	170	5,103			5,103
Produced nonfinancial assets	1,469	63	526	923	131	3,112			3,112
Nonproduced nonfinancial assets	982	28	320	622	39	1,991			1,991
Financial assets/liabilities	1,075	3,651	387	3,465	176	8,754	859		9,613
Monetary gold and SDRs	0	700	81	0	0	781	1		782
Currency and deposits	421	10	124	904	112	1,571	116		1,687
Debt securities	100	1,046	4	214	25	1,389	138		1,527
Loans	69	1,240	118	27	8	1,462	74		1,536
Equity and investment fund shares/units	297	595	15	1,825	23	2,755	360		3,115
Insurance, pension, and standardized guarantee schemes	26	38	21	430	4	519	26		545
Financial derivatives and employee stock options	8	21	0	6	0	35	0		35
Other accounts receivable/payable	154	1	24	59	4	242	144		386

Table 2.2 (concluded)

	Nonfinancial corporations	Financial corporations	General government	Households	NPISHs	Total economy	Rest of the world account	Goods and services account	Total
Stocks and changes in liabilities									
<b>Opening balance sheet</b>									
Nonfinancial assets									
Produced nonfinancial assets									
Nonproduced nonfinancial assets									
Financial assets/liabilities	3,221	3,544	687	189	121	7,762	1,274		9,036
Monetary gold and SDRs						0	770		770
Currency and deposits	40	1,281	102	10	38	1,471	116		1,587
Debt securities	44	1,053	212	2		1,311	77		1,388
Loans	897		328	169	43	1,437	17		1,454
Equity and investment fund shares/units	1,987	765	4			2,756	203		2,959
Insurance, pension, and standardized guarantee schemes	12	435	19		5	471	25		496
Financial derivatives and employee stock options	4	10				14	7		21
Other accounts receivable/payable	237		22	8	35	302	59		361
<b>Net worth</b>	<b>- 88</b>	<b>-30</b>	<b>498</b>	<b>4,500</b>	<b>210</b>	<b>5,090</b>	<b>-469</b>		<b>4,621</b>
<b>Total changes</b>									
Nonfinancial assets									
Produced nonfinancial assets									
Nonproduced nonfinancial assets									
Financial assets/liabilities	157	224	102	16	6	505	72		577
Monetary gold and SDRs							12		12
Currency and deposits	0	65	37	0	0	102	-2		100
Debt securities	7	64	45	0	0	116	23		139
Loans	21	0	9	11	6	47	35		82
Equity and investment fund shares/units	100	39	2	0	0	141	15		156
Insurance, pension, and standardized guarantee schemes	0	48	0	1	0	49	0		49
Financial derivatives and employee stock options	3	8	0	0	0	11	3		14
Other accounts receivable/payable	26	0	9	4	0	39	-14		25
<i>Changes in net worth, total</i>	<i>236</i>	<i>4</i>	<i>-54</i>	<i>305</i>	<i>9</i>	<i>500</i>	<i>-18</i>		<i>482</i>
<i>Saving and capital transfers</i>	<i>88</i>	<i>-5</i>	<i>-90</i>	<i>210</i>	<i>-1</i>	<i>202</i>	<i>-10</i>		<i>192</i>
<i>Other changes in volume of assets</i>	<i>14</i>	<i>-1</i>	<i>-2</i>	<i>-1</i>	<i>0</i>	<i>10</i>			<i>10</i>
<i>Nominal holding gains/ losses</i>	<i>134</i>	<i>10</i>	<i>38</i>	<i>96</i>	<i>10</i>	<i>288</i>	<i>-8</i>		<i>280</i>
Neutral holding gains/losses	82	6	27	87	6	208	-10		198
Real holding gains/losses	52	4	11	9	4	80	2		82
<b>Closing balance sheet</b>									
Nonfinancial assets									
Produced nonfinancial assets									
Nonproduced nonfinancial assets									
Financial assets/liabilities	3,378	3,768	789	205	127	8,267	1,346		9,613
Monetary gold and SDRs							782		782
Currency and deposits	40	1,346	139	10	38	1,573	114		1,687
Debt securities	51	1,117	257	2	0	1,427	100		1,527
Loans	918	0	337	180	49	1,484	52		1,536
Equity and investment fund shares/units	2,087	804	6	0	0	2,897	218		3,115
Insurance, pension, and standardized guarantee schemes	12	483	19	1	5	520	25		545
Financial derivatives and employee stock options	7	18	0	0	0	25	10		35
Other accounts receivable/payable	263	0	31	12	35	341	45		386
<b>Net worth</b>	<b>148</b>	<b>- 26</b>	<b>444</b>	<b>4,805</b>	<b>219</b>	<b>5,590</b>	<b>-487</b>		<b>5,103</b>

**Table 2.3. Link between Instrument and Functional Categories**

**Table 2.3a. International Accounts Financial Account by Instrument**

(Consistent with data in Table 2.1)

Financial account (by instrument)	Changes in assets	Changes in liabilities	Balance
Monetary gold and SDRs	0	1	
Currency and deposits	-2	11	
Debt securities	21	9	
Loans	35	4	
Equity and investment fund shares	14	12	
Insurance, pension, and standardized guarantee schemes	0	0	
Financial derivatives and ESOs	3	0	
Other accounts receivable/payable	-14	10	
Total changes in assets/liabilities	57	47	
Net lending (+) / net borrowing (-) (from financial account)			10

**Note:** ESO = employee stock option.

**Table 2.3b. IIP by Instrument**

(Consistent with data in Table 2.1)

International investment position	Opening position	Transactions (fin. acc.)	Other changes in volume	Revaluation	Closing position
<b>Assets (instrument split)</b>					
Monetary gold and SDRs	770	0	0	12	782
Currency and deposits	116	-2	0	0	114
Debt securities	77	21	0	2	100
Loans	17	35	0	0	52
Equity and investment fund shares	203	14	0	1	218
Insurance, pension, and standardized guarantee schemes	25	0	0	0	25
Financial derivatives and ESOs	7	3	0	0	10
Other accounts receivable/payable	59	-14	0	0	45
Total	1,274	57	0	15	1,346
<b>Liabilities (instrument split)</b>					
Monetary gold and SDRs	0	1	0	0	1
Currency and deposits	105	11	0	0	116
Debt securities	125	9	0	4	138
Loans	70	4	0	0	74
Equity and investment fund shares	345	12	0	3	360
Insurance, pensions, and standardized guarantee schemes	26	0	0	0	26
Financial derivatives and ESOs	0	0	0	0	0
Other accounts receivable/payable	134	10	0	0	144
Total	805	47	0	7	859
Net IIP	469	10	0	8	487

**Table 2.3c. Conversion of Data from Instrument Split to Functional Categories***(Consistent with data in Table 2.1)*

	Functional categories					Total
	DI	PI	FD	OI	RA	
<b>Financial account</b>						
Assets (instrument split)						
Monetary gold and SDRs						
Currency and deposits				-5	3	-2
Debt securities	2	14			5	21
Loans				35		35
Equity and investment fund shares	10	4				14
Insurance, pension, and standardized guarantee schemes						
Financial derivatives and ESOs			3			3
Other accounts receivable/payable	-4			-10		-14
Total	8	18	3	20	8	57
Liabilities (instrument split)						
Monetary gold and SDRs				1		1
Currency and deposits				11		11
Debt securities	4	5				9
Loans				4		4
Equity and investment fund shares	3	9				12
Insurance, pension, and standardized guarantee schemes						
Financial derivatives and ESOs						
Other accounts receivable/payable	4			6		10
Total	11	14	0	22	0	47
<b>IIP (opening)</b>						
Assets (instrument split)						
Monetary gold and SDRs					770	770
Currency and deposits				80	36	116
Debt securities	10	40			27	77
Loans				17		17
Equity and investment fund shares	53	150				203
Insurance, pension, and standardized guarantee schemes						
Financial derivatives and ESOs			7			7
Other accounts receivable/payable	15			44		59
Total	78	190	7	166	833	1,274
Liabilities (instrument split)						
Monetary gold and SDRs						
Currency and deposits				105		105
Debt securities	15	NO				125
Loans				70		70
Equity and investment fund shares	155	190				345
Insurance, pension, and standardized guarantee schemes						
Financial derivatives and ESOs				26		26
Other accounts receivable/payable	40			94		134
Total	210	300	0	295	0	805
<b>Revaluation</b>						
Assets (instrument split)						
Monetary gold and SDRs					12	12
Debt securities	1	1				2
Equity and investment fund shares		1				1
Total	1	2	0	0	12	15
Liabilities (instrument split)						
Debt securities	1	3				4
Equity and investment fund shares	1	2				3
Total	2	5	0	0	0	7

Table 2.3c (concluded)

	Di	Pi	Functional categories		RA	Total
			FD	Oi		
<b>IIP (closing)</b>						
Assets (instrument split)						
Monetary gold and SDRs					782	782
Currency and deposits				75	39	114
Debt securities	13	55			32	100
Loans				52		52
Equity and investment fund shares	63	155				218
Insurance, pension, and standardized guarantee schemes				25		25
Fin. deriv and ESOs			10			10
Other accounts receivable/payable	11			34		45
Total	87	210	10	186	853	1,346
Liabilities (instrument split)						
Monetary gold and SDRs				1		1
Currency and deposits				116		116
Debt securities	20	118				138
Loans				74		74
Equity and investment fund shares	159	201				360
Insurance, pension, and standardized guarantee schemes				26		26
Fin. deriv and ESOs						
Other accounts receivable/payable	44			100		144
Total	223	319	0	317	0	859

Note: DI = direct investment.

PI = portfolio investment.

FD = financial derivatives (other than reserves) and employee stock options.

OI = other investment.

RA = reserve assets.

# Accounting Principles

## A. Introduction

3.1 This chapter discusses the nature of basic entries in the international accounts and the accounting principles governing their recording. Entries in the international accounts are either flows or stocks. In the context of international accounts, stocks are called positions. The entries are recorded following a consistent set of accounting principles to ensure a complete integration of flows and positions as well as symmetry of recording between counterparties. This chapter first describes the important characteristics of flows and positions. It then explains the double-entry and quadruple-entry bookkeeping systems in the context of international accounts. Finally, the chapter describes general accounting principles concerning the time of recording, valuation, and aggregation and netting. Descriptions of specific types of flows and positions and the application of general accounting principles to their recording are discussed in relevant chapters.

## B. Flows and Positions

References:

2008 SNA, Chapter 3, Stocks, Flows and Accounting Rules.

IMF, *Government Finance Statistics Manual (GFSM)* 2001, Chapter 3, Flows, Stocks, and Accounting Rules (Sections A-B).

3.2 *Flows refer to economic actions and effects of events within an accounting period, and positions refer to a level of assets or liabilities at a point in time.* International flows are recorded in the accounts as transactions (balance of payments) and other changes in financial assets and liabilities account. Flows and positions are integrated so that all changes in positions between two points in time are fully explained by the recorded flows. Positions and flows of financial assets and liabilities are grouped according to the functional and instrument classifications of financial assets

and liabilities. Nonfinancial transactions are generally grouped according to their nature and characteristics. Positions of external financial assets and liabilities are shown in the international investment position. Descriptions of specific types of flows are discussed in the relevant chapters. The classification of financial assets and liabilities is discussed in Chapters 5 and 6.

### I. Flows

3.3 *Flows reflect the creation, transformation, exchange, transfer, or extinction of economic value; they involve changes in the volume, composition, or value of an institutional unit's assets and liabilities.* This classification is the basis for the flow accounts, as discussed in Chapters 8-13. Flows also can be classified into (a) those that are associated with transactions and (b) other flows.

#### a. Transactions

3.4 *A transaction is an interaction between two institutional units that occurs by mutual agreement or through the operation of the law and involves an exchange of value or a transfer.* Transactions are classified according to the nature of the economic value provided—namely, goods or services, primary income, secondary income, capital transfers, nonproduced nonfinancial assets, financial assets, or liabilities. Chapters 8 and 10-13 deal with transactions. Mutual agreement means that there is prior knowledge and consent by the institutional units. Transactions imposed by force of law are applicable mainly to certain distributive transactions, such as the payment of taxes, fines, and penalties. Although taxes or penalties are imposed on individual institutional units by administrative or judicial decisions, there is collective recognition and acceptance by the community of the obligation to pay taxes and penalties. Because of the exchange of value, a transaction consists of two economic flows, one in each direction—for example, goods supplied by one



party in return for currency supplied by the other. The definition is extended to cover actions within an institutional unit that are analytically useful to treat as transactions, often because the unit is operating in two different capacities, such as where one part operates as a branch. The definition is also extended to cover unrequited transfers, by the identification of transfers as the corresponding flow to the economic value supplied. Transactions recorded in the international accounts are between two institutional units, one a resident of the compiling economy and the other a nonresident.<sup>1</sup>

**3.5** Illegal transactions are treated the same way as legal actions. Illegal transactions are those that are forbidden by law. Illegal economic actions are transactions only when the institutional units involved enter the actions by mutual agreement. Otherwise, they are other flows. Macroeconomic statistics, including international accounts, cover all economic phenomena irrespective of whether they are illegal or legal. Differences in the definition of illegal transactions between economies or within an economy over time would cause inconsistencies in the international accounts if illegal transactions were omitted. Furthermore, illegal transactions generally affect other legal transactions (e.g., certain legal external financial claims may be created through illegal exports of goods). Thus, exclusion of illegal transactions could lead to an imbalance in the international accounts.

**3.6** Transactions recorded in the balance of payments are interactions between a resident and a nonresident institutional unit. By the nature of international accounts, intra-unit transactions are not recorded. The flows between the branch and its parent enterprise are shown as interactions between institutional units, with a branch recognized as a separate institutional unit (a quasi-corporation). Similarly, when a notional enterprise (a quasi-corporation) is created for holding land and associated buildings by nonresident owners, the flows between the nonresident owners and the notional enterprise are considered interactions between institutional units.

**3.7** Transactions between two resident institutional units in external assets are domestic transactions. Such transactions, however, affect the external asset posi-

tions of the two resident units involved. The external asset position of one resident unit is reduced and the position in the same external asset of another resident unit is increased, and thus leads to a change in domestic sectoral breakdown if the two parties are in different sectors. Such transactions result in changes in structure of external asset positions and should be recorded in the international accounts as a reclassification of sectors of holding (i.e., in the other changes in financial assets and liabilities account).<sup>2</sup> If both units fall in the same institutional sector, such reclassification entries cancel each other out and thus have no effect on sectoral positions. Similarly, when financial instruments issued by residents are exchanged between nonresidents, no transactions are recorded in the balance of payments and there is no change in overall external liabilities.<sup>3</sup>

**3.8** To establish whether a transaction involving an external financial asset is a transaction between a resident and a nonresident, the compiler must know the identities of both parties. The information available on transactions in claims constituting external assets may not, however, permit identification of the two parties to the transaction. That is, a compiler may not be able to ascertain whether a resident, who acquired or relinquished a claim on a nonresident, conducted the transaction with another resident or with a nonresident, or whether a nonresident dealt with another nonresident or with a resident. As a result, recorded international transactions may include not only those that involve assets and liabilities and take place between residents and nonresidents but also those that involve financial assets of economies and take place between two residents and, to a lesser extent, transactions that take place between nonresidents. (See also paragraphs 4.152-4.153 on the additional issues associated with partner attribution of transactions in financial instruments between residents and nonresidents. In addition, transactions between residents in external assets and liabilities may have to be taken into account for specific purposes, particularly as described in paragraph 14.21.)

**3.9** Some mutual agreements involve three parties. For example, guarantees involve the guarantor, the debtor, and the creditor. Transactions occurring between two parties (e.g., between the guarantor and debtor, or between the guarantor and creditor, or between the

<sup>1</sup>As stated in paragraph 3.6, however, notional institutional units are created to account for cross-border transactions that occur within a single corporation. In the national accounts, transactions cover also some actions within an institutional unit (intra-unit transactions) with the purpose of providing a more analytically useful picture of output, final uses, and costs. Examples include consumption of fixed capital, movements in inventories, and production for own final use of goods by producers.

<sup>2</sup>The resident-to-resident transaction between the buyer and seller is recorded in the national accounts.

<sup>3</sup>As discussed in paragraph A3.4, national contributions for compiling financial flows data in currency and economic unions may be allocated along the debtor-creditor approach as a way to ensure bilateral symmetry.

debtor and creditor) should always be identified and recorded as such. For one-off guarantees, the activation of the guarantee gives rise to transactions and, in some cases, other flows (for a definition and discussion of other flows, see paragraphs 3.19-3.22) between each of the three pairs of the three parties (see paragraphs 8.42-8.45 and 13.27 for the treatment of one-off guarantees). For each pair of parties, transactions in the international accounts are recorded if one party is a resident and another party is a nonresident.

**3.10** Service activities may consist of one unit (an agent) arranging for a transaction to be carried out between two other units in return for a fee from one or both parties to the transaction. In such a case, the transaction is recorded exclusively in the accounts of the two parties engaging in the transaction and not in the accounts of the agent facilitating the transaction. Therefore, in the case of agents, transactions should be attributed to the economy of the principal on whose behalf a transaction is undertaken, and not to the economy of the agent acting on behalf of the principal. The accounts of the agent show only the fee charged to the principal for the facilitation services rendered (see also paragraph 4.149).

**3.11** Each transaction involves two entries, a debit entry and a credit entry, for each party to the transaction. That is, each transaction consists of two flows and gives rise to two accounting entries for each party. (Given that each transaction involves two entries, a phrase such as a "goods transaction" may be more correctly called a "transaction involving goods" or "goods entry" or "goods flow.") Reclassification also involves two entries for each economy. All other flows that are not transactions or reclassification involve only one entry for each party as they directly affect net worth.

#### *Types of transactions*

**3.12** Transactions take many different forms. Transactions can be classified according to whether they are exchanges or transfers (see paragraph 3.13) and whether they are monetary or nonmonetary (see paragraph 3.14). Furthermore, certain transactions are rearranged through rerouting and partitioning (see paragraphs 3.16-3.17), whereas other transactions may be imputed to reflect the underlying economic relationship (see paragraph 3.18).

#### *Exchanges or transfers*

**3.13** Every transaction involves either an exchange or a transfer. An exchange involves the provision of something of economic value in return for a corresponding item of economic value. Purchases of goods

and services, acquisition of assets, compensation of employees, dividends, and so on are all exchanges. An exchange is sometimes called a transaction with "something for something" or a transaction with a quid pro quo. A transaction involving a transfer involves a provision (or receipt) of an economic value by one party without receiving (or providing) a corresponding item of economic value. A transfer entry is used to provide a corresponding entry to the unrequited flow. Taxes, debt forgiveness, grants, and personal transfers are examples of transfers. A transaction involving a transfer is also called a transaction with "something for nothing" or a transaction without a quid pro quo.

#### *Monetary or nonmonetary transactions*

**3.14** Every transaction is either a monetary or nonmonetary transaction. *A monetary transaction is one in which one institutional unit makes a payment (receives a payment) or incurs a liability (acquires an asset) stated in units of currency. A nonmonetary transaction is one not initially stated in units of currency by the transacting parties.* Nonmonetary transactions include barter transactions, remuneration in kind, payments in kind, compensation in kind, and transfers in kind. *In kind means that resources are provided in a form other than funds, such as goods, services, and interest forgone.* For example, provision of foreign aid goods is a transfer in kind. Because all flows are to be expressed in monetary terms, the monetary values of nonmonetary transactions need to be indirectly measured or otherwise estimated. The main distinguishing characteristic of a monetary transaction is that the parties to the transaction express their agreement in monetary terms, such as a given amount of units of a currency per unit of a good. Both monetary and nonmonetary transactions may be either exchanges or transfers.

#### *Rearranging transactions for statistical purposes*

**3.15** Most transactions can be clearly observed because the way they take place also reflects the underlying economic relationships. Some transactions (as they appear to the institutional units) do not reflect the underlying economic relationships, however, and need to be rearranged so that the accounts portray economic reality. Rerouting, partitioning, and imputation are three types of rearrangements employed in the international accounts.

#### *Rerouting*

**3.16** Rerouting records a transaction as taking place in channels different from those observed. For example, a direct transaction between unit A and unit C may

be best understood as a transaction first between unit A and unit B and second between unit B and unit C. This most often occurs when a unit that is a party to a transaction does not appear in the actual accounting records because of administrative arrangements. Social contributions paid by employers directly to a retirement scheme are one such example (see paragraphs 12.32-12.39 for recording of social contributions). The economic substance of such a transaction is revealed by rerouting: showing the social contributions as part of compensation of employees that is payable by employers to employees, who then make social contributions to the retirement scheme. Similarly, the transfer elements of lotteries and other gambling are transactions through the gambling operator, but they are rerouted to occur directly between those participating in the lottery or gambling, that is, between households and possibly to charities (see paragraph 12.25).

#### *Partitioning*

3.17 Partitioning unbundles two or more different transactions that appear as a single transaction from the perspective of the parties involved. For example, interest payable and receivable by financial intermediaries is partitioned into two components. One component represents the return on investment (pure interest), while the remainder represents the purchase of financial intermediation services for which the intermediaries do not explicitly charge (see paragraphs 10.126-10.136 for measuring financial intermediation services). Likewise, when a financial derivative is settled with the delivery of the underlying asset, this single event should be broken down into a transaction in the financial derivative and a separate transaction in the underlying asset. One example of partitioning and rerouting is the valuation of goods at FOB (free on board) values, with transportation and insurance services separately recorded (see paragraph 10.34 for CIF (cost, insurance, and freight) and FOB adjustments).

#### *Imputation*

3.18 Imputation of transactions refers to constructing entries in the accounts when no separate transactions are identified by the parties involved. As a general rule, transactions are to be imputed only in specific cases to reflect underlying economic relationships. Imputation of transactions in the international accounts is made in the following specific cases:

- (a) Retained earnings of direct investment enterprises are attributed to direct investors as if the retained earnings had been distributed in proportion to direct investors' shares in the earn-

ings of the direct investment enterprises and then reinvested by them in the direct investment enterprise. The rationale behind this treatment is that, because a direct investment enterprise is, by definition, subject to control or influence by a direct investor or investors, the decision to retain some of its earnings within the enterprise represents an investment decision on the part of the direct investor(s). The treatment of the retained earnings of direct investment enterprises are described in paragraphs 11.40-11.47.

- (b) Investment income earned on technical reserves held by insurance corporations is deemed to be payable to policyholders who are then deemed to return the funds back to insurance corporations as premium supplements even though in terms of actual cash flows the property income is retained by the insurance corporations. The same treatment is followed for the income earned by investing the technical reserves for standardized guarantees. Investment income earned on the technical reserves held by life insurance corporations and defined contribution pension schemes as well as the increase in entitlements during the period for defined benefits pension schemes are also deemed to be payable to policyholders who are then deemed to acquire financial claims on the life insurance corporations and pension funds. The technical reserves are liabilities of insurance corporations, guarantors, and pension funds and assets of policyholders. Therefore, the investment income attributable to policyholders provides a measure of income receivable by the policyholders on their claims. This imputation provides a more suitable picture of the disposable income of policyholders, of their saving, and of production and trade in insurance services.
- (c) Retained earnings of investment funds are treated as if they were distributed to shareholders who are then deemed to reinvest in the investment fund. The treatment and recording of these transactions are explained in paragraphs 11.37-11.39.
- (d) When government has a nonresident entity undertake fiscal functions related to government borrowing or incurring government outlays abroad with no or incomplete economic flows between the government and the nonresident entity related to these fiscal activities, transactions are imputed in the accounts of both the

government and the nonresident entity to reflect the fiscal activities of the government. Imputations of these transactions are described in paragraphs 8.24-8.26, 11.40, and 12.48.

- (e) Implicit taxes or subsidies associated with a multiple exchange rate regime are discussed in paragraph 3.107.

#### b. Other flows

**3.19** *Other flows are changes in the volume, value, or classification of an asset or liability that do not result from a transaction between a resident and a nonresident.* Other flows are genuine economic phenomena and capture changes in assets and liabilities between opening and closing positions that are not due to transactions. In the context of international accounts, other flows are recorded only for financial assets and liabilities that represent claims on and liabilities to nonresidents and gold bullion (see paragraph 3.24), because the international investment position relates only to external financial assets and liabilities.

**3.20** Other flows cover various kinds of changes in assets and liabilities that are recognized analytically under two broad types:

- (a) *Other changes in the volume of assets and liabilities reflect entrances of **new assets into balance sheets** and exits of existing assets and liabilities from balance sheets that are not caused by interactions by mutual agreement between institutional units (i.e., transactions).*
- (b) *Revaluations (holding gains and losses) on an asset or liability arise from changes in their prices and/or the exchange rates.* In international accounts, revaluations are further classified into those that are due to exchange rate changes and those that are due to other price changes.

**3.21** Other changes in the volume of assets and liabilities are recorded when either:

- (a) new assets that were not in the opening balance sheet appear in closing balance sheet,
- (b) or existing assets that were in the opening balance sheet disappear from the closing balance sheet,
- (c) and these appearances or disappearances are not the result of transactions.

Included are write-offs of claims by creditors, reclassification of assets, monetization and demonetization

of gold bullion, and other events. If debt forgiveness is provided, such as in a noncommercial setting, transactions are recorded (see paragraphs 13.22-13.23). In the case of debt cancellations, it may sometimes be unclear whether they should be classified as transactions or other flows. In commercial settings, in the absence of specific information, debt cancellation can be treated as other changes in the volume of assets (see also paragraphs 9.8-9.11). Changes in the status of existing financial claims and liabilities arising from the change in residence of individuals from one economy to another are treated as other changes in the volume of assets. These flows result from a change in the classification of the owner's residence status, and hence, they should not be classified as transactions (see also paragraphs 9.21-9.23). Assumption of debts arising from the activation of guarantees and rescheduling of debts and are the results of mutual agreements between the parties and, hence, are classified as transactions (see paragraphs 8.42-8.45 and 8.54, respectively).

**3.22** A separate account (other changes in financial assets and liabilities account) shows changes in assets and liabilities due to other flows. Chapter 9 describes the structure of this account as well as various categories of other flows and their treatment.

## 2. Positions

**3.23** *Positions refer to the level of financial assets or liabilities at a point in time.* They are recorded in the international investment position, which is a balance sheet of external financial assets and liabilities. Generally, positions are shown at the beginning and end of an accounting period. Positions between two periods are connected with flows during that period because changes in positions are caused by transactions and other flows.

**3.24** Financial assets are economic assets that are financial instruments. Financial assets include financial claims and, by convention, monetary gold held in the form of gold bullion (including gold held in allocated gold accounts). A financial claim is a financial instrument that has a counterpart liability. Gold bullion is not a claim and does not have a corresponding liability. It is treated as a financial asset, however, because of its special role as a means of financial exchange in international payments by monetary authorities and as a reserve asset held by monetary authorities.

**3.25** The international investment position covers financial assets and liabilities that have an international character. All financial claims involve two parties, so

they have an international character if the claim is on a nonresident. Similarly, all liabilities involve two parties, so they have an international character if the obligation is to a nonresident. International investment position is described in Chapter 7.

## C. Accounting System

References:

2008 SNA, Chapter 2, Overview.

Gorter, Cornelis N., and Manik L. Shrestha, "Bookkeeping Conventions and the Micro-Macro Link," *Review of Income and Wealth*, Vol. 50, June 2004.

3.26 The accounting system underlying the international accounts derives from broad bookkeeping principles. To understand the accounting system for international accounts, three bookkeeping principles can be distinguished:

- (a) vertical double-entry bookkeeping (also known in business accounting as simply double-entry bookkeeping);
- (b) horizontal double-entry bookkeeping; and
- (c) quadruple-entry bookkeeping.

### Vertical double-entry bookkeeping—corresponding entries

3.27 The main characteristic of vertical double-entry bookkeeping is that each transaction leads to at least two corresponding entries, traditionally referred to as a credit entry and a debit entry, in the books of the transactor. The international accounts for an economy are to be compiled on a vertical double-entry bookkeeping basis from the perspective of the residents of that economy. Because each transaction is either an exchange or a transfer, it requires two entries. This principle ensures that the total of all credit entries and that of all debit entries for all transactions are equal, thus permitting a check on consistency of accounts for a single unit. Reclassifications also lead to debit and credit entries. Other flows have their corresponding entries directly in changes in net worth. As a result, vertical double-entry bookkeeping ensures the fundamental identity of a unit's balance sheet, that is, the total value of assets equals the total value of liabilities plus net worth. The total value of the assets owned by an entity minus the total value of liabilities provides net worth. In the international accounts, net international investment position provides a measure of net financial claims with nonresidents plus gold bul-

lion held as monetary gold. These terms are discussed in paragraphs 7.1-7.2.

### Horizontal double-entry bookkeeping—counterpart entries

3.28 The concept of horizontal double-entry bookkeeping is useful for compiling accounts that reflect the mutual economic relationships between different institutional units in a consistent way. It means that if unit A provides something to unit B, the accounts of both A and B show the transaction for the same amount: as a payment in A's account and as a receipt in B's account. Horizontal double-entry bookkeeping ensures the consistency of recording for each transaction category by counterparties. For example, at the worldwide level, dividends payable by all economies should be equal to dividends receivable by all economies.

### Quadruple-entry bookkeeping

3.29 The simultaneous application of both the vertical and horizontal double-entry bookkeeping results in a quadruple-entry bookkeeping, which is the accounting system underlying the recording of transactions in the national accounts and international accounts. Additionally, definitions, classifications, and accounting principles in the international accounts are derived from the viewpoint of conceptual symmetry as well as symmetric reporting by partner economies. The quadruple-entry system deals in a coherent way with multiple transactors or groups of transactors, each of which practices vertical double-entry bookkeeping. A single transaction between two counterparties thus gives rise to four entries. In contrast to business bookkeeping, international accounts deal with interactions among a multitude of units in parallel and thus require special care from a consistency point of view. As a liability of one unit is mirrored in a financial asset of another unit, for instance, they should be identically valued, allocated in time, and classified to avoid inconsistencies in aggregating balance sheets of units into regional or global totals. The same is also true for all transactions and other flows that affect balance sheets of two counterparties. The quadruple approach to transactions in the international accounts is needed for bilateral comparisons and global integrated data.

### Types of accounting entries

3.30 The international accounts use the following conventions and terminologies for recording flows. In the current and capital accounts, a credit denotes entries

from exports, primary income receivable, transfers receivable, and disposals of nonproduced nonfinancial assets. A debit is used to record entries for imports, primary income payable, transfers payable, and acquisitions of nonproduced nonfinancial assets.

3.31 In the case of transactions in financial assets and liabilities, the terms "net acquisition of financial assets" and "net incurrence of liabilities" are used. Financial account items are recorded on a net basis separately for each financial asset and liability (i.e., they reflect changes due to all credit and debit entries during an accounting period). The use of the terms "net acquisition of financial assets" and "net incurrence of liabilities" highlights the impact of the financial account on the international investment position. The use of these terms also simplifies the interpretation of data. A positive change indicates an increase in assets or liabilities and a negative change indicates a decrease in assets or liabilities. The interpretation of increase or decrease under the credit or debit notion, however, depends on whether the increase or decrease refers to assets or liabilities (a debit for an asset is an increase; a debit for a liability is a decrease). Although the debit and credit presentation is not emphasized for the financial account transactions, it is important to recognize and maintain the accounting identities. For example, a credit is always conceptually matched with a corresponding debit, the latter relating to either an increase in an asset or a reduction in a liability (see Box 2.1). The conventions for aggregation, consolidation, and netting assets against liabilities are described in Section F.

#### D. Time of Recording of Flows

##### References:

- 2008 SNA, Chapter 3, Stocks, Flows and Accounting Rules.
- IMF, *GFSM2001*, Chapter 3 (Section C), Flows, Stocks, and Accounting Rules.
- IMF, *Monetary and Financial Statistics Manual (MFSM) 2000*, paragraphs 225-228.
- IMF, *External Debt Statistics: Guide for Compilers and Users*, Box 2.1, The Choice of a Recording Basis: The Case for Accrual Accounting.

3.32 Once a flow is identified, the time at which it occurred must be determined so that the value of all flows within a given accounting period can be compiled. The international accounts do not show individual transactions or other flows, but there are several reasons why precise rules on their individual timing

must be given. First, rules have to be formulated to determine in which accounting period the discrete flows are to be recorded. Second, an exact timing of individual flows within the accounting period is crucial to make the distinction between changes in net worth due to transactions and those due to other changes (e.g., other changes in volume and revaluations). Third, the integrated nature of the system means that the positions recorded on the balance sheet are influenced by the timing of flows. Finally, the quadruple accounting system requires that entries for a transaction are made by the counterparties at the same time. This ensures the consistency of accounts for each party (e.g., consistency between the merchandise item and the corresponding financial account entries) as well as the symmetry of recording by partner economies.

3.33 One of the problems in determining the timing of transactions is that activities of institutional units often stretch over periods in which several important moments can be distinguished. For instance, exports and imports of goods commence with the signing of a contract between a seller and a buyer; encompass dates of crossing borders, a date of delivery, and a date or dates on which payments become due; and are completed only when the last payment is received by the seller. Each of these distinct moments in time is, to some extent, economically relevant and may result in multiple transactions in the international accounts. As explained in the following paragraphs, each transaction should be recorded according to the accrual basis, which determines the time period to which it should be attributed.

#### I. Alternative recording bases

3.34 Broadly, the time of recording could be determined on four bases: the accrual basis, the due-for-payment basis, the commitment basis, and the cash basis. Other timing bases, such as physical movement or administrative process, may be used in some data sources. The accrual basis is used in the international accounts as well as in other major macroeconomic statistical systems (e.g., national accounts, government finance, and monetary and financial statistics).

3.35 *Accrual accounting records flows at the time economic value is created, transformed, exchanged, transferred, or extinguished.* This means that flows that imply a change of economic ownership are recorded when ownership passes and services are recorded when provided. In other words, the effects of economic events are recorded in the period in which they occur, irrespective of whether cash was received or paid or was due to

be received or paid. When an economic event is accompanied by a settlement at a later date, such as an import of goods with trade credit, the time lag is bridged by recording each event separately, the corresponding entry at the time of import being trade credit payable.

**3.36** A *due-for-payment basis* records flows that give rise to cash payments at the time the payments fall due. If a payment is made before it is due, then the flows are recorded when the cash payment is made.

**3.37** A *commitment basis* records flows when a unit has committed itself to a transaction. Normally, this basis may be envisaged only for acquisition of financial assets or incurrance of liabilities, and purchases of goods, services, and labor inputs. The time of recording generally is when a commitment is made or a purchase order is issued.

**3.38** A *cash basis* records flows when cash is received or disbursed. In its strict form, only those flows that involve cash as the medium of exchange are included.

## 2. Use of accrual basis in the international accounts

**3.39** The *Manual* recommends use of the accrual basis for determining the time of recording of flows. The accrual basis matches the time of recording with the timing of the events giving rise to the actual resource flows. With the cash basis, the time of recording would potentially diverge significantly from the time of the economic activities and transactions to which the cash flows relate. The due-for-payment basis would usually record transactions after the resource flows have taken place, although the long delays caused by the cash basis would, in most cases, be reduced. The timing of the commitment basis would precede the actual resource flows.

**3.40** The accrual basis provides the most comprehensive information because all resource flows are recorded, including nonmonetary transactions, imputed transactions, and other flows. Such a comprehensive recording ensures the integration of flows and changes in balance sheets. The accrual basis is consistent with the way transactions, other flows, and main economic aggregates (balance on goods and services, net lending/net borrowing) are defined. It is also close to business accounting.

### a. Time of recording of transactions

**3.41** The change of economic ownership is central in determining the time of recording on an accrual basis for transactions in goods, nonproduced nonfinancial assets, and financial assets. The term "economic

ownership" reflects the underlying reality economic accounts are attempting to measure. Economic ownership takes account of where the risks and rewards of ownership lie. The concepts of economic ownership and associated risks and rewards are further elaborated in paragraph 5.3. A change in ownership from an economic point of view means that all risks, rewards, and rights and responsibilities of ownership in practice are transferred. In general, a change in "legal ownership" also involves a change in economic ownership. In some cases, a change of "economic ownership" takes place even though the "legal ownership" remains unchanged (e.g., financial leases and transactions between an enterprise and its foreign branches). In other cases, there is no change in economic ownership, even though there is a change in legal ownership. For example, for repurchase agreements involving the provision of securities for cash, the risks and rewards attached to the securities remain with the original holder (as discussed in paragraphs 5.52-5.54) and the only transaction is a loan. Similarly, in the case of securities lending without cash collateral, there is no change in ownership of the securities, although securities lending fees may arise (see paragraphs 11.67-11.68).

**3.42** Entries for transactions in goods, nonproduced nonfinancial assets, and financial assets owned by institutional units are made at the time economic ownership of the underlying asset is transferred. When a change in economic ownership is not obvious, the change is considered to occur at (or is proxied by) the time the parties to the transaction record it in their books or accounts.

**3.43** General principles for applying the accrual basis for time of recording to various flows are described in paragraphs 3.44-3.66. More specific descriptions of the accrual basis are detailed in relevant chapters.

### *Application to goods*

**3.44** *Transactions in goods should be recorded as of the time that the change of economic ownership takes place.* Goods are considered to change economic ownership when the parties enter the goods in their books and make a corresponding change to their financial assets and liabilities. For high-value capital goods such as ships, heavy machinery, and other equipment, ownership changes are recorded at the time agreed between the parties as to when ownership changes (see paragraph 10.28). When a contract for building and other construction is agreed in advance, progressive change of ownership occurs for the work-in-progress, which may take several months or years to complete. When the contract calls for stage payments (progress pay-

ments), the transaction values may often be approximated by the value of stage payments made each period (see paragraphs 5.71 and 10.107). A difference in timing between the change of ownership and payments may give rise to trade credit and advances.

**3.45** The timing used in international merchandise trade statistics generally follows customs procedures, which are set up to record the movement of goods across borders. The time at which goods cross the border can be taken only as an approximation to the time when the change of economic ownership occurs. A customs-based collection system usually provides a choice of dates at which transactions may be recorded (e.g., lodgment of customs declaration, customs clearance of goods). The time of recording in the international guidelines for merchandise trade statistics is when the customs declaration is lodged. Ideally, for international accounts purposes, customs data should be adjusted (see paragraphs 3.61-3.66). Likewise, an exchange record system that reflects payments may not coincide in timing with the change in economic ownership of the goods.

**3.46** Goods on consignment (i.e., goods intended for sale but not actually sold when the goods cross the frontier) should be recorded only at the time economic ownership changes. Goods under financial lease arrangements are considered to change economic ownership at the inception of the lease (see paragraph 5.56 on the definition of a financial lease and paragraphs 7.57 and 10.17(f) for positions and transactions arising from financial leases). Goods sent abroad for processing under the ownership of the same party are not treated as if they change economic ownership. Goods may move between a parent and its branch abroad. In that case, possibilities exist that either the goods have changed economic ownership or they may have been sent for processing. The correct statistical treatment is to identify which location assumes the risks and rewards of ownership most strongly (e.g., from factors such as whether the goods are included in the accounts, and which location is responsible for subsequent sale of the goods). For goods under merchanting, purchases and resales are recorded at the time the change in economic ownership of goods occurs.

#### *Application to services*

**3.47** *Transactions in services are recorded when the services are provided.* Some services, such as some transport or hotel services, are provided within a discrete period, in which cases, there is no problem in determining the time of recording. Other services are supplied or take place on a continuous basis. For

example, construction services, operating leasing, and insurance services are recorded continuously as long as they are being provided. When construction takes place with a prior contract, the ownership of the structure is effectively transferred progressively as the work proceeds. When services are provided over a period of time, there may be advance payments or settlements at later dates for such services (e.g., freight, insurance, port services). The provision of services should be recorded on an accrual basis in each accounting period (i.e., they should be recorded as they are rendered, not when payments are made). Entries for advance payments or settlements at later dates should be made in the appropriate accounts when they occur (as explained in paragraph 3.35 in the case of import of goods).

#### *Application to primary income and transfers*

**3.48** *Distributive transactions are recorded at the moment the related claims arise.* As a result, for example, compensation of employees, interest, social contributions and benefits are all recorded in the period during which the amounts payable accrue. (See paragraphs 11.20-11.21 for the recording of compensation of employees associated with employee stock options.) With respect to some distributive transactions, the time of accrual depends on the unit's decision as to when to distribute primary income or make a transfer. Dividends are recorded at the moment the shares go ex-dividend. Three dates are associated with dividends:

- (a) the date they are declared;
- (b) the date they are excluded from the market price of shares, known as the ex-dividend date. The recipients of the dividends are determined from the register of shareholders at this time and subsequent shareholders do not have a right to the dividends; and
- (c) the date they are settled.

Although dividends sometimes may be related to the enterprise's profits in the previous period, in other cases, they are only loosely related or not at all. The price of shares includes declared dividends up to the ex-dividend date, thus the holder of the shares before the ex-dividend date owns the share and does not hold a separate debt instrument reflecting declared and unpaid dividends. Between the ex-dividend date and actual settlement, the amount payable is recorded as other accounts receivable/payable. Withdrawals from income of quasi-corporations, such as distributed branch profits, are recorded when they actually take place. Reinvested earnings are derived from retained earnings,



and therefore they are recorded in the period in which retained earnings accrue. (See paragraphs 11.33-11.47 for issues in the calculation of reinvested earnings.)

**3.49** Interest is recorded as accruing on a continuous basis because the financial resources are provided for use on a continuous basis. For some financial instruments, the debtor does not make any payments to the creditor until the financial instrument matures, at which time a single payment discharges the debtor's liability; the payment covers the amount of funds originally provided by the creditor and the interest accumulated over the entire life of the financial instrument. Corresponding entries to the interest accruing in each period before maturity should be recorded as financial transactions that represent an additional acquisition of the financial asset by the creditor and an equal incurrence of a liability by the debtor.

**3.50** Taxes and other compulsory transfers should be recorded when the activities, transactions, or other events occur that create the government's claim to the taxes or other payments. In principle, income taxes and social contributions based on income should be attributed to the period in which the income is earned. In practice, however, some flexibility may be needed so that income taxes deducted at the source and regular prepayments of income taxes may be recorded in the periods in which they are paid, and any final tax liability on income may be recorded in the period in which it is determined.

**3.51** Some compulsory transfers, such as fines, penalties, and property forfeitures, are determined at a specific time. These transfers are recorded when a legal claim is established, which may occur when a court renders judgment or an administrative ruling is published.

**3.52** Determining the time of recording for grants and other voluntary transfers can be complex because there is a wide variety of eligibility conditions that have varying legal powers. In some cases, a potential grant recipient has a legal claim when it has satisfied certain conditions, such as the prior incurrence of expenses for a specific purpose or the passage of legislation. These transfers are recorded when all requirements and conditions are satisfied. In other cases, the grant recipient never has a legal claim on the donor, and the transfer should be attributed to the time at which the settlement is made (e.g., cash payment). In general, the time of recording of voluntary transfers is determined by the time at which there is a change in the economic ownership of the resources

(such as goods, services, or financial assets) that are corresponding entries to transfers.

***Application to transactions in nonproduced nonfinancial assets***

**3.53** Transactions in nonproduced nonfinancial assets are recorded at the time economic ownership of these assets changes. The treatment is similar to those for goods and financial assets, as discussed in paragraphs 3.44 and 3.54-3.55, respectively.

***Application to transactions in financial assets***

**3.54** *Transactions in financial assets (including payments of cash) are recorded when economic ownership changes.* Some financial assets, such as trade credit, are the implicit result of a nonfinancial transaction. In these cases, the financial claim is deemed to arise at the time the corresponding nonfinancial transaction occurs. In some cases, the parties to a transaction may perceive ownership to change on different dates because they acquire the documents evidencing the transaction at different times. This variation usually is caused by the process of clearing, or the time checks are in the mail. The amounts involved in such "float" may be substantial in the case of transferable deposits and other accounts receivable or payable. If no precise date can be fixed, the timing of the transaction is determined according to the date on which the creditor receives payment or some other financial claim.

**3.55** Transactions in securities are recorded at the time ownership changes, which determines the transaction date. Both parties should record the transactions at the time ownership changes, not when the underlying financial asset is delivered. If settlement occurs after the ownership has changed, this gives rise to accounts receivable/payable. In practice, when the delay between the transaction and settlement is short, the time of settlement may be considered as an acceptable proxy, so that accounts receivable/payable would not arise. In cases of longer delays, however, accounts receivable/payable should be identified.

**3.56** According to the accrual basis, repayments of debts are recorded when they are extinguished (such as when they are paid, rescheduled, or forgiven by the creditor). When arrears occur, no transactions should be imputed, but the arrears should continue to be shown in the same instrument until the liability is extinguished. However, if the contract provided for a change in the characteristics of a financial instrument when it goes into arrears, this change should be recorded as a reclas-

sification in the other changes in the financial assets and liabilities account. The reclassification applies to situations in which the original contract remains, but the terms within it change (e.g., interest rates, repayment periods). If the contract is renegotiated or the nature of the instrument changes, as agreed between the parties, from one instrument category to another (e.g., from bonds to equity), the consequences are to be recorded as new transactions. Consistent with the accrual principle, an overdue obligation to settle a financial derivative contract is not recorded as a transaction; however, the obligation is reclassified to a debt liability because of the change in the nature of the claim (see paragraph 5.82).

**3.57** Data on arrears are important in their own right, and thus should be presented as supplementary items, where significant (or memorandum items in the case of Exceptional Financing, see Appendix 1). Although it is useful to identify some commonly important arrears (such as arrears on public and publicly guaranteed debt), flexibility is needed in determining which items of arrears are important to disseminate, depending on each economy's circumstances. Arrears are described further in paragraphs 5.99-5.102.

**3.58** Activation of one-off (nonstandardized) guarantees gives rise to financial transactions because this involves a creation of a new liability. The time of recording of flows arising from activation of one-off guarantees (including capital transfers and other changes in the volume of assets, if applicable) is determined by the occurrence of the events activating the guarantee. The treatment of flows arising from the activation of one-off guarantees is described in more detail in paragraphs 8.42-8.45.

**3.59** Employee stock options are recognized at grant date. Compensation of employees associated with employee stock options should be recorded as accruing over the period to which the option relates, which generally is the period between the granting and vesting dates. Sometimes, the options may cover the period before the granting date, which should also be taken into account when allocating the compensation of employees.

*b. Time of recording of other flows*

**3.60** Other flows include other changes in the volume of assets and revaluations. Other changes in the volume of assets are usually discrete events that accrue at precise moments or within fairly short periods of time. Other changes in the volume of assets, including reclassifications, are recorded as these changes

occur. Revaluations can occur continuously as prices and exchange rates change. In practice, revaluations are usually computed between two points in time at which the relevant assets and liabilities are valued.

### 3. Timing adjustments

**3.61** Differences in the time of recording by partner economies may occur because of various factors. One of the intrinsic problems in the international transactions is the difference in time zones. Differences in time of recording may arise from delays in mail deliveries or settlement clearing processes. Several data sources may often only approximate the required basis. It is important to make timing adjustments in cases in which major divergences occur from the required basis.

**3.62** In choosing among available statistical sources, compilers may wish to consider the advantage of using data for which the correct timing is already recorded. For example, records of actual drawings on loans are preferable to sources that quote authorization dates or program dates that may not be realized.

**3.63** Timing adjustments to international merchandise trade statistics may be necessary because these statistics may not reflect changes in economic ownership. Moreover, they may not always reflect physical movements correctly. Timing adjustments should be made when practices in customs statistics lead to distortions. For example, in the case of the purchase or sale of ships and aircrafts, information on the time at which the goods are entered in the books of the supplier or customer could be used. It is a good practice to identify the timing of large individual shipments or transactions (such as a ship or aircraft) to ensure that the goods flow and corresponding financing transactions are recorded in the same period.

**3.64** A change in the economic ownership of goods can vary widely from the time at which the goods are recorded in trade statistics, if a lengthy voyage is part of the process of importing or exporting. If the unit value of trade changes substantially from the beginning to the end of the reporting period, the possible difference of one or more months between the shipment or receipt of goods and the change of ownership can be a source of error in the statement for a particular economy and a source of asymmetries between partner economies. Inquiries, perhaps on a sample basis, are required to ascertain specific practices, and timing adjustments should, in principle, be applied to correct the trade statistics for those classes of goods that are found to change ownership at times

other than those at which the goods were recorded in the trade statistics.

**3.65** Goods on consignment may often be recorded at the time the goods cross the frontier, on the assumption that a change of ownership has occurred or will shortly occur. If that treatment is followed and there is no change of ownership, adjustments will have to be made, preferably by revising the original entries. In practice, these adjustments may be made in the periods when the goods are returned, if goods returned involve minor cases.

**3.66** Information based on exchange records provides data on a cash basis. For certain transactions, cash and accrual bases for recording may be the same, but for many they will differ. In particular, transactions in goods, services, and income may not coincide with the corresponding payments for settling the transactions. Alternative information should be used routinely to verify or adjust selected transaction categories. Compilers using an exchange record system should check each large settlement transaction. Information on interest from either the payments records or debt service schedule may not be appropriate for accrual accounting. Other possibilities of deriving interest accrual, such as using the data on positions and contractual interest rates, should be explored and implemented.

## E. Valuation

### References:

2008 SNA, Chapter 3, Stocks, Flows and Accounting Rules.

IMF, *GFSM 2001*, Chapter 3, Flows, Stocks, and Accounting Rules.

IMF, *External Debt Statistics: Guide for Compilers and Users*, paragraphs 2.31-2.52, 6.12.

**3.67** *Market prices refer to current exchange value, that is, the values at which goods and other assets, services, and labors are exchanged or else could be exchanged for cash.* Market prices are the basis for valuation in the international accounts. This section describes the general principles for valuation of flows and positions. Valuation of specific types of flows and positions are discussed in further detail in relevant chapters.

### I. Valuation of transactions

**3.68** *Market prices for transactions are defined as amounts of money that willing buyers pay to acquire*

*something from willing sellers'*, the exchanges are made between independent parties and on the basis of commercial considerations only—sometimes called "at arm's length." Thus, according to this strict definition, a market price refers only to the price for one specific exchange under the stated conditions. A second exchange of an identical unit, even under circumstances that are almost exactly the same, could result in a different market price. A market price defined in this way is to be clearly distinguished from a price quoted in the market, a world market price, a going price, a fair market price, or any price that is intended to express the generality of prices for a class of supposedly identical exchanges rather than a price actually applying to a specific exchange. Furthermore, a market price should not necessarily be construed as equivalent to a free market price—that is, a market transaction should not be interpreted as occurring exclusively in a purely competitive market situation. In fact, a market transaction could take place in a monopolistic, monopsonistic, or any other market structure. Indeed, the market may be so narrow that it consists of the sole transaction of its kind between independent parties.

**3.69** Actual exchange values in the contract between two parties in most cases will represent market prices as described in the preceding paragraph, regardless of taxes and subsidies. Paragraphs 3.77-3.79 describe cases in which actual exchange values do not represent market prices. Transactions that involve dumping and discounting represent market prices. Market price is the price payable by the buyer after taking into account any rebates, refunds, adjustments, and so on from the seller. Imports and exports of general merchandise are recorded at FOB values, which take into account any export taxes payable or any tax rebates receivable.

**3.70** Transactions in financial assets and liabilities are recorded according to the general principles described in paragraph 3.68. In particular, transactions in loans, deposits, and other accounts receivable/payable also should be valued at market prices. Transactions in financial assets and liabilities should be recorded exclusive of any commissions, fees, and taxes whether charged explicitly, included in the purchaser's price, or deducted from the seller's proceeds. This is because both debtors and creditors should record the same amount for the transaction in the same financial instrument. The commissions, fees, and taxes should be recorded separately from the transaction in the financial asset and liability, under appropriate categories. The valuation of transactions in financial instruments,

which excludes commission charges (recorded as transactions in services), differs from the valuation of nonfinancial asset transactions, which includes any costs of ownership transfer unless paid separately.

3.71 When market prices for transactions are not observable, valuation according to market-equivalent prices provides approximation to market prices. In such cases, market prices of the same or similar items when such prices exist will provide a good basis for applying the principle of market prices. Generally, market prices should be taken from the markets in which the same or similar items are traded currently in sufficient numbers and in similar circumstances. If there is no appropriate market in which a particular good or service is currently traded, the valuation of a transaction involving that good or service may be derived from the market prices of similar goods and services by making adjustments for quality and other differences.

3.72 Some cases in which market prices are not available or pose specific problems include barter transactions, provision of goods and services without a charge, and goods under financial lease. If a buyer and a seller engage in a barter transaction—the exchange of goods or services for other goods, services, or assets (of equal value)—the goods or services bartered should be valued at the prices that would have been received if the goods or services had been sold in the market. Similarly, a grant and donation in kind can be valued using the market price of the goods or services at the time of transfer. Cost of acquisition also may be used in certain situations, particularly when there is no time lag between the acquisition and the transfer. Acquisition of goods under financial lease should be valued at market prices at the time of acquisition, if such prices are available. When no price is determined, it may be necessary to use the estimated written-down current acquisition values of fixed assets or the present value of expected future returns.

3.73 Market valuation also poses problems for transactions in goods in which the contracts establish a quotation period often months after the goods have changed hands. In such cases, market value at the time of change of ownership should be estimated, which should be revised with the actual market value, when known. Market value is given by the contract price regardless of whether it is unknown at the time of change of ownership.

3.74 Values of imputed transactions will have to be derived from values of other observed transactions to which they are related. For example, values of transactions in reinvested earnings are derived from the direct investors' shares in the net saving of the direct invest-

ment enterprise before reinvested earnings are distributed. Reinvested earnings and the recording of related financial account entries are described in paragraphs 8.15-8.16 and 11.33-11.47.

3.75 When nonfinancial resources are provided, without a quid pro quo, to nonresidents by the government or private nonprofit institutions of an economy, the same values must be reflected in the international accounts of ~~both recipient and donor~~. In conformity with the general principles, such resources should be valued at the market prices that would have been received if the resources had been sold in the market. The donor's view of the imputed value of the transaction may be quite different from that of the recipient. The suggested rule of thumb is to use the value assigned by the donor as a basis for recording.

3.76 In some cases, actual exchange values may not represent market prices. Examples are transactions involving the following: transfer pricing between affiliated enterprises; manipulative agreements with third parties; and certain noncommercial transactions, including concessional interest. Prices may be under- or overinvoiced (i.e., shown at a price other than the actual price, for instance, to evade taxes or exchange controls), in which case, an assessment of a market-equivalent value needs to be made. An adjustment should be made when actual exchange values do not represent market prices, but this may not be practical in many cases. Adjusting the actual exchange values to reflect market prices will have consequences in other accounts. Therefore, when such adjustments are made, corresponding adjustments in other accounts also should be made; for example, if prices of goods are adjusted, associated income account or financial account transactions also should be adjusted.

3.77 Transfer pricing refers to the valuation of transactions between affiliated enterprises. In some cases, transfer pricing may be motivated by income distribution or equity buildups or withdrawals. Replacing book values (transfer prices) with market-equivalent values is desirable, in principle, when the distortions are large and when availability of data (such as adjustments by customs or tax officials or from partner economies) makes it feasible to do so. Selection of the best market-equivalent values to replace book values is an exercise calling for cautious and informed judgment. The treatment of transfer pricing between affiliated enterprises is elaborated in paragraphs 11.101-11.102.

3.78 The exchange of goods between affiliated enterprises often may be one that does not occur between

independent parties (e.g., specialized components that are usable only when incorporated in a finished product). Similarly, the exchange of services, such as management services and technical know-how, may have no near equivalents in the types of transactions in services that usually take place between independent parties. Thus, for transactions between affiliated parties, the determination of values comparable to market values may be difficult, and compilers may have no choice other than to accept valuations based on explicit costs incurred in production or any other values assigned by the enterprise. The valuation of management fees and other similar cases is elaborated in paragraph 10.150.

3.79 Some noncommercial transactions, such as a grant in kind, have no market price; however, other noncommercial transactions may take place at implied prices that include some element of grant or concession, so that those prices also are not market prices. Examples of such transactions could include negotiated exchanges of goods between governments and government loans bearing lower interest rates than those with similar grace and repayment periods or other terms for purely commercial loans. Concessional lending is described in paragraph 12.51. In principle, an adjustment should be made, although this may not be practical in many cases, to record these transactions at market prices and a transfer is recorded for the difference between the implied price and the market price. Transactions by general government bodies and private nonprofit entities not engaged in purely commercial undertakings are often subject to noncommercial considerations. Transfers involving the provision of goods and services also may be provided or received, however, by other sectors of the economy.

3.80 In cases in which a single exchange value reflects more than one transaction category, the transactions captured in the single exchange need to be partitioned (unbundled) into individual transactions, as described in paragraph 3.17. In that case, the total value of the partitioned individual transactions must equal the market value of the exchange that actually occurred. For example, actual exchange values involving foreign currency may include commission for currency conversion. Any portion related to currency conversion should be recorded separately as transactions in services.

## 2. Valuation of other flows

3.81 Other flows in the international accounts capture changes in the international investment position of financial assets and liabilities that are not due to transactions. Holding gains and losses arise from changes in

market values of positions of financial assets and liabilities. Holding gains and losses may accrue continuously. A holding gain occurs when an asset increases in value or a liability decreases in value; a holding loss occurs when an asset decreases in value or a liability increases in value. The value of holding gains and losses during an accounting period shows net holding gains or losses for assets and liabilities separately. In practice, the value of holding gains and losses are calculated for each asset and liability between two points in time: the beginning of the period (or when the asset or liability is acquired or incurred) and the end of the period (or when the asset or liability is sold or extinguished).

3.82 For loans, deposits, and other accounts receivable/payable sold at a discount, the transaction values recorded in the financial account may differ from the nominal values recorded in the international investment position. Such differences are recorded as valuation changes in the other changes in financial assets and liabilities account (see also paragraph 9.33).

3.83 Other changes in the volume of financial assets and liabilities are recorded at the market-equivalent prices of similar instruments. When writing off financial instruments that are valued at nominal values, the value recorded in the other changes in financial assets and liabilities account should correspond to their nominal value prior to being written off. For all reclassifications of assets and liabilities, values of both the new and old instruments should be the same.

## 3. Valuation of positions of financial assets and liabilities

Reference:

IMF, *Monetary and Financial Statistics Compilation Guide*, paragraphs 2.42-2.67.

3.84 *Positions of financial assets and liabilities should, in general, be valued as if they were acquired in market transactions on the balance sheet reporting date.* Many financial assets are traded in markets on a regular basis and therefore can be valued by directly using the price quotations from these markets. If the financial markets are closed on the balance sheet date, the market prices that should be used in the valuation are those that prevailed on the closest preceding date when the markets were open. Debt securities have a current market value as well as a nominal value, and for some purposes, supplementary data on the nominal values of positions of debt securities may be useful (see paragraph 3.88 for definition of nominal value).

3.85 Valuation according to the market-value equivalent is needed for valuing financial assets and liabilities that are not traded in financial markets or that are traded only infrequently. For these assets and liabilities, it will be necessary to estimate fair values that, in effect, approximate market prices. The present value of future cash flows also may be used as an approximation to market prices, provided an appropriate discount rate can be used.

3.86 Loan positions are recorded at nominal value. The use of nominal values is partly influenced by pragmatic concerns about data availability and the need to maintain symmetry between debtors and creditors. In addition, because loans are not intended for negotiability, without an active market, estimating a market price can be somewhat subjective. Nominal value is also useful because it shows actual legal liability and the starting point of creditor recovery behavior. In some instances, loans also may be traded, often at discount, or a fair value may exist or would be possible to estimate. It is recognized that nominal value provides an incomplete view of the financial position, particularly when the loans are nonperforming. Therefore, information on the nominal value of nonperforming loans should be included as a memorandum or supplementary item (see paragraph 7.50 for the definition of nonperforming loans). Loans that have become negotiable de facto should be reclassified under debt securities (see paragraph 5.45 for criteria for reclassification).

3.87 Positions on deposits and accounts receivable/payable are also recorded at nominal value. They give rise to the same issues of nominal and fair values as loans. Deposits at banks and other deposit-taking corporations in liquidation also should be recorded at their nominal value until they are written off. If significant, however, such deposits should be shown separately as a supplementary item. The same treatment is applicable for any other cases of impaired deposits (i.e., where the deposit-taking corporation is not in liquidation but is insolvent).

3.88 Market values, fair values, and nominal values should be distinguished from such notions as amortized values, face values, book values, and historic cost.

- (a) *Fair value* is a market-equivalent value. It is defined as the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's-length transaction. It thus represents an estimate of what could be obtained if the creditor had sold the financial claim.

- (b) *Nominal value* refers to the outstanding amount the debtor owes to the creditor, which is composed of the outstanding principal amount including any accrued interest. So the nominal value reflects the sum of funds originally advanced, plus any subsequent advances, plus any interest that has accrued, less any repayments (which includes any payments covering interest accrual).<sup>4</sup> Nominal value in domestic currency of a debt instrument denominated in foreign currency also includes holding gains or losses arising from exchange rate changes.
- (c) *Amortized value* of a loan reflects the process of gradual elimination of the liability by regular payments over a specified period of time. On the date of each scheduled payment, amortized value is the same as nominal value, but it may differ from the nominal value on other dates because nominal value includes interest that has accrued and not been paid.
- (d) *Face value* is the undiscounted amount to be paid to the holder at maturity. It is also known as "par value" or simply "par." Before maturity, the market value of a bond may be greater or less than face value, depending on the interest rate payable and the perceived risk of default. As bonds approach maturity, market value approaches face value. For example, if interest rates are higher than the bond's coupon rate, then the bond is sold at a discount (below par). Conversely, if interest rates are lower than the bond's coupon rate, then the bond is sold at a premium (above par).
- (e) *Book value* in business accounts generally refers to the value recorded in the enterprise's records. Book values may have different meanings because their values are influenced by the timing of acquisition, company takeovers, frequency of revaluations, and tax and other regulations.
- (f) *Historic cost*, in its strict sense, reflects the cost at the time of acquisition, but sometimes it also may reflect occasional revaluations.

3.89 The valuation of financial assets and liabilities in data reported by enterprises or other respondents may be based on commercial, supervisory, tax, or other

<sup>4</sup>For debt instruments indexed to a "narrow" index, the nominal value can also include holding gains and losses arising from movements in the index (see paragraph 11.61(b)). For further detail on nominal value, see *External Debt Statistics: Guide for Compilers and Users*.

accounting standards that do not fully reflect the market prices of the assets and liabilities. In such cases, the data should be adjusted to reflect, as closely as possible, the market value of the financial assets and liabilities except when they are to be recorded at nominal values (see paragraphs 3.86-3.87).

3.90 When securities are quoted on markets with a buy-sell spread, the midpoint should be used to value the instrument. The spread is an implicit service of the dealer, paid by buyers and sellers (see paragraphs 10.122-10.123). Similarly, positions in financial assets and liabilities denominated in foreign currency should be valued using the midpoint at close of business between the buying and selling rates on the reference date.

3.91 Specific cases of valuation of positions of financial assets and liabilities, particularly when market prices are not available or pose problems, are discussed in Chapter 7, International Investment Position.

#### 4. Unit of account and currency conversion

##### a. Unit of account

3.92 Values of nonfinancial and financial transactions as well as the values of positions of financial assets and liabilities may be expressed initially in a variety of currencies or in other standards of value, such as Special Drawing Rights (SDRs). The conversion of these values into a reference unit of account is a requisite for the construction of consistent and analytically meaningful accounts.

3.93 International accounts can be compiled in the domestic currency as well as in another currency. Data in domestic currency are needed because several other macroeconomic and micro data are compiled in domestic currency, except when a foreign currency is used as a legal tender. Economic analysis often uses data from several macroeconomic statistical systems. Conversely, data in an international unit of account (a foreign currency) may be needed for international liquidity management and to address special issues for high inflation, significant exchange rate fluctuations, and multiple exchange rates. In addition, a standard or international unit of account is necessary to allow for aggregation on a global or regional basis and to facilitate international comparisons.

3.94 From the international perspective, a standard unit of account is required for global presentation and analysis. It is preferable that the unit of account be a stable one; that is, values of international transactions expressed in that unit should not be significantly affected

by changes (relative to the unit of account) in values of currencies in which those transactions occur. Transactions expressed in a unit that is stable in this sense nonetheless may reflect price changes resulting from other causes; that is, a series expressed in a so-called stable unit of account is not the equivalent of a volume measure or constant price series. The theoretical ideal of a widely recognized and perfectly stable standard unit of account simply does not exist in practice.

##### b. Domestic versus foreign currency

3.95 For an economy, a domestic currency is distinguished from foreign currency. *Domestic currency is that which is legal tender in the economy and issued by the monetary authority for that economy; that is, either that of an individual economy or, in a currency union, that of the common currency area to which the economy belongs.* All other currencies are foreign currencies.

3.96 Under this definition, an economy that uses as its legal tender a currency issued by a monetary authority of another economy—such as U.S. dollars—of a common currency area to which it does not belong should classify the currency as a foreign currency, even if domestic transactions are settled in this currency. The term "currency" should be understood in the broad sense (i.e., currency includes not only banknotes and coins but all means of payments issued by financial institutions in an economic territory). Unallocated gold accounts and other unallocated accounts in precious metals giving title to claim the delivery of gold or precious metal are treated as denominated in foreign currency. The treatment of unallocated accounts in other commodities will need to be decided at the time such cases arise in the future.

3.97 SDRs are considered to be foreign currency in all cases, including for the economies that issue the currencies in the SDR basket. Any other currency units issued by an international organization, except in the context of a currency union (see paragraph 3.95), are considered foreign currency.

##### c. Currency of denomination and currency of settlement

3.98 A distinction should be made between the currency of denomination and the currency of settlement. The currency of denomination is determined by the currency in which the value of flows and positions is fixed as specified in the contract between the parties. Accordingly, all cash flows are determined using the currency of denomination and, if necessary, converted into the

domestic currency or another unit of account for the purpose of settlement or compilation of accounts. The currency of denomination is important for distinguishing transaction values and holding gains and losses.

3.99 The currency of settlement may be different from the currency of denomination. Using a currency in settlement that is different from the currency of denomination simply means that a currency conversion is involved each time a settlement occurs. The currency of settlement is important for international liquidity and measurement of potential foreign exchange drains. The currency of settlement is also important for defining reserve assets (see paragraph 6.64).

3.100 The currency of denomination of equity and investment fund shares is generally the domestic currency of the economy in which the issuer is resident. However, when equity is issued in a currency other than the domestic currency, then that currency is the currency of denomination.

3.101 Debt instruments with both the amount to be paid at maturity and all periodic payments (such as coupons) indexed to a foreign currency are classified and treated in the international accounts as being denominated in that foreign currency.

3.102 Some financial assets and liabilities are denominated in more than one currency. However, if the amounts payable are linked to one specific currency, then the liability should be attributed to that currency. Otherwise, compilers are encouraged to disaggregate such multicurrency instruments by the component currencies.

3.103 Determining the currency of denomination is not always clear in financial derivative contracts to purchase or sell foreign currency using domestic currency. The decisive factor in determining the currency of denomination for these contracts is the exposure to currency movements. If settlement of a financial derivative contract is linked to a foreign currency, even though payment is required in domestic currency, then the financial derivative is to be classified as denominated in foreign currency.

#### *d. Currency conversion principles*

3.104 Flows denominated in a foreign currency are converted to their value in the domestic currency at the rate prevailing when the flows take place, and positions are converted at the rate prevailing on the balance sheet date. The midpoint between the buying and selling rates should be used at the time of transaction (for

transactions) and at the close of business on the reference date for positions.<sup>5</sup> The valuation in the domestic currency of a purchase or sale on credit denominated in a foreign currency may differ from the value in domestic currency of the subsequent cash payment because the exchange rate changed in the interim. Both transactions should be valued at their current market values as of the dates they actually occurred, and a holding gain or loss resulting from the change in the exchange rate should be recorded for the period or periods in which the gain or loss occurs.

3.105 In principle, the actual exchange rate applicable to each transaction should be used for currency conversion. The use of a daily average exchange rate for daily transactions usually provides a good approximation. If daily rates cannot be applied, average rates for the shortest period should be used. Some transactions occur on a continuous basis, such as the accrual of interest over a period of time. For such flows, therefore, an average exchange rate for the period in which the flows occur should be used for currency conversion.

3.106 Derived measures (see Section H for the definition of derived measures) relating to a period are calculated by subtracting one type of flow from another. In principle, therefore, derived measures of flows in one currency (e.g., domestic currency) should not be directly converted into another currency (e.g., foreign currency). First, the underlying flows themselves should be converted from the domestic currency into the foreign currency. Then, the derived measures in foreign currency can be calculated from the relevant flows denominated in foreign currency. It is possible that a derived measure, such as the current account balance, denominated in one currency may be different or even with the opposite sign from that denominated in another currency. In addition to the variations in exchange rates, the variations in the timing of underlying flows cause the differences in a derived measure denominated in different currencies.

3.107 Under a multiple exchange rate regime, two or more exchange rates are applicable to different categories of transactions; the rates favor some categories and discourage others. Such rates incorporate elements similar to taxes or subsidies. Because the multiple rates influence the values and the undertaking of transactions expressed in domestic currency, net proceeds implicitly accruing to authorities as a result of these transactions are calculated as implicit taxes or subsi-

<sup>5</sup>The difference between buying or selling prices and midpoint prices represents a service charge (see paragraphs 10.122-10.123).



dies. The amount of the implicit tax or subsidy for each transaction can be calculated as the difference between the value of the transaction in domestic currency at the *actual exchange rate applicable* and the value of the transaction at a *unitary rate* that is calculated as a weighted average of all official rates used for external transactions. For conversion of positions of external financial assets and liabilities in a multiple rate system, the actual exchange rate applicable to specific assets or liabilities at the beginning or end of the accounting period is used.

3.108 Parallel (unofficial) or black market rates cannot be ignored in the context of a multiple rate regime and can be treated in different ways. For instance, if there is one official rate and a parallel market rate, the two should be handled separately. Transactions in parallel markets should be converted using the exchange rate applicable in that market. If there are multiple official rates and a parallel rate, the official rates and the parallel rate should be treated as distinct markets in any calculation of a unitary rate. Transactions effected at the parallel rate usually should be converted separately at that rate. In some instances, however, parallel markets may be considered effectively integrated with the official exchange rate regime. Such is the case when most or all transactions in the parallel market are sanctioned by the authorities or when the authorities actively intervene in the market to affect the parallel rate. In this instance, the calculation of the unitary rate should include both the official and parallel market rates. If only limited transactions in the parallel market are sanctioned by the authorities, the parallel rate should not be included in the calculation of a unitary rate.

## F. Aggregation and Netting

3.109 Transactions, other flows, and positions of external financial assets and liabilities are presented in the international accounts by grouping them into several analytically meaningful categories. The classification of transactions, other flows, and positions of financial assets and liabilities is aimed at developing aggregates that group similar items and separate those items that have different characteristics. Aggregates and classifications are closely linked in that classifications are designed to produce the aggregates thought to be most useful.

**3.110** *Aggregates are summations of elementary items in a class of transactions, other flows, or positions.* For example, compensation of employees is the

sum of all flows that are classified as compensation of employees. For financial assets and liabilities, the aggregation of position or flow data is usually done across all institutional units within a subsector or sector. Aggregation is hierarchical in the sense that upper-level aggregates are derived directly by summing the lower-level aggregates.

3.111 Individual units may have the same kind of transaction both as a credit and a debit—for example, they may pay as well as receive interest or may acquire foreign currency as well as sell the foreign currency. Similarly, individual units may have the same kind of financial instrument both as an asset and as a liability—for example, they may have a claim in the form of debt securities as well as a liability in the form of debt securities.

**3.112** *Aggregations or combinations in which all elementary items are shown for their full values are called gross recordings* (e.g., all interest credits are aggregated separately from all interest debits). *Aggregations or combinations for which the values of some elementary items are offset against the same items that have an opposite sign are called net recordings* (e.g., acquisitions of foreign currency are netted against the sales of the foreign currency).

3.113 The international accounts follow gross recording in the current and capital accounts. For goods under merchanting, both purchases and resales of goods are shown on a gross basis, although both entries are shown under exports with a negative sign for purchases (this is elaborated further in paragraph 10.44). Gross recording is applicable in particular to income on reverse investment where the direct investment enterprise owns less than 10 percent of the voting power in the direct investor (reverse investment is described in paragraphs 6.39-6.40). Acquisitions and disposals of nonproduced, nonfinancial assets are recorded on a gross basis. Capital transfers receivables and payables are also recorded separately on a gross basis. Flows on transactions in nonproduced, nonfinancial assets and capital transfers are recorded on a gross basis, because they are important in the context of cross-border analysis. At the same time, the gross recording allows the derivation of net flows, if needed, provided that a sufficient level of detail is available.

3.114 In the case of flows in financial assets and liabilities, the term "net" may have dual meanings (summing all debits and credits for a financial asset type or a liability type and netting of an asset against a liability). To avoid confusion, this *Manual* adopts the following conventions:

- (a) In the case of flows, "net recording" always refers to aggregations for which all debit entries of a particular asset or a particular liability are netted against all credit entries in the same asset type or in the same liability type (e.g., acquisitions of foreign currency are netted against the sales of the foreign currency; bond issues are netted against redemption of bonds).
- (b) When net is used together with a category of financial instrument (net *financial instrument*), such as "net financial derivatives," netting of a financial asset against the same type of liability is understood.
- (c) Title of some derived measures also uses the term "net." They are "net lending/borrowing" and "net international investment position."

3.115 The international accounts follow net recording in the financial account and other changes in financial assets and liabilities account. Net recording, as explained above, means aggregations or combinations that show net changes (increases less reductions) in a particular financial asset or a liability category on the same side of the balance sheet. Financial assets (changes in financial assets) should not be netted against liabilities (changes in liabilities), except in certain circumstances as explained in paragraph 3.118.

3.116 Transactions and other flows in financial assets and liabilities are recorded as net changes in financial assets and net changes in liabilities, respectively. The net recording principle should be applied at the lowest level of classification of financial instruments taking into account the functional, institutional sector, maturity, and currency classifications, as applicable. Generally, the net recording principle should be applied within a given standard component of assets or liabilities.

3.117 In general, net recording of flows in financial assets and liabilities are recommended in the international accounts from both the analytical and pragmatic perspectives. Net acquisition of external financial claims and net incurrence of external liabilities are generally of more analytical interest than the gross flows. Gross reporting of data may not be possible for different classes of units and for some financial instruments. Furthermore, transactions in some financial assets and liabilities often have to be derived from balance sheet data because gross transactions are not available. Nonetheless, gross flows may be a relevant factor in analyzing aspects of the payments positions or financial markets (e.g., securities transactions) of economies, and such data can be used in supplementary

presentations when appropriate. For example, for direct investment, equity increases and equity decreases may be of analytical interest and may be shown separately in supplementary presentations.

3.118 In some cases, a clear distinction between assets and liabilities may not be feasible (such as for financial derivatives in the form of forward contracts, which could change between assets and liabilities). In such cases, it may not be possible to apply the net recording principle, which requires separate presentation of transactions in assets and transactions in liabilities. For such financial instruments, net transactions in assets and liabilities combined may have to be recorded in the international accounts.

3.119 Positions of financial assets and liabilities are recorded on a gross basis. Positions of the same type of a financial instrument held as both a financial asset and a liability are to be presented gross, so that assets are recorded under assets and liabilities are recorded under liabilities. For example, holding of short-term debt securities as assets is presented separately from the liability for short-term debt securities. For financial derivatives, see also paragraph 6.60.

3.120 Consolidation is a method of presenting statistics for a set of units as if they constituted a single unit. Because the international accounts reflect transactions involving residents and nonresidents and external financial assets and liabilities, including other flows associated with them, consolidation is not relevant for international accounts of an individual economy.

3.121 International accounts for a currency union, economic union, or other regional arrangement may be compiled by eliminating all transactions and asset-liability relationships that occur between member economies of the region. In other words, in the international accounts, a transaction of **one economy is paired with the** same transaction as recorded for another member economy and both transactions are eliminated. For example, if a unit in one economy owns a bond issued by a unit in another member economy, then the stocks of bonds held as assets and liabilities are reported excluding the matched positions between the units of the member economies. At the same time, interest receivable and payable consolidated at the regional or currency union level exclude the interest payable by residents of the debtor economy to residents of the creditor economy in the region or currency union. Similarly, sales of goods and services between consolidated economies are also eliminated. (For further information, see Appendix 3,

Regional Arrangements: Currency Unions, Economic Unions, and Other Regional Statements.)

## **G. Symmetry of Reporting**

3.122 Symmetry of reporting by counterparties is important to ensure consistency, comparability, and analytical usefulness of international accounts. The quadruple-entry accounting system discussed in paragraph 3.29 underlies symmetry of reporting. The internationally agreed guidelines for definitions, classifications, time of recording and valuation principles, and the quadruple-entry accounting system provide a basis for conceptual consistency of reporting by both parties or economies involved in a transaction or financial position. Correct application of these guidelines and principles is important for bilateral comparisons, global balances, and regional and global aggregates. While symmetry rules apply to all financial instruments, they do not fully apply to functional categories of financial positions and transactions. For example, transactions and positions in reserve assets are reflected in the liabilities of counterparts in the rest of the world under other functional categories, particularly portfolio and other investment.

3.123 International accounts group the flow and position data of individual units into sectoral and national aggregates. International accounts also can be prepared for a region and the world as a whole. Without applying strict consistency rules, it would be impossible to give proper interpretation to various aggregates. These requirements apply whether or not the data consolidate flows and positions of the units they cover, and whether or not they show any subgroups of units within the overall total. However, consolidation is clearly impossible without consistency in the basic data, and the requirements of consistency are more obvious when disaggregation of sectors is used.

3.124 Micro-level data on the basis of which the international accounts are compiled do not necessarily meet the consistency requirements needed for international accounts. Differences in valuation, timing, and classification may occur in many cases. Inconsistency in valuation may often occur for barter transactions. Different valuation bases may have been used by creditors and debtors for some financial assets, such as non-performing loans. Timing differences may occur not only due to differences in timing zones and delays in check-clearing systems, but also because units' perceptions of the timing of changes in ownership and recognition of revenues and expenses may vary.

3.125 Significant achievements have been made at the national and international levels to come to more uniform business accounting standards. Accordingly, disparities between individual micro accounts have tended to fall. Business accounting standards are geared toward individual accounts, however, and therefore do not necessarily ensure interunit consistency. Current business accounting standards prescribe that loans be treated differently depending on whether they appear as a credit or a debit. This approach cannot be applied in a consistent horizontal double-entry bookkeeping system. Tax and supervisory regulations are a second source for harmonization of accounting practices. In so far as these rules differentiate between specific sections of the economy, however, they also may be a cause for discrepancies between micro accounts.

## **H. Derived Measures**

3.126 Derived measures are not transactions or other flows. They are economic constructs that are calculated by subtracting one or more aggregates from one or more other aggregates. They are important analytical tools that summarize the values of selected flows or stocks that have been individually recorded in the international accounts.

3.127 A derived measure cannot be obtained independently of the other entries; as a derived entry, it reflects the application of the general accounting rules to the specific entries from which it is derived. Some derived measures are essentially balancing items, because they are obtained by subtracting the total value of the entries on one side of an account from the total value for the other side (e.g., net international investment position is equal to total external financial assets minus total external liabilities).

3.128 Derived measures encapsulate a great deal of information and include some of the most important entries in the international accounts. However, they are best understood and more analytically useful if considered together with the aggregates from which they are derived.

3.129 Some important measures derived as balances in the international accounts are as follows:

- Balance on trade in goods;
- Balance on trade in services;
- Balance on goods and services;
- Balance on goods, services, and primary income;
  - current account balance;

- Net lending/net borrowing:
  - from current and capital accounts;
  - from financial account;
- Changes in net IIP arising from other flows (in total, and for each of other changes in volume, exchange rate changes, and other price changes); and

- Net international investment position.

This list is not comprehensive; other balances can be derived as needed for analysis. For example, balances on components in the financial account may be of interest, such as net direct investment or net portfolio investments.

# CHAPTER 4

## Economic Territory, Units, Institutional Sectors, and Residence

### A. Introduction

Reference:

2008 SNA, Chapter 4, Institutional Units and Sectors.

4.1 This chapter is concerned with identifying statistical units, grouping them (according to the institutional sector classification), and identifying the economic territory to which each entity is most closely connected (according to the residence principles). The principles for economic territory, units, institutional sectors, and residence are harmonized across macroeconomic statistical guidelines, so this chapter identifies the general principles as well as specific issues of relevance in an international accounts context.

4.2 The principles in this chapter define the meaning and coverage of each national economy. An economy consists of the institutional units that are resident in the economic territory of that economy. Most entities have strong links with only one economy, so their residence is clear, but with increasing international economic openness, a growing number of institutional units have connections to more than one economy.

### B. Economic Territory

4.3 In its broadest sense, an economic territory can be any geographic area or jurisdiction for which statistics are required. The connection of entities to a particular economic territory is determined from aspects such as physical presence and being subject to the jurisdiction of the government of the territory. These issues are discussed in the residence section of this chapter (see paragraphs 4.113-4.144).

4.4 The most commonly used concept of economic territory is the area under the effective economic control of a single government. For the purposes of global statistics and reporting to the IMF, it is important to

have data on all areas under control of a particular government, including special zones, even if for some of the government's own statistical purposes, those zones are excluded or shown separately. Another kind of economic territory is a currency or economic union, which is dealt with in Appendix 3. Other types of economic territory include a part of an economy, regions, or the world as a whole. Economic territories reflect any possible scope for macroeconomic policy or analysis.

4.5 The economic territory includes:

- (a) the land area;
- (b) airspace;
- (c) territorial waters, including areas over which jurisdiction is exercised over fishing rights and rights to fuels or minerals;
- (d) in a maritime territory, islands that belong to the territory; and
- (e) territorial enclaves in the rest of the world. These are clearly demarcated land areas (such as embassies, consulates, military bases, scientific stations, information or immigration offices, aid agencies, central bank representative offices with diplomatic status) that are physically located in other territories and used by governments that own or rent them for diplomatic, military, scientific, or other purposes with the formal agreement of governments of the territories where the land areas are physically located. These areas may be shared with other organizations, but the operations must have a high degree of exemption from local laws to be treated as an enclave. However, government operations that are fully subject to the laws of the host economy are not treated as enclaves, but as residents of the host economy.

4.6 Economic territory has the dimensions of legal jurisdiction as well as physical location, so that corporations created under the law are part of that econ-

omy. The concepts of economic territory and residence are designed to ensure that each institutional unit is a resident of a single economic territory. The use of an economic territory as the scope of economic statistics means that each member of a group of affiliated enterprises is part of the economy in which it is resident, rather than being attributed to the economy of its head office. The focus on data for an economic territory means that, in a few cases, a legal entity may be split for statistical purposes into separate units in different territories, as elaborated in paragraphs 4.26-4.49.

### International organizations

4.7 The economic territory of an international organization (defined in paragraphs 4.103-4.107) consists of territorial enclave(s) over which the organization has jurisdiction. These enclaves are clearly demarcated land areas or structures that the international organization owns or rents and uses, and that are formally agreed on with the government of the territory, or territories, in which the enclave(s) are physically located. Each international organization is an economic territory in its own right, covering operations from all its locations.

### Special zones

4.8 Sometimes a government has a separate physical or legal zone that is under its control, but to which, to some degree, separate laws are applied. For example, a free trade zone or offshore financial center may be exempt from certain taxation or other laws. Because of the need to view the whole economy, to have comprehensive global data, and to be compatible with partner data, these special zones always should be included in the economic statistics of that economy. While national totals showing all economic activities in the economy are required for international purposes, separate data may be prepared for different subsets of the economy. To the extent that different laws and policies may apply, and persons, goods, and finance do not flow completely freely between a zone and the rest of the economy, a government may wish to have data to support separate analysis of either or both the special zone and the remainder of the economy.

### Changes in economic territory

4.9 The scope of an economic territory may change under several circumstances:

- (a) The passing of control of a geographic area from one government to another by mutual agreement

or under a decision of an international court or arbitrator. These exchanges satisfy the definition of a transaction. Accordingly, assets conveyed from one government to the other are recorded as an acquisition of land (in the capital account) or equipment and buildings (in goods and services,<sup>1</sup> respectively, if they can be separated). If the exchange is made in exchange for payment or extinguishing of a prior liability, the corresponding entry is a financial account entry for the agreed amount. If there is no amount payable, the corresponding entry is a capital transfer. If there is a mutual exchange of land or buildings, both entries in the exchange are shown on a gross basis (capital account for land, construction in the goods and services account for buildings). In addition to these cases involving the two governments, the exchange of territory could change the territory of residence of other institutional units. As with other changes in residence, these would result in other changes in the volume of assets. (The effects of changes of residence are covered in paragraphs 9.21-9.23.)

- (b) Change in the status of a particular area by seizure. Because this change in status is not by mutual agreement (defined in *GFSM 2001* paragraph 3.5), it is not a transaction. (However, any institutional units that changed residence could have other changes in financial assets and liabilities; see paragraphs 9.21-9.23.)
- (c) The merger of two or more economic territories to have a single national government may be seen as an absorption of one territory by another or the elimination of two territories and the creation of another. These arrangements result in entries in the other changes in volume account (namely, elimination of cross-border liabilities between the two previous constituent territories and possible reclassifications for economies having asset or liability positions with either territory).
- (d) The split of a single economic territory into two or more territories is not in itself a transaction. However, there may be associated flows between the parties, for example, compensation for assuming liabilities that would qualify as transactions and be classified according to usual definitions. There also would be entries in the other changes in volume account for the appear-

<sup>1</sup>The inclusion of international transactions in new and existing buildings in services is discussed in paragraph 10.108.

ance of cross-border liabilities between the two separating economies.

When such events occur, it is essential that metadata are provided to assist users in understanding how the territorial changes affect the data.

### Joint zones

4.10 In some cases, areas are under joint administration or sovereignty, that is, an area is under the effective economic control of two or more governments. These areas can be called joint administration or sovereignty zones. Because, typically, they have laws that differ from the primary territories of the individual governments, the zone could be considered an economic territory in its own right. Because the number of enterprises in these zones typically is small, however, it may be preferred to split the enterprises in the zone between the primary territories rather than publish separate data for the zone. The method of splitting should be to prorate on the basis of a relevant factor according to the circumstances, such as some operational indicator or equal proportions for each of the primary territories. This general guidance needs to be applied appropriately to the economic circumstances faced. For instance, when the enterprises that account for the vast majority, or all, of the economic activity in the zone are effectively operated from the economy of just one of the sovereign authorities, it may be preferred to treat those enterprises as residents of that economy, showing the other economy as recipient of its share of property income, taxes, and so on, and avoiding most of the complexities of prorating for those enterprises. The statistical compilers of each primary territory involved should consult with each other to adopt consistent methods with no gaps or overlaps. Through metadata and consultations, they may also assist compilers in counterpart economies to ensure consistency of bilateral data.

### Definition of an economy

4.11 *An economy consists of all the institutional units that are resident in a particular economic territory.* The concepts of institutional units and residence are the subject of sections C and E of this chapter, respectively.

## C. Units

4.12 Different types of institutional units are explained in more detail in this section. Institutional units and local enterprise groups may be used in international accounts. Statistical units other than institu-

tional units and enterprises are also described briefly in this section.

### I. General principles on institutional units

Reference:

2008 SNA, Chapter 4, Institutional Units and Sectors.

4.13 *The main attributes of an institutional unit are that:*

- (a) it is entitled to own goods or assets in its own right; it is, therefore, able to exchange the ownership of goods or assets in transactions with other institutional units.
- (b) it is able to take economic decisions and engage in economic activities for which it is itself held to be directly responsible and accountable at law.
- (c) it is able to incur liabilities on its own behalf, to take on other obligations or future commitments, and to enter into contracts.
- (d) either a complete set of accounts, including a balance sheet, exists for the unit, or it would be possible and meaningful, from both an economic and legal viewpoint, to compile a complete set of accounts if they were to be required.

Institutional units are recognized in the cases of branches and notional resident units (as discussed in paragraphs 4.26-4.44) even though they may not fully satisfy criteria (a), (b), and (c).

4.14 There are two main types of units in the real world that may qualify as institutional units:

- (a) households—persons or groups of persons; and
- (b) corporations (including quasi-corporations), non-profit institutions, and government units—legal or social entities whose existence is recognized by law or society independently of the persons, or other entities, that may own or control them.

#### a. Corporations

4.15 Corporations in the legal sense are separate legal entities, so qualify as institutional units, except as discussed in paragraph 4.18. In addition to corporations in the legal sense, some arrangements that are not legal entities in their own right may be recognized as being institutional units, including cooperatives, limited liability partnerships that are not incorporated, notional resident units, and other quasi-corporations. For example, branches in separate economies from their head

offices and partnerships are not separate legal entities, and so they do not satisfy criteria (a), (b), and (c) in terms of legal capacity, but may be treated as corporations because they behave in similar ways.

### *Quasi-corporations*

**4.16** A *quasi-corporation* is an unincorporated business that operates as if it were an entity separate from its owner(s). It is treated as if it were a corporation. In this *Manual*, the term "corporations" includes quasi-corporations. Types of quasi-corporations are discussed in paragraphs 4.26-4.49 and may include branches, notional residents for ownership of land, trusts, and so on. The intent behind the concept of a quasi-corporation is to separate from their owners those unincorporated enterprises that are sufficiently self-contained, that is, that behave as if they were corporations.

4.17 For example, a partnership that includes a large number of partners or partners from different economies would normally have its accounts and affairs delineated from its individual owners, and therefore qualify as a quasi-corporation. A partnership may be limited liability or not; however, this does not determine whether the partnership meets the criteria to be recognized as a quasi-corporation. As well as private businesses, quasi-corporations can arise in the public sector when governments produce market output, charge economically significant prices, and have their own accounts. A quasi-corporation in one economy may be owned by residents of the same economy, nonresidents, or a combination of both. Some unincorporated businesses do not satisfy the requirements to be a quasi-corporation, typically businesses owned by members of a single household, and where the business activities are not separated from other household affairs. (However, the criteria for recognizing a branch in paragraph 4.27 mean that significant cross-border businesses will almost always be recognized as quasi-corporations.)

### *Resident artificial subsidiaries*

4.18 A resident artificial subsidiary is a company set up to avoid taxes, to minimize liabilities in the event of bankruptcy, or to secure other technical advantages under the tax or corporation legislation in force in a particular economy. As the term is used in the *2008 SNA*, Chapter 4, Institutional Units and Sectors, an artificial subsidiary is incorporated or created in the same economy as its parent and is merged into an institutional unit with its owner. An entity incorporated in one economy is never combined with a nonresident owner into a single institutional unit. Entities in different economies are

not combined because combining across borders would undermine the concept of the economy as the focus of macroeconomic statistics. As well, an entity that has two or more owners who are resident in different economies cannot be combined with its owners.

4.19 An ancillary corporation is a wholly owned subsidiary whose productive activities are confined to providing services to the parent corporation or other affiliates owned by the same parent corporation. Like other direct investment enterprises, an ancillary corporation in another economy to that of its owners is a separate entity from its owners, even though it is not, in practice, autonomous. Examples of ancillary services that are sometimes undertaken through subsidiaries abroad include transport, purchasing, sales and marketing, financing, various kinds of business services, computing and communications, security, maintenance, and cleaning. (For information about recording these services, see Chapter 10, Part C, Services, and particularly paragraph 10.150.)

### *b. Splitting and combining legal entities*

4.20 Because the focus of economic statistics is on a single economy, a legal entity may be split into separate institutional units for statistical purposes. The step is taken because each of the parts has such a strong connection with the economic territory in which it is located that it should be considered as part of that economy. In these cases, identifying separate institutional units resident in each economy allows a more comprehensive view of the economies concerned. Cases include branches, ownership of land, and other arrangements discussed in paragraphs 4.26-4.44. Similarly, households are defined such that they consist only of individuals who are resident in the same territory, even if individuals who are resident in different territories share expenses and decision making. This definition avoids a single household having members who are resident in different economies.

4.21 As noted in paragraph 4.18, legal entities that are residents of different economies are never combined in the macroeconomic statistics for a single economy. However, entities are combined in the case of an artificial subsidiary if the subsidiary and parent are resident in the same economy. Accordingly, a corporation is always resident in its economy of incorporation, in its own right, or as part of an institutional unit resident in the same economy.

4.22 Having a set of accounts (or potentially having them, see paragraph 4.13(d)) provides an important indi-



cation of the status as a separate institutional unit. The existence of accounts (or the records that could be used to produce them) provides evidence of the existence of a unit for which transactions are implemented and can be measured. It also ensures that data can be obtained for such units. The definition of an institutional unit has no requirement that the unit be effectively autonomous, so a wholly owned subsidiary corporation can be recognized as a separate institutional unit from its parent, because corporations satisfy the criteria for an institutional unit in paragraph 4.13. For statistical purposes, corporations may be combined if they are residents of the same economy (under circumstances discussed in paragraph 4.18) and direct investment data may be collected for a local enterprise group (discussed in paragraph 4.55).

#### c. *Enterprises*

**4.23** *An enterprise is defined as an institutional unit engaged in production.* Investment funds and other corporations or trusts that hold assets and liabilities on behalf of groups of owners are also enterprises, even if they are engaged in little or no production. (As discussed in paragraphs 10.124-10.125, institutional units that hold assets on behalf of their owners are providers of financial services to their owners.) An enterprise may be a corporation (including a quasi-corporation), a nonprofit institution, or an unincorporated enterprise. Corporate enterprises and nonprofit institutions are complete institutional units. An unincorporated enterprise, however, refers to a part of an institutional unit—a household or government unit—only in its capacity as a producer of goods and services.

#### d. *Implementation*

4.24 There may be some variation from institutional unit definitions in practice because of data sources; for example, arising from consolidation or use of administrative approximations. These variations should be monitored by statistical compilers to identify possible problems (e.g., cross-border or cross-sector consolidation). It is important that both data suppliers and compilers have a clear understanding of the scope of the unit being reported—a single legal entity, a selected group of legal entities, or all the legal entities under common ownership. Otherwise, some values could be omitted, double-counted, or misclassified.

## 2. Identification of institutional units with cross-border elements

4.25 Artificial institutional units are sometimes identified by breaking up an actual entity. However, to avoid

excessive creation of artificial units, such cases are limited to the few circumstances discussed in this section.

#### a. *Branches*

4.26 When a nonresident unit has substantial operations over a significant period in an economic territory, but no separate legal entity for those operations, a branch may be identified as an institutional unit. This unit is identified for statistical purposes because the operations have a strong connection to the location of operations in all ways other than incorporation.

4.27 The identification of branches as separate institutional units requires indications of substantial operations that can be separated from the rest of the entity, to avoid creating numerous artificial units. A branch is recognized in the following cases:

- (a) Either a complete set of accounts, including a balance sheet, exists for the branch, or it is possible and meaningful, from both an economic and legal viewpoint, to compile these accounts if they were to be required. The availability of separate records indicates that an actual unit exists and makes it practical to prepare statistics.

In addition, one or both of the following factors tend to be present for a branch:

- (b) The branch undertakes or intends to undertake production on a significant scale that is based in a territory other than that of its head office for one year or more:
  - (i) if the production process involves physical presence, then the operations should be physically located in that territory. Some indicators of an intention to locate in the territory include purchasing or renting business premises, acquiring capital equipment, and recruiting local staff; or
  - (ii) if the production does not involve physical presence, such as some cases of banking, insurance, other financial services, ownership of patents, and "virtual manufacturing," the operations should be recognized as being in the territory by virtue of the registration or legal domicile of those operations in that territory; or
- (c) The branch is recognized as being subject to the income tax system, if any, of the economy in which it is located even if it may have a tax-exempt status. (Usually, treatments by taxa-

tion authorities are a guide to the existence of branches, because the authorities are reluctant to exempt substantial operations within their jurisdiction.)

4.28 The identification of branches has implications for the statistical reporting of both the parent and branch.<sup>2</sup> The operations of the branch should be excluded from the institutional unit of its head office in its home territory and the delineation of parent and branch should be made consistently in both of the affected economies. Each branch is a direct investment enterprise. Branches most commonly arise for financial and nonfinancial corporations, but it is also possible that households, nonprofit institutions serving households (NPISHs), or governments (when government operations do not have diplomatic immunity) may have branches.

#### *Construction projects*

4.29 Some construction projects undertaken by a nonresident contractor may give rise to a branch (direct investment enterprise). Construction may be carried out or managed by a nonresident enterprise, without the creation of a local legal entity:

- (a) For major projects (such as bridges, dams, power stations) that take a year or more to complete and that are managed through a local site office, the operations would usually satisfy the criteria for identification of a branch in paragraph 4.27 and so would not be classified as trade in services;
- (b) In other cases, the construction operations may not satisfy the conditions for recognition as a branch, for example, for a short-term project or one based from the home territory rather than a local office. In those cases, the work provided to customers resident in the territory of those operations is classified as international trade in construction and included in services (i.e., an export of services by the home base and an import of services by the territory of operations). Paragraphs 10.101-10.108 discuss construction operations included under services.

#### *Production delivered from a base*

4.30 Activities such as consulting, maintenance, training, technical assistance, and health care may be

provided by a branch or from a home base. If operations are substantial enough to satisfy the criteria given in paragraph 4.27, a branch would be recognized as a direct investment enterprise. On the other hand, if a branch is not recognized in the territory, the operations will give rise to international trade in services. The residence of units providing services in this way is discussed in paragraph 4.136.

4.31 Mobile equipment, such as ships, aircraft, drilling platforms, and railway rolling stock, may operate across more than one economic territory. The criteria for recognition of a branch also apply in these cases. That is, if the operations in a territory outside the home base are substantial enough, they meet the definition of a branch. For example, a secondary base for servicing the fleet with long-term presence and its own accounts may satisfy the definition of a branch. (If they do not satisfy the definition of a branch, the activities of the ship-operating enterprise are included in the economy where the operator is resident; see paragraph 4.136.)

4.32 Similarly to mobile equipment, a multiterritory pipeline that passes through a territory, but is not operated by a separate legal entity in that territory, would be recognized as constituting a branch if there is a substantial presence, availability of separate accounts, and so on. In cases in which such operations are not separate institutional units (a) there may be payment of rent to a notional unit owning the land or a long-term lease of land, of the kind discussed in paragraphs 4.34-4.40; or (b) there may be a multiterritory enterprise of the type discussed in paragraphs 4.41-4.44.

4.33 When a branch is identified, there are direct investment inflows to the territory, but the provision of goods or services to customers in that territory is a resident-to-resident transaction. In contrast, if the operations are not substantial enough to qualify as a branch, the provision of goods or services to customers in that territory are imports of that territory.

#### *b. Notional resident units for land and other natural resources owned by nonresidents*

4.34 When land located in a territory is owned by a nonresident entity, a notional resident unit is identified for statistical purposes as being the owner of the land. Because land and buildings produce rental services (see paragraph 10.157), the notional unit is usually an enterprise. A notional unit is also identified for a lease of land, or buildings, or land and buildings together

<sup>2</sup>The international accounts use of branch as a term is more limited than common usage, where "branch" may also mean establishments, incorporated subsidiaries, or industrial classification groups.

by a nonresident for long periods. This notional resident unit is a kind of quasi-corporation. The notional resident unit is also treated as the owner of any buildings, structures, and other improvements on that land that belong to the same nonresident owner. The nonresident is treated as owning the notional resident unit, rather than owning the land or structures directly. This treatment is designed so that land and other natural resources are always assets of the economy in whose territory they are located. Otherwise, the land would appear in another economy's national balance sheet. The situation in which the land is acquired or sold for an embassy or other enclave is discussed in paragraph 13.10.

4.35 A nonresident with a resource lease is classified as incurring rent and no notional unit is automatically created. (Rent and resource leases are defined in paragraph 11.85.) However, it is usually the case that ownership of land and other natural resources such as subsoil assets, noncultivated biological resources, water, and rights to use these assets through a lease or other permit over long periods are associated with a branch (see paragraph 4.27). In addition, preliminary expenses for an entity to be incorporated in the future are to be regarded as a notional direct investment enterprise (see paragraph 4.47).

4.36 The operations of notional resident units include holding the asset, paying any associated expenses (such as insurance, repairs, and taxes), collecting rent or rental on the asset,<sup>3</sup> and any other transactions associated with those functions. If the nonresident owner uses the property, the notional resident unit generates rent (in the case of unimproved land, mineral rights, and so on, see paragraph 11.85) or rental included in travel or operating leasing services (for land with buildings or other improvements, see paragraphs 10.99, 10.100, and 10.157) in kind to its owner. The corresponding entry to the rent or rental would be income payable in kind to the owner by the notional resident unit. The notional resident unit should also be treated as incurring expenses and taxes; payments by the nonresident owner to meet a loss arising from these costs therefore would be recorded as direct investment flows from the owner to the notional resident unit. Other transactions of the owner would not be attributed to the notional resident unit, for example, any borrowing or debt service. As a result of the limited nature of notional resident

units, making acceptable estimates for their operations is generally feasible when they are significant.

4.37 When the ownership of land and other natural resources is associated with substantial operations, so that the requirements in paragraph 4.27 are met, a branch is identified. In such cases, a notional resident unit is not identified because the branch already exists as a resident owner.

4.38 The notional resident unit that owns land or other natural resources may be contrasted with a branch, which has a full set of accounts. An example is a nonresident fishing operator having a 10-year fishing license for the waters of a territory. If the operator has a base in the territory, keeps separate records, and so on, then a branch is identified, and its accounts will show sales of fish and other transactions. Another example could be a commercial farm owned by a nonresident entity. In contrast, the only activity of a notional unit will be the supply of rent or rental services arising from the ownership of property.

4.39 When several partners own land, there may be a quasi-corporation, as in paragraph 4.49, by virtue of the management of the land being separate from that of its individual owners. In that case, for statistical purposes, the nonresident partners would own a share in the quasi-corporation, so there would be no need to identify an additional notional resident unit. The notional resident unit for ownership of land is almost always a direct investment enterprise (the exception being for land where an individual nonresident's voting power was below 10 percent).

4.40 Some kinds of time-share accommodation arrangements give rise to a notional resident unit (see paragraph 10.100 and Table 10.3 for a discussion of alternative arrangements).

#### c. *Multiterritory enterprises*

4.41 Some enterprises may operate as a seamless operation over more than one economic territory. Although the enterprise has substantial activity in more than one economic territory, it is run as an indivisible operation with no separate accounts or decisions, so that no separate branches can be identified. Such enterprises may have operations including shipping lines, airlines, hydroelectric schemes on border rivers, pipelines, bridges, tunnels, and undersea cables. Some NPISHs also may operate in this way.

4.42 Governments usually require separate entities or branches to be identified in each economic territory

<sup>3</sup>The distinction between rent and rental is explained in paragraphs 10.153 and 11.84-11.86.

for more convenient regulation and taxation. Multiterritory enterprises may be exempted from such requirements, but there may be arrangements, such as a formula for payment of taxation to the respective authorities.

4.43 In the case of a multiterritory enterprise, it is preferable that separate institutional units be identified for each economy, as discussed in paragraphs 4.26-4.33. If that is not feasible because the operation is so seamless that separate accounts cannot be developed, it is necessary to prorate the total operations of the enterprise into the individual economic territories. The factor used for prorating should be based on available information that reflects the contributions to actual operations. For example, equity shares, equal splits, or splits based on operational factors such as tonnages or wages could be considered. Where taxation authorities have accepted the multiterritory arrangements, a prorating formula may have been determined, which should be the starting point for statistical purposes. Although the situation is somewhat different from the case of joint administration or sovereignty zones, discussed under economic territory in paragraph 4.10, the solution of prorating may be the same.

4.44 The prorating of the enterprise means that all transactions need to be split into each component economic territory. The treatment is quite complex to implement. This treatment has implications for other statistics and its implementation should always be coordinated for consistency. Compilers in each of the territories involved are encouraged to cooperate to develop consistent data, avoid gaps, and minimize respondent and compilation burden, as well as assist counterparties to report bilateral data on a consistent basis.

#### d. *Joint ventures*

4.45 A joint venture is a contractual agreement **between** two or more parties for the purpose of executing a business undertaking in which the parties agree to share in the profits and losses of the enterprise as well as the capital formation and contribution of operating inputs or costs. It is similar to a partnership, but typically differs in that there is generally no intention of a continuing relationship beyond the original purpose. A joint venture does not involve the creation of a new legal entity.

4.46 Whether a quasi-corporation is identified for the joint venture depends on the arrangements of the parties and legal requirements. The joint venture is a quasi-corporation if it meets the requirements for an institutional unit, particularly by having its own records. Otherwise, if each of the operations are effec-

tively undertaken by the partners individually, then the joint venture is not the institutional unit and the operations would be seen as being undertaken by the joint venture partners separately. (In that case, there would usually be direct investment enterprises that undertook the joint venture operations of each of the partners.) Because of the ambiguous status of joint ventures, there is a risk that they could be omitted or double-counted, so particular attention needs to be paid to them.

#### e. *Quasi-corporations identified prior to incorporation*

4.47 A resident enterprise is identified when preliminary expenses, including mining rights, license fees, site preparation, building permits, purchase taxes, local office expenses, and lawyers' fees, are incurred prior to establishing a legal entity. As a result of identifying a quasi-corporation, those preparatory expenses are recorded in the economy of the future operations as being resident-to-resident transactions that are funded by a direct investment inflow, rather than as sale of nonproduced assets to nonresidents, exports of legal services, and so on. Because of the limited scale of these activities, assembly of acceptable data for these enterprises is often feasible, despite the lack of incorporation. If the project does not subsequently go into operation, the value of the direct investment is eliminated by an entry for other changes in the volume of assets or liabilities.

#### f. *Trusts*

4.48 Trusts are legal arrangements that have aspects of legal identity separate from their beneficiaries and trustees. Similarly, the estate of a deceased person is held by an administrator (executor or trustee) on behalf of the beneficiaries and is separate from the executor's other property. A trust is a legal device by which property is held in the name of one party or parties (the administrator or trustee) who is under a fiduciary obligation to hold assets for the benefit of another party or parties (the beneficiary or beneficiaries). (In some cases, a person can be both trustee and beneficiary.) Foundations and other fiduciary arrangements may have similar functions. Administrators and trustees are required to keep the trust and estate assets separate from their personal property and they must account to the beneficiaries for the income and assets. These legal arrangements are treated as separate institutional units—that is, as quasi-corporations—if they are constituted in a different territory to that of any

of the beneficiaries or otherwise satisfy the definition of a quasi-corporation. This treatment is necessary because it is neither meaningful nor feasible for the trust assets to be allocated to the beneficiaries and then be combined with the assets of beneficiaries who are resident in another economy.<sup>4</sup> Trusts can be used for businesses, asset management, and nonprofit institutions. (Related issues are nominee accounts, covered in paragraph 4.160, and depository receipts, covered in paragraph 4.161.)

#### g. Other unincorporated enterprises

4.49 As stated in paragraph 4.16, a quasi-corporation is an unincorporated business that operates as if it were an entity separate from its owners. There is almost always a quasi-corporation if the operations are in a separate economy from at least one of their owners, because taxation, other laws, and convenience are all factors that tend to prevent the affairs of residents of different economies from being mixed. This treatment is applied whether a branch, trust, limited liability or other type of partnership, or other legal structure is used.

#### h. Flexible corporate structures with little or no physical presence

4.50 *Special purpose entities (SPEs) or vehicles, international business companies, shell companies, shelf companies, and brass plate companies are all labels that are applied to flexible legal structures in particular jurisdictions, which offer various benefits that may include any or all of low or concessional tax rates, speedy and low-cost incorporation, limited regulatory burdens, and confidentiality.* Although there is no internationally standard definition of such companies, typical features of these entities are that their owners are not residents of the territory of incorporation, other parts of their balance sheets are claims on or liabilities to nonresidents, they have few or no employees, and they have little or no physical presence.

4.51 Some purposes that such structures are used for include (a) holding and managing wealth for individuals or families, (b) holding assets for securitization, (c) issuing debt securities on behalf of related companies (such a company may be called a conduit), (d) as holding companies that own shares in subsidiaries but without actively directing them, (e) as securitization vehicles, (f) as ancillary companies in different

<sup>4</sup>Indeed, the beneficiaries may be uncertain (with a discretionary trust) or even unborn.

economies to that of their parent, and (g) carrying out other financial functions. The "captive financial institutions and money lenders" institutional sector class is applicable to many of these entities, as discussed in paragraphs 4.82-4.87. Although these entities do not have a standard international definition, the possibility of recording them separately according to national definitions is discussed in paragraph 4.87.

4.52 These entities are always treated as separate institutional units if they are resident in a different territory to that of their owners.

### 3. Statistical units other than institutional units and enterprises

Reference:

2008 SNA, Chapter 5, Enterprises, Establishments and Industries.

#### Establishments

4.53 *An establishment is an enterprise, or part of an enterprise, that is situated in a single location and in which only a single productive activity is carried out or in which the principal productive activity accounts for most of the value added.* The breaking up of enterprises into one or more establishments is useful because some enterprises are large and complex, with different kinds of economic activity undertaken in different locations. The establishment is particularly useful as a unit for production statistics. Because the establishments of a multiestablishment enterprise are part of the same legal entity, financial transactions and positions cannot always be attributed to a particular location or activity, so the use of the institutional unit concept is appropriate for statistics covering financial transactions and positions, such as the balance of payments and IIP.

#### Local and global enterprise groups

4.54 Groups of enterprises are sometimes identified in defining and classifying direct investment. Although enterprises are the basic unit of economic statistics, a single owner or group of owners may have control of more than one enterprise, so they may act in a concerted way and the transactions between the enterprises may not be driven by the same concerns as "arm's-length" transactions, that is, those with unrelated enterprises.

4.55 Enterprise groups may be either global or local. A global enterprise group refers to an investor and all

the enterprises under that investor, whereas the local (or territory-specific) enterprise group refers to an investor and the legal entities under that investor that are resident in the reporting economy. Business accounting may cover groups of related corporate entities (consolidated accounts) including entities that are resident in different economies. However, entities in different economies are not aggregated for macroeconomic statistics that have a focus on an economy. The concepts of global enterprise groups and local enterprise groups are used in the *OECD Benchmark Definition of Foreign Direct Investment*. The global enterprise group is also called a multinational enterprise.

4.56 Local enterprise groups may be used for compiling and presenting direct investment statistics. For example, if direct investment is initially channeled to a holding company and then on to a manufacturing subsidiary, then it may shed light to classify the direct investment in manufacturing rather than in a holding company operation, which is just the initial investment. The implications of combining entities in different institutional sectors need to be carefully considered.

## D. Institutional Sectors

### References:

- 2008 SNA, Chapter 4, Institutional Units and Sectors.  
IMF, *MFSM 2000*, Chapter 3, Institutional Units and Sectors.  
IMF, *GFSM 2001*, paragraphs 2.28-2.62 (for general government and public sectors).

### I. General principles

4.57 Institutional units are grouped into institutional sectors. The units in each sector have similar economic objectives, functions, and behavior. The institutional sector classification is mainly applied to resident units, but it also could be applied to compiling supplementary data on the sector of the nonresident counterpart. For example, in an economy that received international aid, there may be interest in separating data on aid provided by other governments from aid provided by private sources.

4.58 When an ancillary corporation is a separate institutional unit, according to the criteria in paragraph 4.19, it is classified as financial or nonfinancial according to the activities it undertakes, rather than according

to the predominant sector of the company or companies it serves.

4.59 The SNA institutional sector classification is shown in Table 4.1. The international accounts institutional sector classification is shown in Table 4.2. It has the same sectors and subsectors as the SNA institutional sector classification shown in Table 4.1, but with order and groupings to allow greater backward compatibility with the BPM5 classification and a shorter list of sectors for economies in which it is not practical to implement the full classification. The other sectors category includes both financial and nonfinancial sectors, so it is recommended that, at least, the financial corporations be identified separately. The full institutional sector detail is required for international accounts to be fully integrated with monetary, flow of funds, and other financial data. Public corporations may be identified separately on a supplementary basis, as discussed in paragraphs 4.108-4.112.

4.60 Transactions in financial instruments recorded in the balance of payments raise particular issues concerning attribution of institutional sector. The economic owner of the asset, the creditor, is invariably one party to any change of economic ownership of the asset. Therefore, for assets, sector attribution by creditor and by transactor coincide. A claim on a resident debtor, however, may change ownership between a resident creditor and a nonresident creditor so that the domestic sector of the debtor may not coincide with that of the transactor. For instance, the issuer may be a resident in one institutional sector, the seller a resident in another institutional sector, and the buyer a nonresident.

4.61 Although the sector classification for IIP liabilities is clearly according to the issuer, for the sector data in the financial account, there are both practical and analytical considerations over whether the sector allocation should be determined according to the issuer or the seller. By convention, the sector of the debtor is the one that determines the classification of the change of ownership that has occurred, because the original nature of the liability is generally considered more significant than the identity of the resident seller of the claim. These issues are discussed in the context of partner economy data in paragraphs 4.152-4.154 and 14.24.<sup>5</sup> The same issues apply for financial instru-

<sup>5</sup>An additional factor for institutional sector data is that, in the national accounts, data for the sector of the seller will show a disposal of an asset.

**Table 4.1. SNA Classification of Institutional Sectors***(Includes 2008 SNA codes)***SI Total economy**

- SI 1 Nonfinancial corporations<sup>1</sup>
- SI 2 Financial corporations
  - 5121 Central bank<sup>2</sup>
  - 5122 Deposit-taking corporations, except the central bank<sup>1</sup>
  - 5123 Money market funds (MMFs)<sup>1</sup>
  - 5124 Non-MMF investment funds<sup>1</sup>
  - 5125 Other financial intermediaries, except insurance corporations and pension funds<sup>1</sup>
  - 5126 Financial auxiliaries<sup>1</sup>
  - 5127 Captive financial institutions and money lenders<sup>1</sup>
  - 5128 Insurance corporations<sup>1</sup>
  - 5129 Pension funds<sup>1</sup>
- SI 3 General government
  - General government classification—alternative A
    - 51311 Central government
    - 51312 State government
    - 51313 Local government
    - 51314 Social security funds
  - General government classification—alternative B
    - 51321 Central government<sup>3</sup>
    - 51322 State government<sup>3</sup>
    - SI 323 Local government<sup>3</sup>
- SI 4 Households
- SI 5 Nonprofit institutions serving households

**52 Rest of the world**

May be classified in the same way as resident institutional sectors, with the addition of:

- International organizations
  - International financial organizations
    - Central bank of currency union<sup>4</sup>
    - Other
  - International nonfinancial organizations

**Note:** The SNA sector classification also includes scope for a subsector for foreign-controlled corporations, defined similarly, but not identically, to direct investment subsidiaries. It also allows for separate identification of nonprofit institutions and for-profit institutions within the corporations sectors.

<sup>1</sup>Supplementary "of which" items may be provided for public corporations.

Additional subsector may be identified for monetary authorities, where needed, as discussed in paragraph 4.70.

including social security funds of this level of government.

<sup>4</sup>If the reporting economy is a member state of a currency union.

ments issued by a resident that are sold by a nonresident holder to a resident buyer.

## 2. Definitions of institutional sectors and subsectors

### a. Nonfinancial corporations

4.62 *Nonfinancial corporations are corporations whose principal activity is the production of market goods or nonfinancial services.* These include legally constituted corporations, branches of nonresident enterprises, quasi-corporations, notional resident units owning land, and resident nonprofit institutions that are market producers of goods or nonfinancial services.

### b. Financial corporations

Reference:

IMF, *Monetary and Financial Statistics Compilation Guide*, Chapter 3, Institutional Units and Sectors.

4.63 *Financial corporations consist of all corporations and quasi-corporations that are principally engaged in providing financial services, including insurance and pension fund services, to other institutional units.* The production of financial services is the result of financial intermediation, financial risk management, liquidity transformation, or auxiliary financial services. In other manuals, financial corporations are sometimes called financial institutions.

Table 4.2. *BPM6* Classification of Institutional Sectors

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**Central bank<sup>1</sup>**

**Deposit-taking corporations except the central bank<sup>2</sup>**

**General government**

**Other sectors**

- Other financial corporations
  - Money market funds (MMFs)<sup>2</sup>
  - Non-MMF Investment funds<sup>2</sup>
  - Other financial intermediaries except insurance corporations and pension funds (ICPFs)<sup>2</sup>
  - Financial auxiliaries<sup>2</sup>
  - Captive financial institutions and money lenders<sup>2</sup>
  - Insurance corporations<sup>2</sup>
  - Pension funds<sup>2</sup>
- Nonfinancial corporations, households, and NPISHs
  - Nonfinancial corporations<sup>2</sup>
  - Households
  - NPISHs (nonprofit institutions serving households; may be combined with households)

*Additional sectors for counterpart data:*

- International organizations*
- International financial organizations*
- Central bank of currency union*
- Other international organizations*

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<sup>1</sup>Additional subsector may be identified for monetary authorities, where needed, as discussed in paragraph 4.70.  
<sup>2</sup>Supplementary "of which" items may be provided for public corporations, as discussed in paragraphs 4.108–4.112.

4.64 Financial corporations can be divided into three broad classes, namely, financial intermediaries, financial auxiliaries, and other financial corporations:

- (a) Financial intermediaries consist of deposit-taking corporations, investment funds, other financial intermediaries, insurance corporations, and pension funds. *Financial intermediation is a productive activity in which an institutional unit incurs liabilities on its own account for the purpose of acquiring financial assets by engaging in financial transactions on the market.* Financial intermediaries as institutional units collect funds from lenders and transform or repackage them (with respect to maturity, scale, risk, and the like) in ways that suit the requirements of borrowers. Through financial intermediation, funds are channeled between parties with a surplus on one side and those with a need for funds on the other. A financial intermediary does not simply act as an agent for these other institutional units but places itself at risk by acquiring financial assets and incurring liabilities on its own account.
- (b) Financial auxiliaries are institutional units principally engaged in serving financial markets, but they do not take ownership of the financial assets and liabilities they handle or regulate.

- (c) Other financial corporations are institutional units providing financial services, where most of their assets or liabilities are not available on open financial markets. These corporations are included in the captive financial institutions and money lenders subsector.

4.65 The *SNA* further identifies nine subsectors of the financial corporations subsector (shown in Table 4.1 and as discussed in the following paragraphs). They are used in the following ways in international accounts:

- (a) The standard components use three subsectors: the central bank, deposit-taking corporations except the central bank, and the other seven subsectors combined as "other financial corporations." Additional details can be compiled according to circumstances.
- (b) The functional category classification of debt positions between affiliated financial intermediaries is defined in terms of the first five subsectors of the financial sector—that is, the central bank, deposit-taking corporations except the central bank, money market funds (MMFs), other investment funds, and other financial intermediaries (except insurance corporations and pension



funds, ICPFs). Such debt is excluded from direct investment, as discussed in paragraph 6.28.

4.66 Although the financial corporations sector and its subsectors are defined in terms of economic function, data sources may tend to follow regulatory definitions. Differences between regulatory and statistical definitions should be monitored, and adjustments made, where necessary.

#### **Central bank**

**4.67** *The central bank is the financial institution (or institutions) that exercises control over key aspects of the financial system.* It carries out such activities as issuing currency, managing international reserves, transacting with the IMF, and providing credit to deposit-taking corporations. The central bank of a currency union is classified as a central bank in the data for the currency union as a whole; in the data of individual member states, it is part of the rest of the world sector. Central banks in some economies also accept deposits from or provide credit to entities in other sectors.

4.68 The central bank subsector includes the following:

- (a) central banks, which in most economies are separately identifiable institutions that are subject to varying degrees of government control, engage in differing sets of activities, and are designated by various names (e.g., central bank, reserve bank, national bank, or state bank);
- (b) currency boards or independent currency authorities that issue national currency that is fully backed by foreign exchange reserves; and
- (c) government-affiliated agencies that are separate institutional units and primarily perform central bank activities.

If an institutional unit is mainly engaged in central banking activities, the entire unit is classified in the central bank subsector. Many central banks regulate or supervise other deposit-taking corporations and other financial corporations, and these central bank activities also are included in the central bank subsector. However, units that are affiliated with the government or with other sectors and are mainly engaged in regulating or supervising financial units are classified as financial auxiliaries rather than as units in the central bank subsector. Private units that perform activities such as check-clearing operations are assigned to other financial corporations subsectors depending on their activities, rather than to the central bank.

4.69 A few economies do not have central banks. Typical central banking activities that are performed by general government and cannot be separated into specific institutional units are treated as part of general government and are not allocated to the central bank subsector.

4.70 In economies in which some central banking functions are performed wholly or partly outside the central bank, particularly holding reserve assets, consideration should be given to compiling supplementary data for the monetary authorities sector, as defined in paragraph 6.66. The concept of monetary authorities underlies reserves assets.

#### **Deposit-taking corporations, except the central bank**

**4.71** *Deposit-taking corporations, except the central bank have financial intermediation as their principal activity. To this end, they have liabilities in the form of deposits or financial instruments (such as short-term certificates of deposit) that are close substitutes for deposits.* In general, the following financial intermediaries are classified in this subsector:

- (a) commercial banks, "universal" banks, and "all-purpose" banks;
- (b) savings banks (including trustee savings banks and savings and loan associations);
- (c) post office giro institutions, post banks, and giro banks;
- (d) rural credit banks and agricultural credit banks;
- (e) cooperative credit banks and credit unions;
- (f) traveler's check companies that mainly engage in financial activities; and
- (g) specialized banks or other financial institutions if they take deposits or issue close substitutes for deposits.

4.72 The liabilities of deposit-taking corporations to residents are typically included in measures of broad money. The money-issuing sector may be identified on a supplementary basis to assist in reconciliation with monetary data. It consists of the central bank plus deposit-taking corporations plus other institutions included in the definition of broad money (e.g., MMFs in some cases). Deposit-taking corporations that engage exclusively (or almost exclusively) with nonresidents, often called offshore banks or offshore banking units, are included in deposit-taking corpo-

rations, but they may be excluded from the money-issuing sector because their liabilities are not included in broad money. MMFs are separate from deposit-taking corporations and should be identified separately in the circumstances discussed in paragraph 4.73.

#### **Money market funds**

**4.73** *MMFs are collective investment schemes that raise funds by issuing shares or units to the public. The proceeds are invested primarily in money market instruments, MMF shares and units, transferable debt instruments with a residual maturity of less than one year, bank deposits, and instruments that pursue a rate of return that approaches the interest rates of money market instruments. MMF shares can be transferred by check or other means of direct third-party payment.* Because of the nature of the instruments that MMFs invest in, their shares or units may be regarded as close substitutes for deposits. When MMFs are included in monetary aggregates, showing MMFs as an extra subsector will assist comparability. (The corresponding specialized financial instrument—MMF shares or units—is discussed in paragraph 5.29.)

#### **Non-MMF investment funds**

**4.74** *Non-MMF investment funds are collective investment schemes that raise funds by issuing shares or units to the public.* The proceeds are invested predominantly in long-term financial assets and nonfinancial assets (usually real estate). Investment fund shares or units are generally not close substitutes for deposits. They are not transferable by means of check or third-party payments. Some funds may be limited to certain investors only, whereas others are available to the public generally. Investment funds can be open or closed ended. Open-ended funds or open funds are those whose shares or units are, at the request of the holders, repurchased or redeemed directly or indirectly out of the undertaking's assets. Closed-ended, closed, or exchange-traded funds are those with a fixed share capital, where investors entering or leaving the fund must buy or sell existing shares. Investment funds may be constituted as follows: (a) under the law of contract (as common funds managed by management companies), (b) under trust law (as unit trusts), (c) under a statute (as investment companies), or (d) otherwise with similar effect. Some investment funds invest in other funds ("funds of funds"). Pension funds are excluded; they are part of the insurance companies and pension funds subsector. Real estate investment trusts are included. Investment fund shares are shown as a financial instrument (as defined in paragraph 5.28).

Fund managers of investment funds are financial auxiliaries (paragraph 4.80(h)).

**4.75** Hedge funds are a kind of investment fund. Hedge fund is a term that covers a heterogeneous range of collective investment schemes, typically involving high minimum investments, light regulation, and a wide range of investment strategies. However, special purpose government funds, usually called sovereign wealth funds, are more likely to be classified as captive financial institutions than as investment funds, given the nature of their liabilities, if classified as a financial corporation (see the footnote to paragraph 4.92).

#### **Other financial intermediaries, except insurance corporations and pension funds**

**4.76** *Other financial intermediaries, except ICPFs, consist of financial corporations and quasi-corporations that are engaged in providing financial services by incurring liabilities, informs other than currency, deposits, or close substitutes for deposits, on their own account for the purpose of acquiring financial assets by engaging in financial transactions on the market, and that are not included in another subsector.* It is a feature of a financial intermediary that operations for both sides of the balance sheet are carried out in open markets.

**4.77** In general, the following financial intermediaries are classified in this subsector:

- (a) financial corporations engaged in the securitization of assets;
- (b) underwriters, and securities and derivative dealers (on own account). In contrast, security brokers and other units that arrange trades between buyers and sellers but do not purchase and hold securities on their own account are classified as financial auxiliaries (see paragraph 4.80(b));
- (c) financial corporations engaged in lending, including financial leasing, as well as personal or commercial finance;
- (d) central clearing counterparties, which provide clearing and settlement of market transactions in securities and derivatives. Clearing refers to the process of offsetting obligations and entitlements vis-à-vis counterparties to transactions so that settlement—which involves the actual exchange of securities, derivatives, and funds—can occur more efficiently on a net basis. The central clearing counterparties involve themselves in the transaction and mitigate counterparty risk;

- (e) specialized financial corporations that assist other corporations in raising funds in equity and debt markets and provide strategic advisory services for mergers, acquisitions, and other types of financial transactions. (These corporations are sometimes called "investment banks.") In addition to assisting with the raising of funds for their corporate clients, such corporations invest their own funds, including in private equity, in hedge funds dedicated to venture capital, and in collateralized lending. However, if such corporations take deposits or close substitutes for deposits, they are classified as deposit-taking corporations; and
- (f) any other specialized financial corporations that provide short-term financing for corporate mergers and takeovers; export and import finance; factoring companies; and venture capital and development capital firms.
- 4.78** *Securitization involves raising funds by selling a security backed by specific assets or income streams.* For example, an originating mortgage lender could sell a portfolio of loans to a special purpose vehicle that issues units sold to investors. The originator may continue to provide administrative services, but the vehicle is the legal owner of the portfolio. Such vehicles are included in "other financial intermediaries, except ICPFs" if the entity is the legal owner of a portfolio of assets, sells a new financial asset that represents an interest in the portfolio, and has or potentially has a full set of accounts. However, in cases in which the originator issues asset-backed securities on its own books, then securitization may take place without the creation of a separate entity. When the portfolio is not transformed, or the vehicle does not bear market or credit risks, then it can be combined with its parent (if resident in the same economy) or treated as a captive intermediary (if in a different economy to that of its parent). Asset-backed securities are discussed as financial instruments in paragraph 5.47.

#### **Financial auxiliaries**

**4.79** *Financial auxiliaries consist of all financial corporations that are principally engaged in activities associated with transactions in financial assets and liabilities or with providing the regulatory context for these transactions but in circumstances that do not involve the auxiliary taking ownership of the financial assets and liabilities being transacted.*

**4.80** In general, the following financial corporations are classified in the financial auxiliaries subsector:

- (a) insurance brokers, salvage administrators, and insurance and pension consultants;
- (b) loan brokers, securities brokers that arrange trades between security buyers and sellers but that do not purchase and hold securities on their own account, investment advisers, and so on (securities dealers that trade in securities on their own account are other financial intermediaries);
- (c) flotation corporations that manage the issue of securities;
- (d) corporations whose principal function is to guarantee, by endorsement, bills and similar instruments;
- (e) corporations that arrange derivative and hedging instruments, such as swaps, options, and futures (without issuing them);
- (f) stock exchanges, insurance exchanges, and commodity and derivative exchanges;
- (g) other corporations providing infrastructure for financial markets, such as securities depository companies, custodians, clearing offices,<sup>6</sup> and nominee companies;
- (h) fund managers of pension funds, mutual funds, and so on (but not the funds they manage);
- (i) nonprofit institutions recognized as independent legal entities serving financial corporations, but that are not themselves providing financial services, for example, bankers' associations;
- (j) holding companies that exercise some aspects of managerial control over their subsidiaries (see paragraph 4.85);
- (k) foreign exchange bureaus and money transfer operators;
- (l) resident offices of foreign banks that do not accept deposits or extend credit on their own account;
- (m) corporations primarily involved in operation of electronic payment mechanisms that do not incur liabilities against the instruments (if they do incur liabilities against the instruments, then they are other financial intermediaries except ICPFs); and

<sup>6</sup>Clearing offices are classified as financial auxiliaries when they facilitate transactions without acting as the counterparty; in contrast, central clearing counterparties, as discussed in paragraph 4.77(d) are counterparties and thus are classified as intermediaries rather than auxiliaries.

- (n) central supervisory authorities of financial intermediaries and financial markets when they are separate institutional units.

4.81 Corporations facilitating financial transactions, such as central clearing counterparties, stock exchanges, derivative exchanges, and repurchase agreement settlement institutions are financial intermediaries, if they generally act as principals to the counterparties to the underlying transactions; otherwise they are financial auxiliaries.

#### ***Captive financial institutions and money lenders***

**4.82** *Captive financial institutions and money lenders consist of institutional units providing financial services other than insurance, where most of either their assets or liabilities are not transacted on open financial markets.* It includes entities transacting only within a limited group of units, such as with subsidiaries or subsidiaries of the same holding corporation, or entities that provide loans from own funds provided by only one sponsor. Other financial intermediaries, except ICPFs (discussed in paragraphs 4.76-4.77) are distinguished from captive financial institutions and money lenders in that the latter serve a limited group only for at least one side of their balance sheet.

4.83 In general, the following financial corporations are classified in this subsector:

- (a) institutional units with the function of simply holding assets, such as trusts, estates, agencies accounts, and some "brassplate" companies;
- (b) institutional units that provide financial services exclusively with own funds, or funds provided by a sponsor to a range of clients and incur the financial risk of the debtor defaulting. Examples are moneylenders and corporations engaged in lending (e.g., student loans, import and export loans) from funds received from a sponsor such as a government unit or nonprofit institution;
- (c) pawnshops that predominantly engage in lending;
- (d) financial corporations, such as SPEs, that raise funds in open markets to be used by affiliated corporations (in contrast to securitization vehicles, see paragraph 4.78); and
- (e) conduits, intragroup financiers, and treasury functions when these functions are undertaken by a separate institutional unit.

Captive insurance companies and pension funds are not included in this subsector.

#### ***Holding companies***

4.84 Holding companies are included in this subsector, financial auxiliaries, or nonfinancial corporations, according to which functions they undertake. One type of holding company is a unit that holds equity in one or more subsidiaries but does not undertake any management activities. These companies are described in the *International Standard Industrial Classification of All Economic Activities (ISIC)*, Rev. 4, in section K class 6420 as follows:

This class includes the activities of holding companies, i.e. units that hold the assets (owning controlling-levels of equity) of a group of subsidiary corporations and whose principal activity is owning the group. The holding companies in this class do not provide any other service to the businesses in which the equity is held, i.e. they do not administer or manage other units.

Such units are captive financial institutions and are included in the financial corporations sector even if all the subsidiaries are nonfinancial corporations. The subsidiaries may be resident in the same economy or in other economies.

4.85 Another type of unit referred to as a holding company is the head office that exercises some aspects of managerial control over its subsidiaries. The head office sometimes may have noticeably fewer employees, and at a more senior level, than its subsidiaries, but it is actively engaged in production. These types of activities are described in *ISIC*, Rev. 4, in section M class 7010 as follows:

This class includes the overseeing and managing of other units of the company or enterprise; undertaking the strategic or organizational planning and decision making role of the company or enterprise; exercising operational control and managing the day-to-day operations of their related units.

Such units are allocated to the nonfinancial corporations sector unless all or most of their subsidiaries are financial corporations, in which case they are treated by convention as financial auxiliaries. The subsidiaries may be resident in the same economy or in other economies. Other entities that hold and manage subsidiaries may have substantial operations in their own right, in which case the holding company functions may be secondary, so they would be classified according to their predominant operations.

*Conduits*

**4.86** A conduit is an entity that raises funds on open financial markets for passing on to other affiliated enterprises. Often, the conduit's liabilities are guaranteed by a parent company. If a conduit issues new financial instruments, which could be debt securities, shares, or partnership interests, that represent a claim on the conduit, it is acting as a captive financial institution. (Conduits are a case of "pass-through funds," discussed in paragraph 6.34.)

*Wealth-holding entities*

4.87 Institutional units that solely hold assets and liabilities, along with the associated property income, for their owners are classified as captive financial institutions. Some SPEs and trusts perform these functions. SPEs are discussed further in paragraphs 4.50—4.52. Although there is no internationally standard definition of SPEs, in economies in which they are important they may be identified separately, according to either a national company law definition, or in terms of a functional description, possibly referring to their limited physical presence and ownership by nonresidents. In economies with large direct investment flows through resident SPEs, it is recommended that these flows be shown as a supplementary item, so that they can be identified separately.

*Insurance corporations*

**4.88** Insurance corporations consist of incorporated, mutual, and other entities whose principal function is to provide life, accident, health, fire, or other forms of insurance to individual institutional units or groups of units or reinsurance services to other insurance corporations. Captive insurance is included, that is, an insurance company that serves only its owners. Deposit insurers, issuers of deposit guarantees, deposit protection schemes, and other issuers of standardized guarantees that are separate entities and act like insurers by charging premiums and have reserves are classified as insurance corporations. (The relevant specialized instruments—nonlife insurance technical reserves, and life insurance and annuity entitlements—are discussed in paragraphs 5.64-5.65.)

*Pension funds*

4.89 Pension liabilities arise when members of households participate in a social insurance scheme that will provide income in retirement (and often benefits for death or disability). Such schemes may be organized by employers or by government; they also

may be organized by insurance corporations on behalf of employees; or separate institutional units may be established to hold and manage the assets to be used to meet the pension obligations and to distribute the pensions. Pension schemes may be operated by a separately constituted pension fund or a fund that is part of the employer, or they may be unfunded. *The pension fund subsector consists of only those social insurance pension funds that are institutional units separate from the units that create them.*

4.90 Social security schemes are not included in pension funds, although they sometimes may have pension entitlement liabilities if they provide pensions to public sector employees. In the case of unfunded pension schemes, general government and corporations other than pension funds may have pension entitlement liabilities. Nonautonomous pension funds are not separated from the entity of which they are part. (Pension entitlements as a type of financial asset or liability are discussed in paragraph 5.66.)

*c. General government*

4.91 Government units are unique kinds of legal entities established by political processes and have legislative, judicial, or executive authority over other institutional units within a given area. Viewed as institutional units, the principal functions of government are to assume responsibility for the provision of goods and services to the community or individual households and to finance their provision out of taxation or other incomes; to redistribute income and wealth by means of transfers; and to engage in nonmarket production. In general terms:

- (a) A government usually has the authority to raise funds by collecting taxes or compulsory transfers from other institutional units.
- (b) Government units typically make three different kinds of outlays. The first group consists of actual or imputed expenditures on the free provision to the community of collective services, such as public administration, defense, law enforcement, public health, and so on. The second group consists of expenditures on the provision of goods and services for free or at prices that are not economically significant. The third group consists of transfers to other institutional units that are made to redistribute income or wealth.

Within a single territory, many separate government units may exist when there are different levels of government, specifically central, state, or local govern-

ment. In addition, social security funds also constitute government units.

4.92 The general government sector consists of departments, branches, agencies, foundations, institutes, non-market nonprofit institutions controlled by government, and other publicly controlled organizations engaging in nonmarket activities. As discussed in paragraph 4.5, the operations of a government that are located abroad and that are largely exempt from the laws of the territory in which they are located, such as embassies, consulates, and military bases, are a part of the home government. Government units are mainly involved in the production of goods and services that may be provided free of charge or sold at prices that are not economically significant. Government-controlled enterprises that (a) produce market output (i.e., charge prices that are economically significant), and (b) have complete sets of accounts are excluded from general government and are included as public enterprises in the appropriate nonfinancial or financial corporations sector. The requirement that prices be economically significant means that prices must be high enough to have an impact on the demand for, and supply of, a good or service.<sup>7</sup>

#### *Government entities resident abroad*

4.93 If a government uses an entity that is resident in the economic territory of another government to carry out general government activities (i.e., fiscal activities, rather than for a public corporation, as defined in paragraph 4.108), that entity is not included as part of the general government in either its economy of residence or the economy of the government that uses the entity. Such entities are not treated in the same way as embassies and other territorial enclaves if they are created and operate under the laws of the host economy. As noted in paragraph 6.20(d), governments may be direct investors in these cases. However, as noted in paragraphs 8.24-8.26, 11.40, and 12.48, special imputations of transactions and positions between the government and the entity are adopted to ensure that any fiscal operations undertaken through nonresident entities are reflected in the transactions and positions of the government concerned.

<sup>7</sup>The classification of a "special purpose government fund" controlled by government in the general government or financial corporations sectors is determined according to the criteria set out in paragraphs 4.63-4.92, such as whether they charge economically significant prices for their services. If the fund is an entity incorporated abroad or quasi-corporation located abroad, it is classified as a separate institutional unit in the financial corporations sector resident in its economy of incorporation. See also paragraphs 6.93-6.98 for more information on "special purpose government funds."

#### *Restructuring agencies*

4.94 Restructuring agencies are entities set up to sell corporations and other assets, and to reorganize companies. They also may be used for defeasance of impaired assets or repayment of liabilities of insolvent entities, often in the context of a banking crisis. Restructuring agencies are involved in such activities as managing liabilities and their repayment, managing impaired assets and their sale on the market, and in the financing of the process.

4.95 When the restructuring agency is government funded and is considered not to be putting itself at risk, for example, because the debt liabilities it manages are disproportionately large relative to the fair value of its assets, then it is considered to be operating for fiscal purposes, rather than on a commercial basis, so that the agency is part of the general government sector. For instance, if a restructuring agency deliberately purchases assets at above-market prices with direct or indirect financial support from the government and does not place itself at risk, it is considered to be operating for fiscal purposes and therefore should be classified in the general government sector. Otherwise, it is classified as a financial corporation according to the nature of its operations, usually in the subsector other financial intermediaries except ICPFs. For instance, if the restructuring agency borrows on the market at its own risk to acquire financial or nonfinancial assets that it actively manages, the unit should be classified as a financial corporation. Asset management companies that acquire, manage, and dispose of impaired bank assets, and that are considered to be putting themselves at risk, are classified this way.

#### *d. Households*

Reference:

2008 SNA, Chapter 24, The Households Sector.

**4.96** A household is defined as a group of persons who share the same living accommodation, who pool some or all of their income and wealth, and who consume certain types of goods and services collectively, mainly housing and food. Households often coincide with families. However, members of a family are not always members of the same household, if they live separately. Equally, members of the same household do not necessarily have to belong to the same family if they share resources and consumption.

4.97 Households may be of any size and take a wide variety of different forms in different societies or cultures depending on tradition, religion, education,

climate, geography, history, and other socioeconomic factors. Institutional households include persons in retirement homes, jails, hospitals, and religious orders.

4.98 Although each member of a household is a legal entity, the household is an appropriate unit for statistical purposes because many economic decisions are made at the household level and transactions within the household are outside the scope of economic statistics. The members of a household are all residents in the same economic territory. A person who pools income with the household in one economic territory, but is resident of another economic territory, is not classified as a member of that household. A single person can constitute a household.

4.99 The households sector includes enterprises owned by household members that do not satisfy the definition of a quasi-corporation. For example, if the business affairs of a household are not separable from the personal consumption of household members, then the business would not satisfy the requirements for a quasi-corporation to have the ability to produce accounts. (Some unincorporated businesses are treated as quasi-corporations, as discussed in paragraphs 4.34-4.40 and 4.49.)

e. *Nonprofit institutions serving households*

Reference:

2008 SNA, Chapter 23, Non-profit Institutions in the SNA.

4.100 *NPISHs are entities mainly engaged in providing goods and services to households or the community at large free of charge or at prices that are not economically significant (and thus are classified as nonmarket producers), except those that are controlled and mainly financed by government units.* Examples include charities, relief and aid organizations financed by voluntary transfers, as well as trade unions, professional or learned societies, consumers' associations, religious institutions, and social, cultural, and recreational clubs that do not charge economically significant prices. They may be corporations, foundations, trusts, or other unincorporated entities.

4.101 NPISHs are mainly financed from contributions, subscriptions from members, or earnings on holdings of real or financial assets. The NPISH sector is a subset of nonprofit institutions. Those that charge economically significant prices are included in the financial or nonfinancial corporations or households sectors, as relevant. Additionally, nonprofit institutions

serving businesses, such as chambers of commerce and trade associations, are included in the corporations sectors (see paragraph 12.57 on their membership dues). When this *Manual* refers to nonprofit institutions, it includes all nonprofit institutions.

f. *Rest of the world*

4.102 The rest of the world consists of all nonresident institutional units that enter into transactions with resident units or that have other economic links with resident units. The rest of the world sector is identified in the national accounts, while it is the counterparty in all international accounts items.

*International organizations*

4.103 International organizations have the following characteristics:

- (a) The members of an international organization are either national states or other international organizations whose members are national states; they thus derive their authority either directly from the national states that are their members or indirectly from them through other international organizations.
- (b) They are entities established by formal political agreements between their members that have the status of international treaties; their existence is recognized by law in their member countries.
- (c) International organizations are created for various purposes:
  - International financial organizations—these entities conduct financial intermediation at an international level (i.e., channeling funds between lenders and borrowers in different economies). A central bank to a group of economies (including currency union central banks) is an example of an international financial organization. Other examples are the IMF, World Bank Group, BIS, and regional development banks; and
  - Other international organizations—these entities provide nonmarket services of a collective nature for the benefit of their member states, such as peacekeeping, education, science, policy issues, and other research.

4.104 International organizations may be global or regional. An international agency responsible for functions normally undertaken by general government, such

as administration and policing, is classified as an international organization, but it may be useful to identify such agencies separately in statistics.

4.105 International organizations are treated as not being resident of the territories in which they are located. This treatment is because they are generally exempted from, or are only partially subject to, national laws or regulations, and so they are not considered to be part of the national economy of the territory, or territories, in which they are located.

4.106 International organizations may be presented as an institutional sector in some cases. First, they may appear in data for a currency union or economic union, in which case, international organizations of the union are residents of the union as a whole. Second, they may be of relevance when data by sector of counterparty are prepared, for example, for sources of current transfers. Such data would be of particular interest in economies in which international organizations have a substantial presence.

4.107 In contrast to international organizations, enterprises owned jointly by two or more governments are not treated as international organizations but like other enterprises. The distinction is based on whether the organization produces for the market and is important because of the different treatments for the residence of international organizations and enterprises. Separate pension funds for the staff of international organizations are treated as pension funds, rather than as international organizations. Therefore, the residence of these pension funds is determined in accord with paragraph 4.141.

g. *Additional detail for public corporations*

Reference:

2008 SNA, Chapter 4, Institutional Units and Sectors, and Chapter 22, The General Government and Public Sectors.

**4.108** *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. (This use of public corporation as a term should be distinguished from the use of the same term to refer to a public corporation whose shares are traded on public markets.) Public corporations may be shown as "of which" items for the

financial and nonfinancial corporations sectors or sub-sectors as supplementary items, when relevant.

4.109 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. 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. 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 factors to consider:

- (a) ownership of the majority of the voting interest;
- (b) control of the board or other governing body;
- (c) control of the appointment and removal of key personnel;
- (d) control of key committees of the entity;
- (e) golden shares and options (golden shares give the holder a decisive vote, even without a majority of shares);
- (f) regulation and control;
- (g) control by a dominant customer; and
- (h) control attached to borrowing from the government.

4.110 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. International accounts compilers should consult with government finance statisticians to ensure consistent treatments.

4.111 Public-private partnerships are long-term contracts, whereby a private entity acquires or builds an asset, operates it for a period, and then hands it over to a government. The private entity may be a direct investment enterprise. These schemes may be called private finance initiatives; build, own, operate, transfer (BOOT) schemes; and so on. As with leases, the economic owner of the assets related to such an arrangement 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. More details are available in *2008 SNA*, Chapter 22.

4.112 Corporations subject to the control of a government that is resident in a different economy from that government are not classified as public corporations. They receive this treatment because they are not public companies related to the government of their economy of residence. These corporations differ from embassies and military bases in that they are subject to local laws and so should be seen as part of their economy of location.

## E. Residence

### I. General principles

Reference:

*2008 SNA*, Chapter 4, Institutional Units and Sectors, and Chapter 26, The Rest of the World Accounts.

**4.113** *The residence of each institutional unit is the economic territory with which it has the strongest connection, expressed as its center of predominant economic interest.* Each institutional unit is a resident of one and only one economic territory determined by its center of predominant economic interest. Specific criteria for determining residence are given below. The definitions given below are designed to apply the concept of center of predominant economic interest. These definitions should be used in preference to a discretionary choice between different possible aspects of economic interest.

**4.114** *An institutional unit is resident in an economic territory when there exists, within the economic territory, some location, dwelling, place of production, or other premises on which or from which the unit engages and intends to continue engaging, either indefinitely or over a finite but long period of time, in economic activities and transactions on a significant scale.* The location need not be fixed so long as it remains within the economic territory. Actual or intended location for one year or more is used as an operational definition; although the choice of one year as a specific period is somewhat arbitrary, it is adopted to avoid uncertainty and facilitate international consistency.

4.115 In overview, residence of selected entities is as follows, subject to the more detailed elaboration in paragraphs 4.116-4.144:

- (a) The residence of individual persons is determined by that of the household of which they are a part

and not by their place of work. All members of the same household have the same residence as the household itself, even though they may cross borders to work or otherwise spend periods of time abroad. If they work and reside abroad so that they acquire a center of predominant economic interest abroad, they cease to be members of their original households.

- (b) Unincorporated enterprises that are not quasi-corporations are not separate institutional units from their owners and, therefore, have the same residence as their owners. (However, the criteria for recognizing a branch in paragraph 4.27 mean that significant cross-border businesses will almost always be recognized as quasi-corporations.)
- (c) Corporations and nonprofit institutions normally may be expected to have a center of economic interest in the economy in which they are legally constituted and registered. Corporations may be resident in economies different from their shareholders and subsidiaries may be resident in different economies from their parent corporations. When a corporation, or unincorporated enterprise, maintains a branch, office, or production site in another territory to engage in a significant amount of production over a long period of time (usually one year or more) but without creating a corporation for the purpose, the branch, office, or site is considered to be a quasi-corporation (i.e., a separate institutional unit) resident in the territory in which it is located.
- (d) For entities, such as many SPEs, that have few if any attributes of location, the residence is determined by their place of incorporation.
- (e) When a nonresident has ownership of land and buildings, and natural resources other than land, the assets are deemed to be owned by a notional resident institutional unit in the economy of location, even if they do not engage in other economic activities or transactions in the economy. All land, buildings, and natural resources other than land are therefore owned by residents.

### 2. Residence of households

4.116 Although many people are clearly strongly connected to only one economy, others have substantial economic interests in two or more economic territories. Factors such as location of dwellings, employment, asset holdings, citizenship, migration status, income tax

status, income received, expenditure, business interests, and location of dependent family members may point to different economies. To identify the economy of residence when there are connections to two or more economies, the following definition is used to identify the center of predominant economic interest.

**4.117** *A household is resident in the economic territory in which household members maintain or intend to maintain a dwelling or succession of dwellings treated and used by members of the household as their principal dwelling. Being present for one year or more in a territory or intending to do so is sufficient to qualify as having a principal dwelling there.* If there is uncertainty about which dwelling is the principal dwelling, it is identified from the length of time spent there, rather than other factors such as presence of other family members, cost, size, or length of tenure.

**4.118** Individuals who belong to the same household must be residents of the same territory. If a member of an existing household ceases to reside in the territory where his or her household is resident, the individual ceases to be a member of that household. As a result of this definition, the use of households as the institutional unit is compatible with residence being determined on an individual basis.

**4.119** Further to the general principles, some other factors are used to determine residence of particular categories. These categories are students, medical patients, ship's crew, as well as national diplomats, military personnel, staff of scientific stations, and other civil servants employed abroad in government enclaves (these enclaves are discussed in paragraph 4.5(e)). In these cases, some other connections are considered to be more important in determining residence. In the case of significant population movements between two particular territories, compilers in each territory should cooperate to ensure consistent definitions and measurement.

#### *Students*

**4.120** People who go abroad for full-time study generally continue to be resident in the territory in which they were resident prior to studying abroad. This treatment is adopted even though their course of study may exceed a year. However, students change to being residents of the territory in which they are studying when they develop an intention to continue their presence in the territory of study after the completion of the studies. For students, the rationale for not changing the territory of residence is that the movement to the different territory is considered to have a temporary motivation, that is, their center of

predominant economic interest remains with the home territory. The residence of accompanying dependents of students is determined in the same manner as the persons they accompany. The tuition and other expenditure of students in their host economies are included in travel (see paragraph 10.89).

#### *Patients*

**4.121** People who go abroad for the purpose of medical treatment maintain their predominant center of interest in the territory in which they were resident before they received the treatment, even in the rare cases in which complex treatments take a year or more. As with students, the movement is considered to have a temporary motivation. The residence of accompanying dependents of patients is determined in the same manner as the persons they accompany.

#### *Crew of ships and so on*

**4.122** Crew of ships, aircraft, oil rigs, space stations, or other similar equipment that operate outside a territory or across several territories are treated as being resident in their home base territory. The home base is determined from where they spend most time other than undertaking their duties. The home base is regarded as a stronger connection than the location of the mobile equipment or its operator, even though most of the time may be spent at the latter location.

#### *Diplomats, military personnel, and so on*

**4.123** National diplomats, peacekeeping and other military personnel, and other civil servants employed abroad in government enclaves, as well as members of their households are considered to be residents of the economic territory of the employing government. Those enclaves—military bases, embassies, and the like, as discussed in paragraph 4.5(e)—form part of the economic territory of the employing government. They continue to be residents in their home economies even if they live in dwellings outside the enclaves. The expenditure of diplomats and so on in their host economies is included in government goods and services n.i.e. (see paragraph 10.177). Other employees, such as locally recruited staff, are resident in the location of their principal dwelling.

#### *International organization staff*

**4.124** Staff of international organizations, including those with diplomatic status and military personnel,

are resident in the territory of their principal dwelling. The treatment of international organization staff is different from national diplomats and others discussed in the previous paragraph because the latter continue to be paid from and directed by their home government and tend to have shorter postings and rotate back to their economy of origin.

#### *Cross-border workers*

4.125 Border workers, seasonal workers, and other short-term workers cross borders for a short period to undertake a job. No special treatment is adopted, so their residence is determined according to the criteria in paragraph 4.117. Border workers are employed persons who cross from one territory to another to attend their place of employment. Seasonal workers cross the border for particular periods, such as the harvest or tourist seasons to attend a place of employment. Other short-term employment may occur for a particular task, such as a construction project, repairs, delivery of advice, and so on. In each case, the residence of the persons concerned is based on the principal dwelling, rather than the territory of employment.

#### *Highly mobile individuals*

4.126 Some individuals have close connections with two or more territories, for example, they have dwellings in more than one territory in which they spend significant amounts of time. For individuals who do not have continuous actual or intended presence in any one territory for one year, the territory of the principal dwelling they maintain is the key consideration. In cases of no principal dwelling, or two or more principal dwellings in different economies, the territory of residence is determined on the basis of the territory in which the predominant amount of time is spent in the year. Although these individuals need to be classified as residents of a single economy for statistical purposes, additional information may be needed in recognition of strong ties to another economy. The statistical result of classifying long-term guest workers as residents of the host economy is appropriate, however, in that their income and consumption in the host territory are not treated as international transactions, only the amounts actually sent to the home economy are. The alternative would involve artificial rerouting—the income credits and travel debits would be attributed to the home territory.

4.127 Nevertheless, it may be desirable for compilers to provide supplementary data on groups of non-residents that have significant links with the economy,

for example, by remitting funds to family members remaining there or by intending to return there with savings or pension entitlements. Similarly, it may be desirable to have supplementary data on those who are classified as residents of the economy, but maintain significant links to other economies. Appendix 5 discusses some supplementary presentations for flows associated with some of these mobile individuals.

#### *Refugees*

4.128 No special treatment is adopted for refugees. Their residence will change from their home territory to the territory of refuge, if they have stayed or intend to stay in their place of refuge for one year or more, even if that residence is involuntary or transient, and its future status is unclear.

#### *Application of residence principles*

4.129 In practice, residence principles are generally not applied to specific individuals, but to broad groups of people. As a result, factors such as intention to stay for one year or more are typically inferred from patterns of similar groups in the past. Some administrative data sources may vary somewhat from statistical definitions of residence. If the variations are significant, some adjustment may be made, or the administrative definition may be considered as an acceptable approximation in practice.

4.130 The determination of residence results in how the income, expenditure, and financial positions of the households concerned are treated in international accounts statistics. Table 4.3 provides a brief summary of some of the implications for the international accounts of whether a household is classified as resident or non-resident of the reporting economy for different types of flows. For example, a nonresident student studying in a territory is shown as being a source of service credits for education, housing, food, other goods and services, and possibly transfer debits, if the student is receiving a scholarship from the host economy. For a resident student, these transactions would be out of scope of the international accounts. The effect of changes of residence of persons is discussed in paragraph 4.165.

### **3. Residence of enterprises**

4.131 *As a general principle, an enterprise is resident in an economic territory when the enterprise is engaged in a significant amount of production of goods or services from a location in the territory.* Additional

**Table 4.3. Selected Effects of a Household's Residence Status on the Statistics of the Host Economy**

Economic flow or position	Resident (e.g., long-term guest worker)	Nonresident (e.g., short-term guest worker)
Compensation of employees received from enterprises in the reporting economy	Not international transaction	Primary income
Personal expenditure in the reporting economy	Not international transaction	Services, mainly travel
Transfers to relatives in home economy	Current or capital transfers	Resident-resident transfer within home economy, so outside balance of payments (However, possible financial account transactions if made from bank in host economy)
A resident institutional unit's financial claims on or liabilities to the household	Not in international accounts	Included in international accounts
Land and buildings in host economy	Not included in international investment position	Direct investment liability of the reporting economy in notional resident unit
Land and buildings in home economy	Direct investment asset in notional resident unit	Not included in international investment position

principles are spelled out in paragraphs 4.134-4.136. As stated in paragraph 4.23, an enterprise is an institutional unit engaged in production and may be a corporation or quasi-corporation, a nonprofit institution, or an unincorporated enterprise (part of household sector).

4.132 In contrast to individuals and households, which may have connections to two or more economies, enterprises are almost always connected to a single economy. Taxation and other legal requirements tend to result in the use of a separate legal entity for operations in each legal jurisdiction. In addition, a separate institutional unit is identified for statistical purposes in cases in which a single legal entity has substantial operations in two or more territories (e.g., for branches, land ownership, and multiterritory enterprises, as noted in paragraphs 4.26-4.44). As a result of splitting such legal entities, the residence of each of the subsequently identified enterprises is clear. The introduction of the terminology "center of predominant economic interest" does not mean that entities with substantial operations in two or more territories no longer need to be split.

4.133 It is generally required that production take place or is planned to take place in the territory over a period of a year or more for a quasi-corporation to be identified. All enterprises must be resident somewhere, however, so if an actual institutional unit's only activity is a production process that is undertaken over a shorter period, the unit is resident in the territory of location of the production.

#### *Corporations with little or no physical presence*

4.134 A legal entity is resident in the economic territory under whose laws the entity is incorporated or registered. If it is a resident artificial subsidiary, it is combined with a parent resident in the same economy to form an institutional unit (paragraph 4.18) or, for some purposes, combined into a local enterprise group (paragraph 4.55). However, it must not be combined with entities resident in other economies. If it has substantial operations in another economy, a branch may be identified there (paragraph 4.26). In some cases, a corporation has little or no physical presence, for example, its administration is entirely contracted out to other entities. Banking, insurance, investment funds (as distinct from their managers), securitization vehicles, and some SPEs often operate this way. Similarly, with virtual manufacturing, all the physical processes are outsourced to other units.

4.135 A single corporation might be registered in several jurisdictions, for example, incorporation, income tax, value-added tax, and particular regulations, and a jurisdiction may have been agreed on for settling disputes involving the enterprise. In such cases, the jurisdiction of the laws that govern the creation and continued existence of the entity should be used as the criterion for determining residence. If there is no incorporation or registration, legal domicile is used as a criterion. The incorporation and registration represents a substantial degree of connection to the economy, asso-

**Table 4.4. Selected Effects of the Residence Status of an Enterprise Owned by a Nonresident on the Statistics of the Host Economy**

Economic flow or position	Resident enterprise (e.g., long-term construction project)	Nonresident enterprise (e.g., short-term construction project)
Sales by enterprise to residents	Not international transaction	Imports of goods and services
Purchases by enterprise from residents	Not international transaction	Exports of goods and services
Compensation of employees payable to residents of host economy	Not international transaction if receivable	Compensation of employees
Compensation of employees payable to residents of home economy	Compensation of employees	Not transaction of host economy
Net operating surplus	Dividends payable or reinvested earnings (enterprise is a direct investment enterprise)	Not international transaction
Injections of funds by owners	Direct investment liabilities of the reporting economy (enterprise is a direct investment enterprise)	Not international transaction
A resident institutional unit's financial claims on or liabilities to the enterprise	Not included in international accounts	Included in international accounts

ciated with jurisdiction over the enterprise's existence and operations. In contrast, other connections such as ownership, location of assets, or location of managers or administration may be less clear-cut.

#### *Production delivered from a base*

4.136 In some cases, an enterprise has a location that is used as a base to deliver services to other locations. For example, this mode is used for transport (discussed under mobile equipment in paragraph 4.31) and also may be used for delivery of many kinds of services, such as on-site repairs, short-term construction, and many types of business services. In such cases, the residence of the enterprise is determined from its base of operations, rather than the point of delivery or location of mobile equipment, unless the activities at the point of delivery are sufficiently substantial to amount to a branch, as defined in paragraph 4.27. For example, an institutional unit that operates ships on the high seas and various territorial waters has its residence determined according to the criteria in paragraphs 4.131-4.135, and the economy of residence is not necessarily the same as the location where the ships spend the most time or the territory of registration of the ships. Additionally, the enterprise that operates the ships is not necessarily the same as the enterprise that owns the ships, such as where the ship operator has an operating lease from the ship owner, who is resident in another economy. The residence of

the enterprise that owns the ship is determined according to the criteria in paragraphs 4.131-4.135. Flags of convenience used by enterprises do not determine the residence of the operator, and indeed a single shipping operator may have ships registered in several economies. Similarly, the residence of enterprises that charter ships is determined by the location of its own base of operations, rather than the flags or locations of particular ships. The base of operations does not necessarily equate to the location from which the enterprise is managed. A company operating mobile equipment may be legally domiciled in one economy but managed from another economy.

4.137 Table 4.4 provides a brief summary of some of the implications for the international accounts of whether an enterprise is treated as a resident enterprise or as a nonresident for different types of flows and positions. The possibility of change of residence by enterprises is discussed in paragraph 4.167.

#### **4. Residence of other institutional units**

##### *a. General government*

4.138 General government includes operations outside the home territory, such as embassies, consulates, military bases, and other enclaves of foreign governments, including those providing training and other forms of assistance. Usually, these operations are not

separate institutional units, but even if they were, they are residents of their home territory, rather than the host territory in which they are physically located. This treatment is adopted because they usually have some degree of immunity from the host territory's laws and are deemed under international law to be extensions of the home government's territory. However, an entity created by a government under the laws of the host jurisdiction is an enterprise resident in the host economy and not part of the general government sector in either economy. (See also paragraph 4.93 for further discussion of such cases.) The residence of the employees of these operations is discussed in paragraph 4.123.

#### b. *International organizations*

4.139 International organizations are defined in paragraphs 4.103-4.107. International organizations are resident in an economic territory of their own, and not of the economy in which they are physically located. This treatment applies to both international organizations located in only one territory and those located in two or more territories. The residence of the employees of these operations is discussed in paragraph 4.124.

4.140 An international organization that operates peacekeeping and other military forces or that acts as the interim administration in a territory remains classified as an international organization and is nonresident in that territory, even if it undertakes general government functions. In cases in which these organizations are significant, it may be desirable to identify them separately.

4.141 A separately constituted pension fund of an international organization is not treated as an international organization, but it is regarded as a financial corporation. Its residence is determined according to the general principles in paragraphs 4.131-4.135—that is, it is a resident of the territory in which it is located, and if it lacks a physical presence, it is a resident of the economy in which it is incorporated or registered.

#### c. *Regional international organizations*

4.142 Some international organizations cover a group of economies in a particular region, such as with economic or currency unions. If statistics are prepared for that region as a whole, these regional organizations are residents of the region as a whole, even though they are not residents of any member economy (see Appendix 3 for further information in the case of currency and economic unions).

4.143 When producing global or regional totals, international organizations are combined with national data when deriving global and regional totals, such as for the international transactions and positions compiled by the IMF.

#### d. *NPISHs*

4.144 An NPISH has a center of economic interest in the economy in which the institution was legally created and is officially recognized and recorded as a legal or social entity. In practice, residence of the vast majority of NPISHs may be determined without ambiguity. When an NPISH is engaged in charity or relief work on an international scale, it may maintain substantial operations for individual territories that may amount to branches (see discussion in paragraph 4.27). Such a branch is usually financed largely or entirely by current or capital transfers from abroad. NPISHs are not international organizations, which are limited to those created by governments.

## F. Issues Associated with Residence

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

4.145 Some financial assets have owners who are residents of different economic territories. Examples include joint bank accounts or other cases in which an account holder authorizes relatives to withdraw funds from the account. In these cases, the allocation between the owners may be unclear:

- In the case of deposits of emigrant workers in their home economies that are freely usable by family members resident in the home economies, a convention can be adopted to treat these assets as being held by residents of the home economy.
- Similarly, for deposits of emigrant workers in the host economy that are freely usable by family members, a convention can be adopted to treat these as being held by a resident of the host economy.

(See *Monetary and Financial Statistics Compilation Guide*, paragraph 3.46.)

Compilers may adopt another treatment if better information is available. Because these accounts may be used to make transfers, it is important that such transactions are recognized at either the time of deposit or time of withdrawal (depending on the convention adopted). It is also important that compilers discuss methods with

the compilers of monetary and financial statistics and compilers in the counterpart economy with a view to adopting consistent and realistic treatments in cases in which the values are significant.

## 2. Data by partner economy

4.146 The primary presentation of international accounts shows positions and transactions with all non-residents as a total, but data on positions and transactions with nonresidents broken down into individual partner economies or groups of economies are of considerable interest. (The possible split of data by partner institutional sector is discussed in paragraph 4.57.) Data may be provided for the balance of payments or IIP as a whole, or for particular components, such as goods, services, direct investment, or portfolio investment. As well as for economic analysis, partner data make bilateral comparisons possible and, hence, assist in identifying data problems. For example, partner data are an essential element of the IMF's Coordinated Portfolio Investment Survey and Coordinated Direct Investment Survey as well as the BIS's international banking statistics.

4.147 Partner data are often prepared for groups of economies or a mix of groupings and major individual partner economies. (Because partner economies are often grouped into regions, the data are sometimes called regional statements.) It is desirable to follow standard lists of economies and regions, such as those of the United Nations or IMF. The partner data published may be aggregated to groups of economies because of confidentiality and to avoid categories with minimal values. In addition to economies and regions, categories for international organizations as counterparties are needed. Partner data are also necessary to consolidate data from member states into data for a currency union. Additional information on partner data is dealt with in paragraphs A3.21-A3.28.

4.148 The basic principle for data by partner economy is based on the economy of residence of the counterparty to the transaction or financial position. The same principles for determining residence, as discussed in Section E of this chapter, are applicable, but they are often more difficult to apply because the information is not known to the resident counterparty. In a number of cases listed in paragraphs 4.149-4.164, the main potential source of information may fall short of the preferred basis. In each case, such divergences should be noted by compilers and their significance assessed to determine whether adjustments are needed. The balance of payments statement as a whole is conceptually balanced because each transaction involves two equal

flows; however, bilateral balance of payments may not balance (even in theory) (see paragraph A3.73).

### a. Agents

4.149 An agent is a party who acts on behalf of or as a representative for another party. Transactions arranged by an agent on behalf of a principal should be attributed to the principal, not to the agent. For example, if an agent issues tickets on behalf of an airline resident in another economy, the transactions and positions related to those tickets are attributed to the airline. However, an agent also may undertake transactions on its own account, including the agency services it provides to the principal.

### b. Goods

4.150 In line with the change of ownership principle, the residence of the seller or purchaser of the good is the preferred concept for identification of the partner. In practice, available data may be based on the economy of origin,<sup>8</sup> consignment, destination, or other criteria that, in some cases, may differ from the economy of the seller or purchaser. In general, the economy of final destination (for the partner to exports) is considered to be more likely to correspond with the party taking ownership of the goods. Similarly, the economy of origin (for the partner to imports) is considered to be more likely to correspond with the party conveying ownership of the goods. However, economy of origin, destination, and consignment can be misleading as to ownership in cases of merchanting and goods processed on a fee basis. In those cases, adjustments should be considered to accord with the change of ownership principle as much as possible.

### c. Freight and insurance

4.151 Freight and insurance beyond the frontiers of the exporter are imputed in international accounts statistics as being payable by the importer, even if payable by the exporter, wholesaler, or other third party. In practice, data may be recorded on other bases, such as the economy of source or destination of the goods carried, or the registration of the ship. In cases in which this occurs, adjustments for the effect of these factors should be made, where possible.

<sup>8</sup>Economy of origin is defined in *International Merchandise Trade Statistics: Concepts and Definitions*, paragraph 139, as where the goods were wholly produced, or where there was "substantial transformation" in cases of production taking place in two or more economies.

#### d. Financial instruments

4.152 Partner data on asset positions are classified to the partner economy according to the residence of the issuer, not other factors such as the place of issue, the residence of a guarantor, or the currency of issue. Similarly, partner data on liability positions are classified according to the residence of the holders. In practice, identification of counterparty for securities positions, income, and transactions is difficult for various reasons, including that (a) the issuer is not always aware of current holders of securities, (b) transactors in securities markets may not be aware of the identity of the counterparty, and (c) security holders may be unaware that income on securities positions may be payable by a financial intermediary that created a "short" or reverse position in the security rather than by the issuer of the security.

4.153 Classification of balance of payments transactions in financial instruments by partner raises some additional issues to those for the IIP, in terms of data availability and user interest. These issues arise when an existing instrument is sold by a holder to another party. Such transactions involve only an exchange of assets, in contrast to the initial issue of a new instrument, which involves the creation of a new liability. This situation applies not only to securities, but also to other instruments that are traded, such as loans, deposits, banknotes, and coin.

4.154 For balance of payments transactions, the partner attribution could be made on the basis of the parties to the transaction (namely, the buyer and the seller, the so-called transactor approach), or for assets owned, the residence of the issuer (the so-called debtor-creditor approach). In these cases, it is acceptable to adopt a convention for partner attribution of assets owned based on the residence of either the counterparty to the transaction or the issuer. On practical grounds, the information available does not always permit identification of the two parties to the transaction. As noted in paragraph 14.24, both the debtor-creditor and transactor bases could be of analytical interest. (See also paragraphs 3.7-3.8.)

#### e. Securities

4.155 The partner attribution of a liability position or issue of a liability is made on the basis of the residence of the issuer. In cases in which a security is issued in a market other than where the issuer is resident, there is a need for particular attention. For example, for debt securities, the security identification number could be based on the economy of issue.

#### f. Direct investment

4.156 For direct investment, there can be chains of voting power, such as when a direct investor in Economy A has a subsidiary in Economy B, which in turn has a subsidiary in Economy C. In this case, for the direct investment in Economy C

- (a) the economy of **immediate** ownership is Economy B; and
- (b) the **ultimate** investing economy is Economy A.

As a basic principle, direct investment transactions and positions by partner economy should be reported according to the immediate host or investing economy, based on the direct relationships between the parties rather than based on the residence of the ultimate partner economies or transactors. The partner allocation is based on the economy of the debtor (for transactions in securities, this is the economy of the issuer) rather than that of the counterpart transactor, if different. However, a resident and a nonresident must engage in a transaction with one another for the transaction to be included in the balance of payments.

4.157 Supplementary data on direct investment positions may be prepared according to ultimate source and host economy (destination). The *OECD Benchmark Definition of Foreign Direct Investment*, fourth edition, provides further information for the identification of ultimate source. When direct investment is channeled through intermediate entities, such as holding companies or SPEs, there may be particular interest in supplementary data, such as the following:

- (a) in original source economies, data on the basis of **the ultimate host economy;**
- (b) in final recipient economies, data on the basis **of the ultimate investing economy Of ultimate controlling parent; and**
- (c) in intermediate economies, data with **pass-through funds** excluded (see paragraph 6.33).

In the case of round tripping, as discussed in paragraph 6.46, the ultimate investing economy and ultimate host economy are the same.

#### g. Stripped securities

4.158 Stripped securities (or strips) may be treated as the liability of the original issuer if there is no new security, or of the party creating the stripped securities if a new security is created (as discussed in paragraph 5.50).



*h. Securities repurchase agreements*

4.159 The treatment of securities under reverse transactions, such as repurchase agreements, is discussed in paragraphs 5.52-5.54. Under that treatment, securities under reverse transactions are regarded as still being owned by the security-providing party, because there is no change of economic ownership.

*i. Nominee accounts and custodians*

4.160 Nominees are a legal device for holding assets for confidentiality or convenience reasons. The assets held in nominee accounts should be attributed to the beneficial owner, not the nominee. However, for issuers of securities, it may be difficult to identify whether nominees hold assets in their own right or as nominees. Furthermore, if the assets are held by a nominee, it is recognized that it may be difficult to identify the beneficial owner.

*j. Depository receipts*

4.161 Depository receipts are securities that represent ownership of securities held by a depository (see paragraph 5.23 for further information). The economy of issue of the underlying securities is different from the economy in which the depository receipts are issued. Depository receipts allow investors to acquire an interest in companies in other economies, while still using the payment and settlement systems and registration procedures of another economy. Depository receipts are treated as being a claim on the issuer of the underlying security, not that of the issuer of the depository receipt.

*k. Gold bullion included in monetary gold*

4.162 Gold bullion that has no counterpart liability is shown as unallocated in position data on assets by counterpart. For partner data on transactions, if a convention based on issuer is adopted, the transaction can be assigned to an unallocated or residual partner economy.

*l. Special drawing rights*

4.163 These instruments are discussed in paragraphs 5.34-5.35. SDRs are based on a cooperative arrangement among the members of the SDR Department and other participants. The membership (SDR Department participants) incurs the asset and liability positions unto itself. Given that claims on and liabilities to members in the SDR system are attributed on a cooperative basis, an unallocated or residual partner category is used as the counterparty to SDR holdings and SDR allocations.

*m. Quasi-corporations*

4.164 When an actual entity is split into separate institutional units (such as for joint administration zones, branches, notional resident units, and multiterritory enterprises, as noted in paragraphs 4.10 and 4.26-4.44), they should be split consistently in partner data for statistics in the economy of the counterparties.

**3. Changes in residence of institutional units***a. Change in residence of individuals*

4.165 Households or their individual members can change their territory of residence. Because all members of a household are residents of the same territory, the movement of an individual may require that the person leave one household and become a member of another household. The change in the residence by an owner of an asset or by someone who has a liability requires a reclassification, because no exchange is made between two parties and, accordingly, no transaction occurs. (The entries are discussed in paragraphs 9.21-9.22.)

*b. Assets moved between entities*

4.166 For what are called "corporate migrations," two situations can occur: one in which assets are moved between entities and another in which the corporation itself changes residence. When a company is said to relocate to another jurisdiction, it usually involves transactions to move assets from a corporation in one economy to a related corporation in a different economy (see paragraphs 8.19-8.22, "corporate inversion and other restructuring"). That is, the ownership of assets is moved, rather than the entity changing residence.

*c. Change in residence of entities other than persons*

4.167 In contrast, in some rare cases, an entity changes its residence (i.e., without moving assets to ownership by another entity). These cases could arise from exchanges of territory between governments. Additionally, corporation or trust law in some cases allows entity emigration or immigration (e.g., it could be permitted within an economic union, but is not generally the case for most jurisdictions). The effects on the IIP would be treated as other changes in volume in the same way as for the change in residence of an individual, recorded in the other changes in financial assets and liabilities account. (These cases are discussed in paragraph 9.23.)

#### 4. Alternatives to the residence concept

4.168 With globalization, an increasing number of entities have connections to two or more economies. Some additional data sets provide alternatives to the residence concept, such as those based on ownership (as in data on the activities of multinational enterprises, as discussed in Appendix 4, and consolidated bank-

ing statistics) and provide additional information, such as on resident workers who send remittances abroad (as discussed in Appendix 5). In consolidated banking statistics, banking groups and their global operations are reported as a single entity (i.e., all the controlled affiliates of an enterprise are allocated to the economy of the head office).

# Classifications of Financial Assets and Liabilities

5.1 This chapter discusses the classifications of financial assets and liabilities used in the international accounts. These classifications are applied to positions, the associated income and financial account transactions, and other changes involving financial assets and liabilities. Classifications are used to group similar components and to separate components with different characteristics. The international accounts functional categories and their relationship to the instruments classification are discussed in Chapter 6.

## A. Definitions of Economic Assets and Liabilities

References:

2008 SNA, Chapter 11, The Financial Account, and Chapter 13, The Balance Sheet.

IMF, *MFSM 2000*, Chapter 4, Classification of Financial Assets.

IMF, *Monetary and Financial Statistics Compilation Guide*, 2008.

IMF, *Financial Soundness Indicators: Compilation Guide*, 2006, Appendix IV, Reconciliation Between the Guide's Methodology and National and Commercial Accounting.

BIS, ECB, and IMF, *Handbook on Securities Statistics* (forthcoming).

### I. Economic assets in general

5.2 *Economic assets are resources over which ownership rights are enforced and from which future economic benefits may flow to the owner.* They include fixed assets, such as equipment and research and development, that are used repeatedly or continuously in production over more than one year. They also include inventories, valuables, nonproduced assets, and financial assets.

5.3 Every economic asset has an owner. *The economic owner of the asset is the party who has the risks*

*and rewards of ownership.* Rewards of ownership usually include the right to use, rent out, or otherwise generate income, or to sell the asset. The risks include the potential losses caused by damage, theft, and holding losses; that management, transfer, or maintenance costs are greater than anticipated; and, in the case of financial assets, default of the counterparty. Ownership may be subject to costs such as maintenance and taxes. Usually, the economic owner is the same as the legal owner, but they may differ in cases such as financial leases. Under some legal arrangements, elements of the risks and rewards are split between different parties, so it is necessary to identify which party has the bulk of risks and rewards to identify the economic ownership. Every economic asset has demonstrable value, functioning as a store of value that reflects the amounts of the economic benefits that its owner can derive by holding it, using it, or providing it temporarily to another entity. It may be tangible or intangible. Different kinds of economic benefits that may be derived from an asset include:

- (a) the ability to use assets, such as buildings or machinery, in production;
- (b) the generation of services, for example, renting out produced assets to another entity;
- (c) the generation of property income (e.g., interest and dividends received by the owners of financial assets); and
- (d) the potential to sell and thus realize holding gains.

In the special case of a short position, a negative asset is identified, as discussed in paragraph 7.28.

5.4 The classification system of economic assets recognized in macroeconomic data sets is shown in Table 5.1. In the international accounts, produced assets are covered in the goods and services account, nonproduced nonfinancial assets in the capital account, and financial assets and liabilities in the financial account

**Table 5.1. Economic Asset Classification***(Includes 2008 SNA codes)*

Asset classes	Examples
AN Nonfinancial assets	
AN 1 Produced assets	
AN 11 Fixed assets	Tangible assets: dwellings; other buildings and structures; machinery and equipment; weapons systems; cultivated biological resources. Intangible assets: research and development; mineral exploration; computer software and databases; entertainment, literary, and artistic originals.
AN 12 Inventories	Materials and supplies, work-in-progress, finished goods, goods for resale.
AN 13 Valuables	Precious metals and stones, antiques, and other art objects.
AN 2 Nonproduced assets	
AN 21 Natural resources	Land and subsoil assets, noncultivated biological resources, water resources, radio spectra.
AN 22 Contracts, leases, and licenses	Marketable operating leases, permissions to use natural resources, permissions to undertake specific activities, entitlement to future goods and services on an exclusive basis.
AN 23 Goodwill and marketing assets	Brand names, mastheads, trademarks.
AF Financial assets	See Table 5.3.

and IIP. This chapter deals with the classification of financial assets and liabilities.

## 2. Financial instruments

**5.5** *Financial instruments consist of the full range of financial contracts made between institutional units.* Financial instruments may give rise to financial claims (as discussed in paragraph 5.6) or not (as discussed in paragraphs 5.10-5.13).

## 3. Claims

**5.6** *A claim is a financial instrument that gives rise to an economic asset that has a counterpart liability.* Claims arise from contractual relationships entered into when one institutional unit promises to provide funds or other resources to another in the future. (Usually, funds or resources are supplied at the beginning of the relationship, but not in the case of futures contracts.) The only financial instrument that does not give rise to a claim is gold bullion that is included in monetary gold. (The term claim is used in a different sense in the context of insurance; see paragraph 5.64(b).)

**5.7** Each claim is a financial asset that has a corresponding liability. The existence of two parties to a claim means that it can arise in a cross-border situation.

Equity is regarded as a claim as it represents a claim of the owner on the residual value of the entity.

**5.8** Nonfinancial assets do not have a corresponding liability. For example, emission rights and commodities may be traded on organized markets similar to those of traded financial assets, but do not have a corresponding liability. In contrast, a financial derivative relating to a commodity price does have a counterpart liability and is a financial asset.

## 4. Financial assets

**5.9** *Financial assets consist of claims and the gold bullion component of monetary gold.* Financial assets consist of equity and investment fund shares, debt instruments, financial derivatives and employee stock options, and monetary gold. Financial assets can be delineated from financial instruments in that:

- some instruments do not give rise to financial assets, as discussed in paragraphs 5.10-5.14. Examples of instruments not recognized as assets are one-off guarantees not yet activated and unrealized commitments such as lines of credit, loan commitments, and letters of credit; and
- when held as monetary gold, gold bullion is a financial asset that is not created by an instru-

ment and that does not represent a claim on another entity. It is considered to be a financial asset because of its role as a means of international payments and store of value for use in reserve assets. (The unallocated gold account component of monetary gold does have a counterpart claim; it is discussed in paragraph 5.74.)

## 5. Other financial instruments not recognized as financial assets

**5.10** *Contingent assets and liabilities are contractual financial arrangements between institutional units that do not give rise to unconditional requirements either to make payments or to provide other objects of value. They are not recognized as financial assets or liabilities prior to the condition(s) being fulfilled. However, by conferring certain rights or obligations that may affect future decisions, they can produce an economic impact on the parties involved. As a result, supplementary information may be provided on significant contingent assets or liabilities. A contingent claim sold to another party is classified under contracts, leases, and licenses; is not included in the IIP; and has no counterpart liability.*

**5.11** Although the value of future payments arising from equity, financial derivatives, index-linked instruments, insurance reserves, and provisions for standardized guarantees is uncertain, they are recognized as financial assets rather than as contingent assets. In these cases, the liability exists, but the amounts payable depend on subsequent events.

**5.12** One-off guarantees of payment by third parties are contingent because payment is required only if the principal debtor defaults. However, provisions for calls under standardized guarantees are not considered to be contingent because of the more predictable expectation of payment under standardized guarantees. (Definitions of standardized and one-off guarantees are given in paragraph 5.68.)

**5.13** Lines of credit, letters of credit, and loan commitments assure that funds will be made available, but no financial asset (i.e., loan) is created until funds are actually advanced. Letters of credit are promises to make payment only when certain documents specified by contract are presented. Note issuance facilities assure that parties will be able to sell short-term securities that they issue and that the financial corporations providing the facility will purchase any notes not sold in the market. Only if the financial corporation providing the facility makes funds available will it acquire

an actual asset, to be recorded in its balance sheet. Uncalled share capital is contingent unless there is an obligation to pay the amount.

**5.14** Sums set aside in business accounting to provide for future liabilities or for future expenditures are not recognized as liabilities. Only actual current liabilities to another party or parties are explicitly included in financial assets and liabilities. When the anticipated liability becomes actual, it is recognized. A future stream of revenue, such as future tax collections or royalties receipts, is not recognized as a financial asset.

## 6. Other issues

**5.15** *Securities are debt and equity instruments that have the characteristic feature of negotiability. That is, their legal ownership is readily capable of being transferred from one unit to another unit by delivery or endorsement. While any financial instrument can potentially be traded, securities are designed to be traded, usually on organized exchanges or "over the counter." (The over-the-counter market involves parties negotiating directly with one another, rather than on a public exchange.) Negotiability is a matter of the legal form of the instrument. Some securities may be legally negotiable, but there is not, in fact, a liquid market where they can be readily bought or sold. Listed financial derivatives, such as warrants, are sometimes considered to be securities.*

**5.16** A discussion of Islamic banking instruments and how they can be treated in terms of the classification of financial assets and liabilities can be found in Appendix 2 of *MFSM 2000*.

## B. Classification of Financial Assets and Liabilities by Type of Instrument

### I. Introduction to classification of particular financial assets and liabilities

**5.17** This *Manual* uses three broad categories of financial assets and liabilities: (1) equity and investment fund shares, (2) debt instruments, and (3) other financial assets and liabilities. The *2008 SNA* and this *Manual* use an additional, more detailed classification of financial assets and liabilities. The classification is based primarily on the legal characteristics that describe the form of the underlying relationship between the parties to an instrument, which are also related to their liquidity and economic purpose. Although financial innovation leads to the emergence of new types of instruments, the clas-

**Table 5.2. Returns on Financial Assets and Liabilities: Financial Instruments and Their Corresponding Type of Income***(Includes 2008 SNA codes)*

Financial Instrument	Type of Income Receivable/Payable on Instrument
Equity and investment fund shares	
AF51 Equity	D42 Distributed income of corporations D43 Reinvested earnings' D41 Interest <sup>2</sup>
AF511+AF512 Listed and unlisted shares	D421 Dividends D43 Reinvested earnings' D41 Interest <sup>2</sup>
AF519 Other equity	D422 Withdrawals from income of quasicorporations D43 Reinvested earnings' D41 Interest <sup>2</sup>
AF52 Investment fund shares/units	D443 Investment income attributable to investment fund shareholders (dividends and reinvested earnings)
Debt instruments	
AF12 Special drawing rights	D41 Interest
AF2 Currency and deposits	D41 Interest
AF3 Debt securities	D41 Interest
AF4 Loans	D41 Interest
AF6 Insurance, pension, and standardized guarantee schemes	D44 Other investment income
AF81 Trade credit and advances	D41 Interest
AF89 Other accounts receivable/payable	D41 Interest
Other financial assets and liabilities	
AF11 Monetary gold <sup>3</sup>	D41 Interest <sup>2</sup>
AF7 Financial derivatives and employee stock options	None

<sup>1</sup> Reinvested earnings—direct investment equity only.<sup>2</sup> By convention, lending fees on equity securities, gold loans, and gold swaps are classified as interest (see paragraph 11.67).<sup>3</sup> Monetary gold consists of gold bullion and unallocated gold accounts. Gold bullion has no counterpart liability. However, the counterpart liability of unallocated gold accounts is in deposits.

sification is intended to provide broad categories that allow for international comparability and the inclusion of new instruments within the existing categories.

5.18 Table 5.2 shows the *SNA* instruments classification and the corresponding type of income they generate. The linking of income with the corresponding assets and liabilities facilitates calculation of rates of return, which are useful for both analysis and data verification. Table 5.3 shows the 2008 *SNA* classification and the corresponding broad categories.

## 2. Equity and investment fund shares

5.19 Equity and investment fund shares have the distinguishing feature that the holders own a residual claim on the assets of the institutional unit that issued the instrument. Equity represents the owners' funds in the institutional unit. In contrast to debt, equity does not generally provide the owner with a right to a predetermined amount or an amount determined according to a fixed formula.

5.20 Investment fund shares have a specialized role in financial intermediation as a kind of collective investment in other assets, so they are identified separately. Additionally, the treatment of portfolio investment income differs, in that reinvested earnings are imputed for investment fund shares (as shown in paragraphs 11.37-11.39).

### a. Equity

**521** *Equity consists of all instruments and records that acknowledge claims on the residual value of a corporation or quasi-corporation, after the claims of all creditors have been met.* Equity is treated as a liability of the issuing institutional unit (a corporation or other unit).

5.22 Ownership of equity in legal entities is usually evidenced by shares, stocks, participations, depository receipts, or similar documents. Shares and stocks have the same meaning. Participating preferred shares are those that provide for participation in the residual value on the dissolution of an incorporated enterprise. Such

**Table 5.3.2008 SNA Financial Instruments Classification (with Corresponding BPM6 Broad Categories)**

(Includes 2008 SNA codes)

2008 SNA Financial Assets and Liabilities Classification	Broad international accounts category (BPM6)
AF11 Monetary gold	
Gold bullion	}Other financial assets
Unallocated gold accounts	} and liabilities
AF12 Special drawing rights	Debt instruments
AF2 Currency and deposits	}Debt instruments
AF21 Currency	
AF221 Interbank positions	
AF229 Other transferable deposits	
AF29 Other deposits	
AF3 Debt securities	Debt instruments
AF4 Loans	Debt instruments
AF5 Equity and investment fund shares	}Equity
AF51 Equity	
AF511 Listed shares	
AF512 Unlisted shares	
AF519 Other equity	
AF52 Investment fund shares/units	
AF521 Money market fund shares/units	
AF522 Other investment fund shares/units	
AF6 Insurance, pension, and standardized guarantee schemes	}Debt instruments
AF61 Nonlife insurance technical reserves	
AF62 Life insurance and annuity entitlements	
AF63 Pension entitlements	
AF64 Claims of pension funds on pension managers	
AF65 Entitlements to nonpension benefits	
AF66 Provisions for calls under standardized guarantees	
AF7 Financial derivatives and employee stock options	}Other financial assets
AF71 Financial derivatives	} and liabilities
AF711 Forward-type contracts	
AF712 Options	
AF72 Employee stock options	
AF8 Other accounts receivable/payable	}Debt instruments
AF81 Trade credit and advances	
AF89 Other accounts receivable/payable	

shares are also equity securities, whether or not the income is fixed or determined according to a formula. (For nonparticipating preferred shares, see paragraph 5.46.) In addition to the purchase of shares, the value of equity can be affected by a range of factors, such as share premiums, accumulated reinvested or retained earnings, or revaluations. In addition, a direct investor may increase its equity in an affiliate by providing goods and services (see paragraph 8.17) or assuming debt (see paragraph 8.45(c)).

**523** *Depository receipts are securities that represent ownership of securities listed in other economies.*

Depository receipts listed on one exchange represent ownership of securities listed on another exchange, and ownership of the depository receipts is treated as if it represents direct ownership of the underlying securities. Depository receipts facilitate transactions in securities in economies other than their home listing. The underlying securities may be equity or debt securities.

5.24 Equity may be split on a supplementary basis into:

- (a) listed shares,
- (b) unlisted shares, and
- (c) other equity.

Both listed and unlisted shares are equity securities (securities are defined in paragraph 5.15). *Listed shares are those listed on an exchange* and may sometimes be referred to as quoted shares. Unlisted shares may sometimes be referred to as private equity<sup>1</sup> (venture capital often takes this form).

5.25 The existence of quoted prices of shares listed on an exchange means that current market prices are usually readily available. In addition to the valuation aspects, listed and unlisted shares tend to be issued by different types of corporations (subsidiaries and smaller businesses) and typically have different regulatory requirements.

**5.26** *Other equity is equity that is not in the form of securities.* It can include equity in quasi-corporations, such as branches, trusts, limited liability and other partnerships, unincorporated funds, and notional units for ownership of real estate and other natural resources. The ownership of many international organizations is not in the form of shares and so is classified as other equity (although equity in the BIS is in the form of unlisted shares). Ownership of currency union central banks is included in other equity (see paragraph A3.44).

5.27 The general principles of valuation given in paragraphs 3.84-3.91 apply to equity. However, because prices may not be observable for unlisted shares and other equity positions, other methods are noted in paragraphs 7.15-7.18.

#### b. Investment fund shares or units

**5.28** *Investment funds are collective investment undertakings through which investors pool funds for investment in financial or nonfinancial assets or both.* These funds issue shares (if a corporate structure is used) or units (if a trust structure is used). Investment funds include money market funds (MMF) and non-MMF investment funds, discussed further in paragraphs 4.73-4.74. Investment fund shares or units refer to the shares issued by mutual funds and unit trusts, rather than the shares they may hold.

**5.29** *MMFs are investment funds that invest only or primarily in short-term money market securities such as treasury bills, certificates of deposit, and commercial paper.* MMF shares and units sometimes are functionally close to transferable deposits, for example,

<sup>1</sup>Private equity refers to the source of equity funds being on private markets; however, private equity may be used to invest in listed shares, including to take over publicly listed companies, and delist them.

accounts with unrestricted check-writing privileges. If MMF shares are included in broad money in the reporting economy, they should be recorded as a separate item to allow reconciliation with monetary statistics. (See also paragraph 4.73 on MMFs as a subsector.)

5.30 Investment funds invest in a range of assets, such as debt securities, equity, commodity-linked investments, real estate, shares in other investment funds, and structured assets. Data on the composition of their assets could be useful in economies in which investment funds are significant.

### 3. Debt instruments

Reference:

IMF and others, *External Debt Statistics: Guide for Compilers and Users*, paragraphs 2.3-2.11.

**5.31** *Debt instruments are those instruments that require the payment of principal and/or interest at some point(s) in the future.* Debt instruments consist of SDRs, currency and deposits, debt securities, loans, insurance technical reserves, pension and related entitlements, provision for calls under standardized guarantees, and other accounts receivable/payable. The term debt instrument is applicable to both the liability and the corresponding claim. Some instruments, such as currency and some deposits, pay no interest. With insurance and pension schemes, the income flow is called investment income attributable to policyholders, rather than interest.

5.32 Debt instruments can be contrasted with equity and investment shares in the nature of the liability and risk. Whereas equity gives a residual claim on the assets of the entity, a debt instrument involves an obligation to pay an amount of principal and/or interest usually according to a predefined formula, which usually means that the creditor has a more limited risk exposure. Provided that the debtor is solvent, debt obligations are largely fixed or linked by a formula to some other variable, such as a market interest rate or the price of a selected item. In contrast, the return on equity is largely dependent on the economic performance of the issuer. Because of the different nature of risk, debt is an important grouping for analysis. Financial derivatives,

interest payments are periodic payments of interest costs. All other payments on debt instruments are principal payments. Further information is available in *External Debt Statistics: Guide for Compilers and Users*, Chapter 2, The Measurement of External Debt: Definition and Core Accounting Principles, and Appendix III, Glossary of External Debt Terms.



both forwards and options, are distinguished from debt instruments because no principal amount is advanced that is required to be repaid, and no interest accrues on any financial derivative instrument. That is, unlike financial derivatives, debt instruments have a principal amount, usually associated with the supply of financial or other resources.

5.33 Because debt instruments involve an obligation to repay principal, short- or long-term classification (according to either original or remaining maturity) is of analytical significance. The maturity splits are explained in paragraphs 5.103-5.105.

#### *a. Special drawing rights*

**534** *SDRs are international reserve assets created by the IMF and allocated to members to supplement existing official reserves.* SDRs are held only by the monetary authorities of IMF members and a limited number of international financial institutions that are authorized holders. SDR holdings represent unconditional rights to obtain foreign exchange or other reserve assets from other IMF members. (For more information, see paragraph 7.83.)

5.35 Holdings of SDRs by an IMF member are recorded as an asset, while the allocation of SDRs is recorded as the incurrence of a liability of the member receiving them (because of a requirement to repay the allocation in certain circumstances, and also because interest accrues). The holdings and allocations should be shown gross, rather than netted.

#### *b. Currency and deposits*

##### **Currency**

**536** *Currency consists of notes and coins that are affixed nominal values and are issued or authorized by central banks or governments.*

5.37 Some countries issue gold coins, which are held for intrinsic value, or commemorative coins, which are held for numismatic value. If not in active circulation, such coins are not classified as financial assets but as goods (except for gold coins that are classified as monetary gold; see paragraph 6.78). Similarly, central bank or central government holdings of unissued or demonetized currency are not financial assets. (Acquisition of unissued currency by a monetary authority from a printer or coin manufacturer is included in goods; see paragraph 10.17(a).)

5.38 Foreign currency in circulation, including as legal tender, is shown as a currency asset of the resident

holder and as a liability of the issuer. Transactions that take place between residents settled in foreign currency in circulation are domestic transactions. Currency as an instrument, as discussed in this section, can be contrasted with the classification of all kinds of instruments as being either domestic currency or foreign currency (as discussed further in paragraphs 3.98-3.103).

##### **Deposits**

**539** *Deposits include all claims that are (a) on the central bank, deposit-taking corporations other than the central bank, and, in some cases, other institutional units; and (b) represented by evidence of deposit.* A deposit is usually a standard contract, open to the public at large, that allows the placement of a variable amount of money. The nominal value of deposits is usually fixed in terms of the currency in which the deposits are denominated. In some cases, deposits may have their value expressed in terms of an index or linked to a commodity price, for example, gold, oil, or share prices. Unallocated accounts for precious metals are also deposits, except for unallocated gold accounts held by monetary authorities for reserves purposes, for which the asset holding is included in monetary gold (with the counterpart liability being recorded as a deposit—see paragraph 5.77).

5.40 Deposits are distinguished from loans on the basis of the representation in the documents that evidence them. There may be cases in which the distinction is unclear, because the parties are uncertain or take different views. When one party is a deposit-taking corporation and the other is not, a possible convention is that an asset position of a deposit-taking corporation is classified as a loan by both parties. Similarly, a liability of a deposit-taking corporation to another type of entity is classified as a deposit by both parties. Classification of interbank positions as deposits is discussed in paragraph 5.42.

##### **Transferable deposits**

**541** *Transferable deposits consist of all deposits that are (a) exchangeable for banknotes and coins on demand at par and without penalty or restriction and (b) directly usable for making payments by check, draft, giro order, direct debit or credit, or other direct payment facility.* Some types of deposit accounts embody only limited features of transferability. For example, some deposits have restrictions such as on the number of third-party payments that can be made per period or on the minimum size of the individual third-party payments. An overdraft arising from the overdraft facility of a transferable deposit account is classified as a loan.

***Interbank positions***

5.42 Interbank positions can be shown as a separate component of deposits. In some cases, the instrument classification of interbank positions may be unclear, for example, because the parties are uncertain or one party considers it as a loan and the other a deposit. Therefore, as a convention to ensure symmetry, all interbank positions other than securities and accounts receivable/payable are classified under deposits.

***Other deposits***

**5.43** *Other deposits consist of all claims, other than transferable deposits, that are represented by evidence of deposit.* Other deposits include savings and fixed-term deposits, and nonnegotiable certificates of deposit. (Negotiable certificates are classified as debt securities.) Restricted deposits, defined as those for which withdrawals are restricted on the basis of legal, regulatory, or commercial requirements, are included in other deposits, as well as shares or similar evidence of deposit issued by savings and loan associations, building societies, credit unions, and the like. Liabilities under securities repurchase agreements that are included in national measures of broad money are also other deposits (while liabilities under other repurchase agreements are included in loans). Reserve position in the IMF (see paragraph 6.85) is included in other deposits.

**c. Debt securities**

**5.44** *Debt securities are negotiable instruments serving as evidence of a debt.* They include bills, bonds, notes, negotiable certificates of deposit, commercial paper, debentures, asset-backed securities, money market instruments, and similar instruments normally traded in the financial markets. Bills are defined as securities that give the holders the unconditional rights to receive stated fixed sums on a specified date. Bills are generally issued at discounts to face value that depend on the rate of interest and the time to maturity and are usually traded in organized markets. Examples of short-term securities are treasury bills, negotiable certificates of deposit, bankers' acceptances, promissory notes, and commercial paper. Debt securities give the holders the unconditional right to fixed or contractually determined variable payments (i.e., earning of interest is not dependent on earnings of the debtors. Depository receipts whose underlying securities are debt securities are debt securities (see paragraph 5.23).

***Possible reclassification of traded loans as securities***

5.45 Loans that have become negotiable from one holder to another are to be reclassified from loans to debt securities under certain circumstances. For such reclassification, there needs to be evidence of secondary market trading, including the existence of market makers, and frequent quotations of the instrument, such as provided by bid-offer spreads.

***Nonparticipating preferred stocks and convertible bonds***

5.46 Nonparticipating preferred stocks or shares are those that pay a fixed income but do not provide for participation in the distribution of the residual value of an incorporated enterprise on dissolution. These shares are classified as debt securities. (See also paragraph 5.22 concerning participating preferred shares.) Bonds that are convertible into equity should be classified as debt securities prior to the time that they are converted.

***Asset-backed securities***

5.47 Asset-backed securities, collateralized debt obligations, and collateralized mortgage obligations are arrangements under which payments of interest and principal are backed by payments on specified assets or income streams. They are backed by mortgages, home equity loans, student loans, and other debts as well as pools of leased property. Securitization of these assets provides liquidity in assets that are otherwise not so liquid.<sup>3</sup> Asset-backed securities may be issued by a specific holding unit or vehicle, which issues securities that are sold to raise funds to pay the originator for the underlying assets. Asset-backed securities are classified as debt securities because the security issuers have a requirement to make payments, while the holders do not have a residual claim on the underlying assets; if they did, the instrument would be equity or investment funds shares. Asset-backed securities are backed by various types of financial assets (e.g., mortgages and credit card loans), nonfinancial assets, or future income streams—such as the earnings of a musician or a government's future revenue—that are not recognized as economic assets in macroeconomic statistics.

<sup>3</sup>Another term used is "structured finance." This refers to the repackaging of existing financial assets—securities, loans, or other assets—into new instruments that are structured to meet the liquidity, creditworthiness, and return preferences of particular investors. These arrangements may incorporate financial derivatives.

**Bankers' acceptances**

**5.48** Bankers' acceptances involve the acceptance by a financial corporation, in return for a fee, of a draft or bill of exchange and the unconditional promise to pay a specific amount at a specified date. Much international trade is financed this way. Bankers' acceptances are classified under the category of debt securities. Bankers' acceptances represent unconditional claims on the part of the holder and an unconditional liability on the part of the accepting financial corporation; the financial corporation's counterpart asset is a claim on its customer. Bankers' acceptances are treated as financial assets from the time of acceptance, even though funds may not be exchanged until a later stage.

**Index-linked securities**

**5.49** Index-linked securities are those for which the principal or coupons or both are linked to another item, such as a price index or the price of a commodity. These securities are classified as variable-rate instruments (see paragraph 5.113). Issues for the measurement of revaluations and interest are discussed in paragraphs 9.34 and 11.59-11.65, respectively.

**Stripped securities**

**5.50** Stripped securities are securities that have been transformed from a principal amount with coupon payments into a series of zero-coupon bonds, with a range of maturities matching the coupon payment date(s) and the redemption date of the principal amount(s). They are also called strips. The function of stripping is that investor preferences for particular cash flows can be met in ways that are different from the mix of cash flows of the original security. Stripped securities may have a different issuer from the original issuer—in which case new liabilities are created. Following are the two cases of stripped securities:

- When a third party acquires the original securities and uses them to back the issue of the stripped securities. Then new funds have been raised and a new financial instrument is created.
- When no new funds are raised and the payments on the original securities are stripped and separately marketed by the issuer or through agents (such as strip dealers) acting with the issuer's consent.

(Paragraph 11.58 discusses how interest on stripped securities is calculated on an accrual basis.)

**d. Loans**

**5.51** Loans are financial assets that (a) are created when a creditor lends funds directly to a debtor, and (b) are evidenced by documents that are not negotiable.<sup>4</sup> This category includes all loans, including those under overdraft facilities, except accounts receivable/payable, which are treated as a separate category of financial assets. Loans that have become debt securities (as noted in paragraph 5.45) are also excluded from loans. This category includes installment loans, hire-purchase credit, and loans to finance trade credit. Claims on or liabilities to the IMF (including use of IMF credit) that are in the form of loans are also included in this category (see also paragraph 6.85 on the treatment of loans provided to the IMF General Resources Account; and Annex 7.1 on loans and credit from the IMF). An overdraft arising from the overdraft facility of a transferable deposit account is classified as a loan. However, undrawn lines of credit are not recognized as a liability. The distinction between loans and deposits is discussed under deposits in paragraph 5.40.

**Securities repurchase agreements and gold swaps**

Reference:

**BIS**, *Securities Lending Transactions: Market Development and Implications*, CPSS Publications No. 32, July 1999.

**5.52** A securities repurchase agreement is an arrangement involving the provision of securities in exchange for cash with a commitment to repurchase the same or similar securities at a fixed price. The commitment to repurchase may be either on a specified future date (often one or a few days hence, but also further in the future) or an "open" maturity. Repos, securities lending with cash collateral, and sale-buybacks are different terms for arrangements with the same economic effect as a securities repurchase agreement—all involve the provision of securities as collateral for a loan or deposit. A repo is used as a term from the perspective of the security provider, while a reverse repo is used from the perspective of the security taker. Securities repurchase agreements are a subset of reverse transactions (as discussed in paragraphs 7.58-7.61).

**5.53** The supply and receipt of funds under a securities repurchase agreement is treated as a loan or deposit. It is generally a loan, but it is classified as a deposit if it

<sup>4</sup>Negotiability is defined in paragraph 5.15. Loans may be traded, but their legal form is not designed for negotiability in the same way as debt securities.

involves liabilities of a deposit-taking corporation and is included in national measures of broad money. If a securities repurchase agreement does not involve the supply of cash (i.e., there is an exchange of one security for another, or one party supplies a security without collateral), there is no loan or deposit. Margin calls in cash under a repo are also classified as loans.

5.54 The securities provided as collateral under securities lending, including a securities repurchase agreement, are treated as not having changed economic ownership, as discussed in paragraph 7.58. This treatment is adopted because the cash receiver is still subject to the risks or rewards of any change in the price of the security. (The same treatment is adopted for repurchase agreements without cash collateral, in which case there is no transaction in the securities and no loan.)

**555** *A gold swap involves an exchange of gold for foreign exchange deposits with an agreement that the transaction be reversed at an agreed future date at an agreed gold price.* The gold taker (cash provider) usually will not record the gold on its balance sheet, while the gold provider (cash taker) usually will not remove the gold from its balance sheet. In this manner, the transaction is analogous to a repurchase agreement and should be recorded as a collateralized loan or deposit. Gold swaps are similar to securities repurchase agreements except that the collateral is gold.<sup>5</sup>

### **Financial leases**

References:

2008 SNA, Chapter 17, Cross-Cutting and Other Special Issues, Part 5, Contracts, leases and licences.

International Accounting Standards Board, *International Financial Reporting Standards*, International Accounting Standard 17, Leases.

**556** *A financial lease is a contract under which the lessor as legal owner of an asset conveys substantially all the risks and rewards of ownership of the asset to the lessee.* In other words, the lessee becomes the economic owner of the asset. Under a financial lease, the lessor is shown as making a loan to the lessee with which the lessee acquires the asset. Thereafter the leased asset is shown on the balance sheet of the lessee and not of the lessor; the corresponding loan is shown as an asset of the lessor and a liability of the lessee.

<sup>5</sup>Gold swaps should not be confused with a swap giving rise to a financial derivative. The two types of arrangements have different risk transfer implications; under a gold swap, the economic ownership of the gold does not change hands (see paragraph 5.91).

5.57 Examples of situations that would normally lead to a lease being classified as a financial lease include that:

- (a) the lease transfers legal ownership to the lessee at the end of the lease term; or
- (b) the lease has the option for the lessee to acquire legal ownership at the end of the lease term at a price that is sufficiently low that the exercise of the option is reasonably certain; or
- (c) the lease term is for the major part of the economic life of the asset; or
- (d) at inception, the present value of the lease payments amount to substantially all of the value of the asset; or
- (e) if the lessee can cancel the lease, the lessor's losses are borne by the lessee; or
- (f) gains or losses in the residual value of the residual asset accrue to the lessee; or
- (g) the lessee has the ability to continue the lease for a secondary period for a payment substantially lower than market value.

These examples may not be conclusive that substantially all of the risks have been conveyed; for example, if the asset is conveyed to the lessee at the end of the lease at its fair value at that time, then the lessor holds substantial risks of ownership. Financial leases are also called finance leases or capital leases, highlighting that the motivation is to finance acquisition of the asset. Accounting practices generally recognize financial leases in the same manner as this definition. In addition to financial leases recognized in business accounts, a treatment akin to financial leases is adopted for some public-private partnerships<sup>6</sup> (see 2008 SNA, Chapter 22, The General Government and Public Sectors).

5.58 The treatment of financial leases is designed to move away from the legal arrangements to capture the economic reality of such arrangements, by treating assets under a financial lease as if they were purchased and owned by the user. For example, if a bank leases an aircraft to an aviation company, at the time the company is deemed to take economic ownership of the aircraft, it is shown as an asset in the balance sheet of

<sup>6</sup>For example, a build, own, operate, transfer scheme could be found to assign the risks and rewards of ownership to the government, so the private partner would be treated as a provider of a financial lease.

the aviation company, while the loan is recorded as a liability. That is, the IIP will show a loan between the aviation company and the bank.

5.59 The debt liability at the inception of the lease is defined as the value of the asset and is financed by a loan of the same value, a liability of the lessee. The loan is repaid through payments during the contract (which consist of interest, principal, and, if a financial intermediary is involved, FISIM (financial intermediation services indirectly measured) elements) and any residual payment at the end of the contract (or alternatively, by the return of the good to the lessor). Appendix 6b provides references to where financial leases are discussed in various parts of this *Manual*.

5.60 Financial leases may be distinguished from other kinds of leases identified in macroeconomic statistics because substantially all the risks and rewards of ownership are transferred from the legal owner of the good (the lessor) to the user of the good (the lessee). Other kinds of leases are as follows:

- (a) Operating leases. An operating lease is one in which the legal owner of a produced asset is also the economic owner and has the operating risks and rewards from ownership of the asset. One indicator of an operating lease is that it is the responsibility of the legal owner to provide any necessary repair and maintenance of the asset. Under an operating lease, the asset remains on the balance sheet of the lessor. Operating leases give rise to services, as discussed in more detail in paragraphs 10.153-10.157.
- (b) Resource leases. A resource lease is an agreement whereby the legal owner of a natural resource that has an infinite life makes it available to a lessee in return for a regular payment, which is recorded as rent. The resource continues to be recorded on the balance sheet of the lessor even though it is used by the lessee. Other arrangements involving natural resources may amount to an outright sale of a natural resource to the lessee (such as spectrum licenses for a long period; see paragraph 13.9). Some leases of natural resources, such as mining licenses held by nonresidents lead to the imputation of a notional resident unit (see paragraphs 4.34-4.40), so that the lease is between residents, and the international transactions associated with the lease are recorded as being for direct investment equity in the notional unit.

- (c) Contracts, leases, and licenses. A transferable lease other than a financial lease that meets the definition of an economic asset is shown in the capital account as a nonproduced nonfinancial asset, as discussed in paragraphs 13.11-13.15.

#### ***Financial or finite risk reinsurance***

5.61 *Financial or finite risk reinsurance is defined as a kind of insurance policy that involves no or very limited transfer of risk.* Depending on how much risk is transferred, it could be classified as a loan or an insurance policy. For example, an insurance company may have a finite risk reinsurance policy that allows it to borrow funds in the event of incurring large values of claims. Because those amounts are repayable, however, the policy has a financing function and amounts drawn under the policy are classified as a loan. In contrast, if the amounts under the policy are not repayable, then risk is transferred to the reinsurer, so it has a risk pooling function and is a part of insurance.

#### ***e. Insurance, pension, and standardized guarantee schemes***

5.62 *Insurance, pension, and standardized guarantee schemes consist of the following:*

- (a) *nonlife insurance technical reserves;*
- (b) *life insurance and annuity entitlements;*
- (c) *pension entitlements, claims of pension funds on pension managers, and entitlements to nonpension funds; and*
- (d) *provisions for calls under standardized guarantees.*

5.63 These reserves, entitlements, and provisions represent liabilities of the insurer, pension fund, or issuer of standardized guarantees, and a corresponding asset of the policyholders or beneficiaries. The aggregate values of liabilities can be estimated actuarially because the company or fund has a pool of liabilities, but the value is less clear for the asset holders. The insurers, pension funds, and guarantors usually hold a range of assets to allow them to meet their obligations; however, these are not necessarily equal to the provision and entitlement liabilities.

#### ***Nonlife insurance technical reserves***

5.64 Nonlife insurance technical reserves consist of the following:

- (a) Reserves for unearned insurance premiums, which are prepayment of premiums. Premiums are usually paid at the beginning of the period covered by the policy. On an accrual basis, the premiums are earned through the policy period, so that the initial payment involves a prepayment or advance. It also includes reserves for unexpired risks.
- (b) Reserves against outstanding insurance claims, which are amounts identified by insurance corporations to cover what they expect to pay out arising from events that have occurred but for which the claims are not yet settled. Other reserves, such as equalization reserves, may be identified by insurers. However, these are recognized as liabilities and corresponding assets only when there is an event that gives rise to a liability. Otherwise, equalization reserves are internal accounting entries by the insurer that represent saving to cover irregularly occurring catastrophes, and thus do not represent any existing corresponding claims for policyholders.

Both nonlife direct insurance and reinsurance are included in this item. Insurance and its terminology are explained in more detail in Appendix 6c.

#### *Life insurance and annuity entitlements*

Reference:

2008 SNA, Chapter 17, Cross-Cutting and Other Special Issues, Part 1, The treatment of insurance.

5.65 This category consists of reserves of life insurance companies and annuity providers for prepaid premiums and accrued liabilities to life insurance policyholders and beneficiaries of annuities. Life insurance and annuity entitlements are used to provide benefits to policyholders upon the expiry of the policy, or to compensate beneficiaries upon the death of policyholders, and thus are kept separate from shareholders' funds. These entitlements are regarded as liabilities of the insurance companies and assets of the policyholders and beneficiaries. Annuities entitlements are the actuarial calculation of the present value of the obligations to pay future income until the death of the beneficiaries.

#### *Pension entitlements*

Reference:

2008 SNA, Chapter 17, Cross-Cutting and Other Special Issues, Part 2, Social insurance schemes.

5.66 Pension entitlements show the extent of financial claims both existing and future pensioners hold against either their employer or a fund designated by the employer to pay pensions earned as part of a compensation agreement between the employer and employee. The economy of residence of pension schemes may differ from that of some of their beneficiaries, in particular, for border workers, guest workers who return home, people who retire to a different economy, staff of international organizations, and employees of transnational enterprise groups that have a single pension fund for the whole group. In addition to liabilities of pension funds, liabilities of unfunded pension schemes are included in this category. There are assumptions and different methods in the measurement of pension fund entitlements, so the nature of coverage and estimation should be stated in metadata. As well as pensions, some schemes may have other related liabilities, such as for health benefits, which are included under entitlements to nonpension benefits. In addition to its pension entitlement liabilities to its beneficiaries, a pension fund may sometimes have a claim on the employer, other sponsor, or some other party such as an administrator of the scheme. On the other hand, the sponsor or some other party may have a claim on a surplus of the fund. Such claims are shown under claims of pension funds on pension managers.

5.67 Potential payments by social security schemes may not be recognized as financial assets or liabilities. However, if a social security fund also acts as a pension scheme (as is sometimes the case for benefits for present and former government employees), those pension obligations are included under this category, but not the pension fund's social security obligations.

#### *Provisions for calls under standardized guarantees*

Reference:

2008 SNA, Chapter 17, Cross-Cutting and Other Special Issues, Part 3, The treatment of loan guarantees in the SNA.

5.68 *Standardized guarantees are defined as those that are not provided by means of a financial derivative (such as credit default swaps), but for which the probability of default can be well established.* These guarantees cover similar types of credit risk for a large number of cases. Examples include guarantees issued by governments on export credit or student loans. Generally it is not possible to estimate precisely the risk of any one loan being in default, but it is possible to make a reliable estimate of how many out of a large number

of such loans will default. It is therefore possible for a guarantor to determine suitable fees to charge for a guarantee working on the same sort of principle as an insurance corporation for which the fees received in respect of many policies cover the losses by a few. Standardized guarantees can be contrasted with two other types of guarantees:

- (a) Guarantees that are financial derivatives (as defined in paragraph 5.80). Guarantees that meet the definition of financial derivatives protect, on a guarantee-by-guarantee basis, the lender against certain types of risk arising from a credit relationship by paying the guarantor a fee for a specified period. The guarantees covered are such that experience in the market allows the guarantor to apply standard master legal agreements or to make a reasonable estimate of the likelihood of the borrower defaulting and to calculate suitable terms for the financial derivative. Credit default swaps are included in financial derivatives as options.
- (b) One-off guarantees. *One-off guarantees occur in situations in which the conditions of the loan or of the security that is guaranteed are so particular that it is not possible for the degree of risk associated with it to be calculated with any degree of precision.* These guarantees are not recognized as economic assets until their activation, that is, when the event occurs that makes the guarantor responsible for the liability. These are contingent assets until activated (see paragraph 5.12). (See paragraphs 8.42-8.45 on flows associated with their activation.) However, one-off guarantees granted by governments to corporations in financial distress and that have a very high likelihood of being called are treated as if they were activated at inception (see paragraph 13.34).

i. *Other accounts receivable/payable*

**5.69** *Other accounts receivable/payable consist of (a) trade credit and advances and (b) other.*

**Trade credit and advances**

**5.70** *Trade credit and advances consist of (a) credit extended directly by the suppliers of goods and services to their customers and (b) advances for work that is in*

<sup>8</sup>Trade credit is sometimes described as supplier credit or supplier's credit.

*progress (or is yet to be undertaken) and prepayment by customers for goods and services not yet provided.*

5.71 Trade credit and advances arise when payment for goods or services (other than FISIM and prepayment of insurance services)<sup>8</sup> is not made at the same time as the change in ownership of a good or provision of a service. If a payment is made before the change of ownership, there is an advance. For example, down payments or holding deposits (where ownership of the funds changes hands) are included in trade advances. Changes of ownership for high-value capital goods may give rise to trade credit and advances, only if there is a difference in timing between the change of ownership and progress payments (see paragraphs 3.44 and 10.28). If goods or services under barter arrangements do not change ownership at the same time as the corresponding goods or services, an entry is made for trade credit and advances.

5.72 Trade credit and advances do not include loans to finance trade made by an institutional unit other than the supplier of the good or service, as they are included under loans.<sup>9</sup> Trade bills drawn on an importer and provided to an exporter, which are subsequently discounted by the exporter with a financial institution, might be regarded by the importer as the direct extension of credit by the exporter, but once they are discounted they become a claim by a third party on the importer. In cases in which an instrument is provided to the exporter with such characteristics that it is a negotiable instrument, it should be classified as a security. A supplier may also sell trade claims other than trade bills to a factoring company, in which the claim is reclassified from trade credit to accounts receivable/payable.

**Other accounts receivable/payable—other**

5.73 The other category of other accounts receivable/payable includes accounts receivable or payable other than those included in trade credit and advances or other instruments. It includes liabilities for taxes, purchase and sale of securities, securities lending fees, gold loan fees, wages and salaries, dividends, and social contributions that have accrued but not yet paid. It also

<sup>8</sup>FISIM accrued but not yet paid is included with the relevant debt instrument, like interest (see paragraph 7.41). Prepayment of insurance premiums is included in insurance technical reserves (see paragraph 5.64).

<sup>9</sup>Trade-related credit is identified as a concept in *External Debt Statistics: Guide for Compilers and Users*, Chapter 6, Further External Debt Accounting Principles. It consists of trade credit as well as trade bills and credit provided by third parties to finance trade. It should be compiled as a supplementary item, where significant.

includes prepayments of those items. Interest accrued should be recorded with the financial asset or liability on which it accrues, not as other accounts receivable/payable. However, for securities lending and gold loan fees, which are treated as interest by convention (see paragraphs 11.67-11.68), the corresponding entries are included under other accounts receivable/payable, rather than with the instrument to which they relate.

#### 4. Other financial assets and liabilities

##### a. Monetary gold

**5.74** *Monetary gold is gold to which the monetary authorities (or others who are subject to the effective control of the monetary authorities) have title and is held as reserve assets.* Gold includes gold bullion and unallocated gold accounts with nonresidents that give title to claim the delivery of gold. *Gold bullion takes the form of coins, ingots, or bars with a purity of at least 995 parts per 1,000, including such gold held in allocated gold accounts.*

5.75 All monetary gold is included in reserve assets or is held by international financial organizations. Monetary authorities and reserve assets are discussed further in Chapter 6, Functional Categories, Section F. Gold bullion included in monetary gold is a financial asset for which there is no corresponding liability. Gold bullion not held as reserve assets is not a financial asset and is included in nonmonetary gold, within the goods and services account, see paragraphs 10.50-10.54. In some cases, a central bank may own gold bullion that is not held as reserves (such as sometimes occurs when it acts as a monopoly reseller of mined gold).

##### **Gold accounts**

###### *Allocated gold accounts*

**5.76** *Allocated gold accounts provide ownership of a specific piece of gold.* The ownership of the gold remains with the entity placing it for safe custody. These accounts typically offer the purchasing, storing, and selling of investment-grade bars and coin to order. Accounts of this type constitute full outright ownership of the gold. When held as reserve assets, allocated gold accounts are classified as monetary gold. When not held as reserve assets, allocated gold accounts are treated as representing ownership of a good.

###### *Unallocated gold accounts*

5.77 In contrast, *unallocated gold accounts represent a claim against the account operator to deliver*

*gold.* For these accounts, the account provider holds title to a reserve base of physical (allocated) gold and issues claims to account holders denominated in gold. When held as reserve assets, unallocated gold accounts are classified as monetary gold. Unallocated gold account assets not held as reserve assets, and all unallocated gold account liabilities, are classified as deposits. Gold accounts can be distinguished from accounts that are linked (indexed) to gold but do not give title to claims for the delivery of gold; such accounts are not part of monetary gold. They are classified according to their nature as a financial instrument, usually as deposits.

##### **Relationship to nonmonetary gold**

5.78 In contrast to monetary gold, which is a financial asset, nonmonetary physical gold is a good. (Paragraphs 10.50-10.54 deal with nonmonetary gold in the goods and services account.) Similarly, other precious metals are goods, not financial assets. Monetary gold is treated differently because of its role as a means of international payments and store of value for use in reserve assets. Changes in the classification between monetary and nonmonetary gold are shown in the other changes in assets and liabilities account, as discussed in paragraphs 9.18-9.20.

##### b. Financial derivatives and employee stock options

5.79 Financial derivatives and employee stock options are financial assets and liabilities that have similar features, such as a strike price and some of the same risk elements. However, although both transfer risk, employee stock options are also designed to be a form of remuneration.

##### **Financial derivatives**

**5.80** *A financial derivative contract is a financial instrument that is linked to another specific financial instrument or indicator or commodity and through which specific financial risks (such as interest rate risk, foreign exchange risk, equity and commodity price risks, credit risk, and so on) can be traded in their own right in financial markets.* Transactions and positions in financial derivatives are treated separately from the values of any underlying items to which they are linked.

5.81 The risk embodied in a financial derivative contract can be traded either by trading the contract



itself, as is possible with options, or by creating a new contract embodying risk characteristics that match, in a countervailing manner, those of the existing contract. The latter practice, which is termed offsetability, occurs in forward markets. Offsetability means that it is often possible to eliminate the risk associated with a derivative by creating a new but "reverse" contract having characteristics that countervail the risk underlying the first derivative. Buying the new derivative is the functional equivalent of selling the first derivative because the result is the elimination of the underlying financial risk. The ability to countervail the underlying risk in the market is therefore considered the equivalent of tradability in demonstrating value. The outlay that would be required to replace the existing derivative contract represents its value; actual offsetting is not required.

5.82 In many cases, derivatives contracts are settled by payments of net amounts in cash, rather than by the delivery of the underlying items. Once a financial derivative reaches its settlement date, any unpaid overdue amount is reclassified as accounts receivable/payable, as its value is fixed, and thus the nature of the claim becomes debt.

5.83 The following types of financial arrangements are not financial derivatives:

- (a) A fixed-price contract for goods and services is not a financial derivative unless the contract is standardized so that the market risk therein can be traded in financial markets in its own right. For example, an option to purchase an aircraft from the manufacturer is not classified as a financial derivative; if the option to purchase is transferable, and is in fact transferred, the transaction is recorded under contracts, leases, and licenses, discussed in paragraphs 13.11-13.12.
- (b) Insurance and standardized guarantees are not financial derivatives. Insurance involves the collection of funds from policyholders to meet future claims arising from the occurrence of events specified in insurance policies. That is, insurance and standardized guarantees are used to manage event risk primarily by the pooling, not the trading, of risk. However, some guarantees other than standardized guarantees meet the definition of financial derivatives (as covered in paragraph 5.68).
- (c) Contingent assets and liabilities, such as one-off guarantees and letters of credit, are not financial assets (as discussed in paragraphs 5.10-5.13).

(d) Instruments with embedded derivatives are not financial derivatives. *An embedded derivative arises when a derivative feature is inserted in a standard financial instrument and is inseparable from the instrument.* If a primary instrument, such as a security or loan, contains an embedded derivative, the instrument is valued and classified according to its primary characteristics—even though the value of that security or loan may well differ from the values of comparable securities and loans because of the embedded derivative.<sup>10</sup> Examples are bonds that are convertible into shares, and securities with options for repayment of principal in currencies that differ from those in which the securities were issued. However, detachable warrants are treated as separate financial derivatives, because they can be detached and sold in financial markets.

(e) Timing delays that arise in the normal course of business and may entail exposure to price movements do not give rise to financial derivatives. Timing delays include normal settlement periods for spot transactions in financial markets.

5.84 There are two broad types of financial derivatives—options and forward-type contracts.

#### *Options*

5.85 *In an option contract (option), the purchaser acquires from the seller a right to buy or sell (depending on whether the option is a call (buy) or a put (sell)) a specified underlying item at a strike price on or before a specified date.* The purchaser of an option pays a premium to the writer of the option. In return, the buyer acquires the right but not the obligation to buy (call option) or sell (put option) a specified underlying item (real or financial) at an agreed-on contract price (the strike price) on or before a specified date. (On a derivatives exchange, the exchange itself may act as the counterparty to each contract.)

5.86 Options can be contrasted with forward-type contracts in that:

- (a) at inception, there is usually no up-front payment for a forward-type contract and the derivative contract begins with zero value, whereas there is

<sup>10</sup>If the owner of the primary instrument subsequently creates a new but reverse financial derivative contract to offset the risk of the embedded derivative, the creation of this new financial derivative contract is recorded as a separate transaction, and it does not affect the recording of transactions and positions in the primary instrument.

usually a premium paid for an option representing a nonzero value for the contract;

- (b) during the life of the contract, for a forward-type contract, either party can be creditor or debtor, and it may change, whereas for an option, the buyer is always the creditor and the writer is always the debtor; and
- (c) at maturity, redemption is unconditional for a forward-type contract, whereas for an option it is determined by the buyer of the option.

5.87 Warrants are a form of financial derivative option giving the owner the right but not the obligation to purchase from the issuer of the warrant a fixed amount of an underlying asset, such as equities and bonds, at an agreed contract price for a specified period of time or on a specified date. Although similar to other traded options, a distinguishing factor is that the exercise of the warrants can create new securities, thus diluting the capital of existing bond or shareholders, whereas traded options typically grant rights over assets that are already available.

#### *Forward-type contracts*

**5.88 A** *forward-type contract (forward) is an unconditional contract by which two counterparties agree to exchange a specified quantity of an underlying item (real or financial) at an agreed-on contract price (the strike price) on a specified date.* Forward-type contracts include futures and swaps (other than as discussed in paragraph 5.91). Forward-type contract is used as a term because the term "forward" is often used more narrowly in financial markets (often excluding swaps).

5.89 Futures are forward-type contracts traded on organized exchanges. The exchange facilitates trading by determining the standardized terms and conditions of the contract, acting as the counterparty to all trades, and requiring margin to be deposited and paid to mitigate against risk. Forward rate agreements and forward foreign exchange contracts are common types of forward-type contracts.

5.90 At the inception of a forward-type contract, risk exposures of equal market value are exchanged, so a contract typically has zero value at that time. As the price of the underlying item changes, the market value will change, although it may be restored to zero by periodic settlement during the life of the forward. The classification of a forward-type contract may change between asset and liability positions.

Other issues associated with financial derivatives

#### *Swap contracts*

**5.91 A** *swap contract involves the counterparties exchanging, in accordance with prearranged terms, cashflows based on the reference prices of the underlying items.* Swap contracts classified as forward-type contracts include currency swaps, interest rate swaps, and cross-currency interest rate swaps. Under a swap contract, the obligations of each party may arise at different times, for example, an interest rate swap for which payments are quarterly for one party and annual for the other. In such cases, the quarterly amounts payable by one party prior to payment of the annual amount payable by the other party are recorded as transactions in the financial derivative contract. Other types of arrangements also called swaps but not meeting the definition above include gold swaps (see paragraphs 5.55 and 7.58 for a discussion of their treatment), central bank swap arrangements (see paragraphs 6.102-6.104), and credit default swaps (see paragraph 5.93).

5.92 For foreign currency financial derivative swap contracts, such as currency swaps, it is necessary to distinguish between a transaction in a financial derivative contract and transactions in the underlying currencies. At inception, the parties exchange the underlying financial instruments (usually classified under other investment). At the time of settlement, the difference in the values, as measured in the unit of account at the prevailing exchange rate, of the currencies swapped are allocated to a transaction in a financial derivative, with the values swapped recorded in the relevant other item (usually other investment).

#### *Credit derivatives*

**5.93** *Credit derivatives are financial derivatives whose primary purpose is to trade credit risk.* They are designed for trading in loan and security default risk. In contrast, the financial derivatives described in the previous paragraphs are mainly related to market risk, which pertains to changes in the market prices of securities, commodities, interest, and exchange rates. Credit derivatives take the form of both forward-type (total return swaps) and option-type contracts (credit default swaps). Under a credit default swap, premiums are paid in return for a cash payment in the event of a default by the debtor of the underlying instrument. Like other financial derivatives, credit derivatives are frequently drawn up under standard master legal agree-

ments and involve collateral and margining procedures, which allow for a means to make a market valuation.

#### *Margins*

**5.94** *Margins are payments of cash or deposits of collateral that cover actual or potential obligations incurred.* The required provision of margin reflects market concern over counterparty risk and is standard in financial derivative markets, especially futures and exchange-traded options. The classification of margins depends on whether they are repayable or nonrepayable:

- (a) Repayable margin consists of cash or other collateral deposited to protect a counterparty against default risk. Ownership of the margin remains with the unit that deposited it. Repayable margin payments in cash are classified as deposits (if the debtor's liabilities are included in broad money) or in other accounts receivable/payable. When a repayable margin deposit is made in a noncash asset (such as securities), no transaction is recorded because no change in economic ownership has occurred.
- (b) Nonrepayable margin payments reduce the financial liability created through a derivative. In organized exchanges, nonrepayable margin (sometimes known as variation margin) is paid daily to meet liabilities recorded as a consequence of the daily marking of derivatives to market value. The entity that pays nonrepayable margin no longer retains ownership of the margin or has the right to the risks and rewards of ownership. Nonrepayable margin payments are classified as transactions in financial derivatives.

These principles for the classification of margins also apply more generally to margin calls relating to positions in other financial assets.

#### *Supplementary detail*

**5.95** Possible additional supplementary breakdowns on financial derivatives are by type:

- (a) options; and
- (b) forward-type contracts.

These types of derivatives are defined in paragraphs 5.85 and 5.88, respectively. Additional supplementary breakdowns on financial derivatives also are by market risk categories:

- (a) foreign exchange;
- (b) single-currency interest rate;

- (c) equity;
- (d) commodity;
- (e) credit; and
- (f) other.

In practice, however, individual derivatives may straddle more than one risk category. In such cases, derivatives that are simple combinations of exposures should be reported separately in terms of their individual components. Derivatives that cannot be readily broken down into separable risk components should be reported in only one risk category. The allocation of such products with multiple exposures should be determined by the underlying risk component that is most significant. However, if there is doubt about the correct classification of multiexposure derivatives, the allocation by risk component should be made according to the order of precedence adopted by the BIS: commodities, equities, foreign exchange, and single-currency interest rate.

#### *Employee stock options*

**5.96** *Employee stock options are options to buy the equity of a company, offered to employees of the company as a form of remuneration.* In a few cases, the company that issues the option is a resident of a different economy from the employee (e.g., where the employer is a branch or subsidiary of the company to which the option relates). Employee stock options have similar pricing behavior to financial derivatives, but they have a different nature—including arrangements for the granting and vesting dates—and purpose (i.e., to motivate employees to contribute to increasing the value of the company, rather than to trade risk). If a stock option granted to employees can be traded on financial markets without restriction, it is classified as a financial derivative.

**5.97** In some cases, stock options may be provided to suppliers of goods and services to the enterprise. Although these are not employees of the enterprise, for convenience they are also recorded under employee stock options because their nature and motivation is similar. (Whereas the corresponding entry for stock options granted to employees is compensation of employees as discussed in paragraph 11.20, the corresponding entry for stock options granted to suppliers is the goods and services supplied.)

**5.98** For transactions associated with the issue of employee stock options, see paragraph 8.41.

### C. Arrears

5.99 An additional subclassification can be made for instruments in arrears. *Arrears are defined as amounts that are both unpaid and past the due date for payment.* Only the amounts past due are classified as arrears—for example, in the case of overdue installments, only the overdue part is in arrears.

5.100 Arrears related to exceptional financing are shown as memorandum items in all cases. (Exceptional financing is defined and discussed in Appendix 1.)

5.101 Arrears not related to exceptional financing may be recorded as a supplementary category in total and under the specific financial asset or liability class affected. Separate data on arrears may be of analytical interest when there is evidence of a high or rapidly rising value of arrears. Measures of other aspects of impairment of loans and other financial claims are discussed in paragraphs 7.45-7.54.

5.102 Arrears may be associated with either (a) reclassification of an existing instrument when a change in terms is triggered by the provisions of the original contract, or a change of the nature of the claim when the settlement of a financial derivative becomes overdue (see paragraph 5.82); or (b) the creation of a new instrument as a result of renegotiated terms (also discussed in paragraph 8.58). In either case, amounts not paid when due should be included in arrears. A liability ceases to be in arrears if all overdue payments are met. The accrual treatment of arrears is discussed in paragraphs 3.56-3.57.

### D. Classification by Maturity

5.103 The maturity of a debt instrument is classified as either short-term or long-term:

- (a) *Short-term is defined as payable on demand or with a maturity of one year or less.* (Payable on demand refers to a decision by the creditor; an instrument where the debtor can repay at any time may be short- or long-term.)
- (b) *Long-term is defined as having a maturity of more than one year or with no stated maturity (other than on demand, which is included in short-term).*

This classification provides information on the liquidity dimensions of debt. Currency is included in short-term maturity. Because of the nature of the relationship between the parties, in the case in which the maturity is unknown, all intercompany lending (which is defined in

paragraph 6.26) may be classified as long-term maturity by convention. Insurance reserves, pension entitlements, and standardized guarantee provisions can potentially be classified by the maturity; however, if data are not available, a convention that they are all long-term can be adopted. When securities contain an embedded option with a date on which or after which the debt can be put (sold) back to the debtor by the creditor, the maturity is determined without reference to these embedded put options. If significant in presenting remaining maturity data (see paragraph 5.105), supplementary data could be provided on long-term securities whose maturity is within one year or less assuming early repayment at the option date. Financial derivatives could also potentially be classified according to maturity.

5.104 Maturity may relate to:

- (a) original maturity (i.e., the period from issue until the final contractually scheduled payment); or
- (b) remaining maturity (i.e., the period from the reference date until the final contractually scheduled payment). This is also called residual maturity.

In this *Manual*, original maturity is used in the standard components, while remaining maturity is used in Table A9-IV of Appendix 9 and is encouraged for some position data.

5.105 Data on both original and remaining maturity bases are accommodated by using the following split:

- (a) short-term on an original maturity basis;
- (b) long-term due for payment within one year or less; and
- (c) long-term due for payment in more than one year.

Item (b) can be combined with item (a) to derive liabilities due within a year, that is, short-term debt on a remaining maturity basis. Alternatively, item (b) can be combined with (c) to derive long-term debt on an original maturity basis. The remaining maturity breakdown is recommended in this *Manual* for outstanding debt liabilities to nonresidents by sector and instrument (see Table A9-IV of Appendix 9).

### E. Classification by Currency

5.106 A financial asset or liability may be classified as domestic currency or foreign currency, according to its unit of account, denomination, or settlement. These terms are discussed in paragraphs 3.95-3.97.

5.107 Table A9-I of Appendix 9 provides a format for presenting the currency composition of outstanding debt claims and liabilities using the currency of denomination. This table includes a currency breakdown of reserve assets into currencies held that are in the SDR basket and those that are not. In recognition that for some sectors, such as nonfinancial corporations and households, there may be difficulties in obtaining comprehensive data from reporters, the table includes an "unallocated" row.

5.108 In Table A9-I of Appendix 9, by convention, SDR holdings, reserve position in the IMF, and monetary gold are to be classified as reserve assets in the SDR basket. It also includes financial derivatives with nonresidents to receive and to pay foreign currency. A financial derivatives contract to purchase foreign currency with domestic currency is classified as a financial derivative to receive foreign currency. If instead the contract is to purchase domestic currency with foreign currency at a future date, this is a financial derivative to pay foreign currency. Similarly, an option to buy foreign currency (sell domestic currency) is classified as a financial derivative to receive foreign currency, and vice versa.<sup>11</sup> The decisive factor in determining whether the financial derivative is to be classified as to receive or to pay foreign currency is the exposure to currency movements. Thus, if payment of a financial derivatives contract is linked to a foreign currency, even though payment is required in domestic currency, the financial derivative is to be classified as a contract to pay foreign currency, and vice versa. If a single financial derivatives contract both pays and receives foreign currency, the notional amount should be included under both categories (i.e., to pay and to receive foreign currency).<sup>12</sup>

## F. Classification by Type of Interest Rate

**5.109** *Debt instruments may be classified as either variable-rate or fixed-rate.* This breakdown may be useful for some analysis, in that variable-rate instruments are subject to fluctuation in income flows in response to changes in market conditions, while fixed-rate securities are more subject to changes in prices. The split may be considered as possible supplementary information, as in *External Debt Statistics: Guide for Compilers and Users*.

<sup>11</sup>There may be analytical interest in distinguishing the financial derivatives data in Table A9-I between positions in options and positions in forwards, as in Table A9-III in Appendix 9.

<sup>12</sup>Paragraph 5.95 provides further detail on the classification of financial derivatives contracts by risk categories when there is doubt about the correct classification of multiexposure derivatives.

5.110 Variable-rate debt instruments are those for which interest is linked to a reference index—for example, LIBOR (London interbank offered rate), or the price of a specific commodity, or the price of a specific financial instrument that normally changes over time in a continuous manner in response to market conditions. All other debt instruments should be classified as fixed-rate. An interest rate that is adjusted, but only at intervals of more than a year, is considered to be fixed. Interest that is adjusted each one year or less is considered to be variable.

5.111 Interest on debt that is linked to the credit rating of another borrower should be classified as fixed-rate, because credit ratings do not change in a continuous manner in response to market conditions, whereas interest on debt that is linked to a reference price index should be classified as variable-rate, provided that the prices that are the basis for the reference index are primarily market determined.

5.112 The classification of a financial asset or liability can change over time, for example, if it switches from fixed- to variable-rate interest. In the period when a fixed rate is applied, the financial asset or liability is to be classified as fixed-rate debt. After the rate switches to variable, it is classified as variable-rate debt.

5.113 Index-linked instruments are classified as being variable-rate. For these instruments, the principal or coupons or both are indexed to some variable, for example, to a general or specific price index. Because index-linked instruments have variable aspects, an instrument is classified as variable-rate if the indexation applies to the principal or coupons, or both (notwithstanding the treatment of interest discussed in paragraphs 11.59-11.65). However, a foreign-currency-linked instrument (as discussed in paragraph 11.50(b)) is treated as being denominated in the foreign currency, rather than indexed to it.

5.114 If interest is linked to a reference index, commodity price, or financial instrument price but is fixed unless the reference index or price passes a particular threshold, it should be regarded as fixed-rate. But if thereafter interest becomes variable, then it should be reclassified as a variable-rate instrument. Alternatively, if interest is variable-rate until it reaches a predetermined ceiling or floor, the instrument becomes fixed-rate debt when that ceiling or floor is reached. If the income stream of a variable-rate instrument is swapped with the income stream of a fixed-rate instrument, the swap is recorded as giving rise to a financial derivative, while the classification of the original debt instruments is unchanged.

## 6 Functional Categories

### A. Introduction

6.1 The functional categories<sup>1</sup> are the primary classification used for each of financial transactions, positions, and income in the international accounts. Five functional categories of investment are distinguished in the international accounts:

- (a) direct investment,
- (b) portfolio investment,
- (c) financial derivatives (other than reserves) and employee stock options,
- (d) other investment, and
- (e) reserve assets.

6.2 The functional categories are built on the classification of financial assets and liabilities discussed in Chapter 5, but with an additional dimension that takes into account some aspects of the relationship between the parties and the motivation for investment. The functional categories are designed to facilitate analysis by distinguishing categories that exhibit different economic motivations and patterns of behavior.

6.3 While linked to the classification of financial assets and liabilities, the functional categories highlight features that are particularly relevant for understanding cross-border financial flows and positions. For example, a loan can appear under direct investment or other investment, but the different nature of the relationship between the parties in these two cases has analytical significance because the risks and motivations behind the transaction may be different.

6.4 A different relationship exists between the counterparties for portfolio investors compared with direct investors. Direct investment is related to control or a significant degree of influence, and tends to

be associated with a lasting relationship. As well as funds, direct investors may supply additional contributions such as know-how, technology, management, and marketing. Furthermore, enterprises in a direct investment relationship are more likely to trade with and finance each other.

6.5 In contrast to direct investors, portfolio investors typically have less of a role in the decision making of the enterprise with potentially important implications for future flows and for the volatility of the price and volume of positions. Portfolio investment differs from other investment in that it provides a direct way to access financial markets, and thus it can provide liquidity and flexibility. It is associated with financial markets and with their specialized service providers, such as exchanges, dealers, and regulators. The nature of financial derivatives as instruments through which risk is traded in its own right in financial markets sets them apart from other types of investment. Whereas other instruments may also have risk transfer elements, these other instruments also provide financial or other resources.

6.6 Reserve assets are shown separately because they serve a different function and thus are managed in different ways from other assets. Reserve assets include a range of instruments that are shown under other categories when not owned by monetary authorities. As reserve assets, however, they have the distinct motive to meet balance of payments financing needs and undertake market intervention to influence the exchange rate.

6.7 Monetary and financial statistics and flow of funds data primarily use the instruments classification, as shown in Chapter 5, so it is desirable that data on the same basis can be derived from the international accounts for compatibility. Table 6.1 shows the linkages between the financial assets classification shown in Chapter 5 and the functional categories shown in this chapter.

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<sup>1</sup>The term functional classification is also used in different contexts in other areas of statistics, such as the classification of the functions of government.

Table 6.1. Link between Financial Assets Classification and Functional Categories

2008 SNA Financial Assets and Liabilities Classification	Functional categories				
	DI	PI	FD	OI	RA
<b>AF1 Monetary gold and SDRs</b>					
<b>AF11 Monetary gold</b>					
Gold bullion					X
Unallocated gold accounts					X
AF 12 Special drawing rights				XI	XI
<b>AF2 Currency and deposits</b>					
AF21 Currency				X	X
AF221 Interbank positions				X	X
AF229 Other transferable deposits	X			X	X
AF29 Other deposits	X			X	X
<b>AF3 Debt securities</b>	X	X			X
<b>AF4 Loans</b>	X			X	X
<b>AF5 Equity and investment fund shares</b>					
<b>AF51 Equity</b>					
AF511 Listed shares	X	X			X
AF512 Unlisted shares	X	X			X <sup>2</sup>
AF519 Other equity	X			x	
<b>AF52 Investment fund shares/units</b>					
AF521 Money market fund shares/units	x	X			X
AF522 Other investment fund shares/units	x	X		x	X
<b>AF6 Insurance, pension, and stand, guarantee schemes</b>					
AF61 Nonlife insurance technical reserves	x			X	
AF62 Life insurance and annuity entitlements	x			X	
AF63 Pension entitlements				X	
AF64 Claims of pension funds on pension managers	X			X	
AF65 Entitlements to nonpension benefits				X	
AF66 Provisions for calls under standardized guarantees	X			X	
<b>AF7 Financial derivatives and employee stock options</b>					
<b>AF71 Financial derivatives</b>					
AF711 Forward-type contracts			X		X
AF712 Options			X		X
AF72 Employee stock options			X		
<b>AF8 Other accounts receivable/payable</b>					
AF81 Trade credit and advances	X			X	
AF89 Other accounts receivable/payable	X			X	

Note: DI—direct investment; PI—portfolio investment; FD—financial derivatives (other than reserves) and employee stock options; OI—other investment; RA—reserve assets. X shows applicable functional categories (x shows cases considered to be relatively uncommon) for the most detailed instrument categories.

<sup>1</sup>SDRs: Assets = Reserve assets; Liabilities = Other investment.

<sup>2</sup>Unlisted shares must be liquid, as stated in paragraph 6.87.

## B. Direct Investment

References:

Organization for Economic Cooperation and Development (OECD), *OECD Benchmark Definition of Foreign Direct Investment*, fourth edition.

IMF, *Coordinated Direct Investment Survey Guide*.

### I. Definition of direct investment

**68** Direct investment is a category of cross-border investment associated with a resident in one economy

having control or a significant degree of influence on the management of an enterprise that is resident in another economy. As well as the equity that gives rise to control or influence, direct investment also includes investment associated with that relationship, including investment in indirectly influenced or controlled enterprises (paragraph 6.12), investment in fellow enterprises (see paragraph 6.17), debt (except selected debt set out in paragraph 6.28), and reverse investment (see paragraph 6.40). The Framework for Direct Investment Relationships (FDIR) provides criteria for determining whether cross-border ownership results in a direct investment relationship,

based on control and influence.<sup>2</sup> The definition of direct investment is the same as in the fourth edition of the *OECD Benchmark Definition of Foreign Direct Investment*, which provides additional details on the FDIR and the collection of direct investment data. Appendix 6a, Topical Summary—Direct Investment, provides references to paragraphs in which different aspects of direct investment are discussed in this *Manual*.

*a. Definition of a direct investment relationship*

**6.9** A **direct investment relationship** arises when an investor resident in one economy makes an investment that gives control or a significant degree of influence on the management of an enterprise that is resident in another economy. Operational definitions of control and influence are given in paragraph 6.12. Enterprises in a direct investment relationship with each other are called affiliates or affiliated enterprises. In addition, all enterprises that are under the control or influence of the same direct investor are considered to be in a direct investment relationship with each other.

**6.10** Because there is control or a significant degree of influence, direct investment tends to have different motivations and to behave in different ways from other forms of investment. As well as equity (which is associated with voting power), the direct investor may also supply other types of finance, as well as know-how. Direct investment tends to involve a lasting relationship, although it may be a short-term relationship in some cases. Another feature of direct investment is that decisions by enterprises may be made for the group as a whole.

*b. Definitions of direct investor and direct investment enterprise*

**6.11** A **direct investor** is an entity or group of related entities that is able to exercise control or a significant degree of influence over another entity that is resident of a different economy. A **direct investment enterprise** is an entity subject to control or a significant degree of influence by a direct investor. In some cases, a single entity may be, at the same time, a direct

<sup>2</sup>The coverage of direct investment is determined from the relationship between the owner and issuer of the financial instrument. That is, it is not determined from the relationship between the buyer and the seller of the instrument. For example, if a direct investor buys shares in its direct investment enterprise from an unrelated party, the direct investor will classify the purchase as direct investment.

investor, a direct investment enterprise, and a fellow enterprise (defined in paragraph 6.17(c)) in its relationships to other enterprises.

*c. Definitions of control and influence—definitions of immediate and indirect relationships*

**6.12** Control or influence may be achieved directly by owning equity that gives voting power in the enterprise, or indirectly by having voting power in another enterprise that has voting power in the enterprise. Accordingly, two ways of having control or influence are identified:

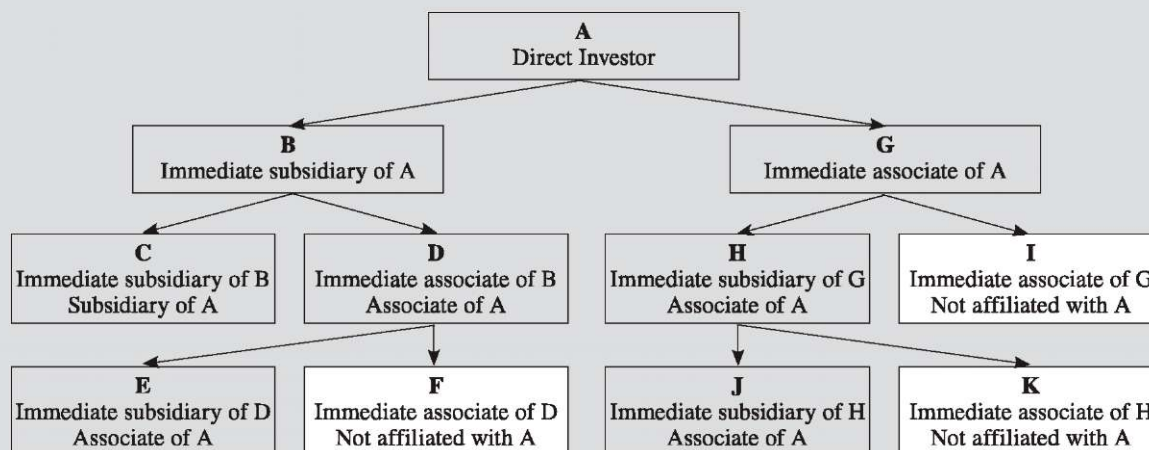
- (a) **Immediate direct investment relationships** arise when a direct investor directly owns equity that entitles it to **10 percent or more** of the voting power in the direct investment enterprise.
- Control is determined to exist if the direct investor owns more than 50 percent of the voting power in the direct investment enterprise.
  - A significant degree of influence is determined to exist if the direct investor owns from 10 to 50 percent of the voting power in the direct investment enterprise.
- (b) **Indirect direct investment relationships** arise through the ownership of voting power in one direct investment enterprise that owns voting power in another enterprise or enterprises, that is, an entity is able to exercise indirect control or influence through a chain of direct investment relationships. For example, an enterprise may have an immediate direct investment relationship with a second enterprise that has an immediate direct investment relationship with a third enterprise. Although the first enterprise has no equity in the third enterprise, it may be able to exercise indirect control or influence, according to the FDIR criteria specified in paragraph 6.14.

In addition to direct investment relationships between two enterprises that arise because one enterprise controls or influences the other, there are also direct investment relationships between two enterprises that do not control or influence each other, but that are both under the control or influence of the same investor (i.e., fellow enterprises, as discussed in paragraph 6.17).

**6.13** In practice, effective control or influence may arise in some cases with less than these percentages. These definitions should be used in all cases, however, for international consistency and to avoid subjective judgments.



## Box 6.1. Examples of Identification of Direct Investment Relationships under FDIR



Each enterprise is resident in a different economy from the others. Shaded boxes are direct investment enterprises of the Direct Investor A (so all are affiliates of each other).

For further examples, see the *OECD Benchmark Definition of Foreign Direct Investment*. In particular, it considers more complex situations, such as where an enterprise receives investment from two members of the same group.

6.14 The principles for indirect transmission of control and influence through a chain of ownership for the purposes of paragraph 6.12(b) are as follows:

- (a) Control can be passed down a chain of ownership as long as control exists at each stage.
- (b) Influence can be generated at any point down a chain of control.
- (c) Influence can be passed only through a chain of control but not beyond.

Whereas the FDIR applies a criterion of 10 percent or more of voting power for immediate direct investment, transmission through chains of ownership is not linked to a particular equity share, but a chain of control. For example, a chain of ownership of enterprises with each link involving 60 percent of the voting power involves a chain of control, even though the indirect equity by the top enterprise is 36 percent at the second level (i.e., 60 percent of 60 percent), 21.6 percent at the third level (i.e., 60 percent of 36 percent), and so on. The application of these principles may be understood more readily by numerical examples—see Box 6.1 and the *OECD Benchmark Definition of Foreign Direct Investment*.

*d. Definitions of subsidiaries, associates, fellow enterprises, and affiliates*

6.15 In regard to its relationship with a direct investor, a direct investment enterprise is either a subsidiary or an associate:

- (a) A subsidiary is a direct investment enterprise over which the direct investor is able to exercise control.
- (b) An associate is a direct investment enterprise over which the direct investor is able to exercise a significant degree of influence, but not control.

Control and influence are defined in paragraph 6.12 and may arise from an immediate relationship or in indirect relationship through a chain of ownership. The terms subsidiary and associate refer to both incorporated and unincorporated enterprises. The FDIR makes no distinction on the basis of incorporation, so directly owned branches are always treated as subsidiaries.

6.16 Under the FDIR, an entity is a direct investor in another entity where the second entity is

- (a) an immediate subsidiary of the direct investor;
- (b) an immediate associate of the direct investor;

- (c) a subsidiary of a subsidiary of the direct investor (also considered to be an indirect subsidiary of the direct investor);
- (d) a subsidiary of an associate of the direct investor (also considered to be an indirect associate of the direct investor); or
- (e) an associate of a subsidiary of the direct investor (also considered to be an indirect associate of the direct investor).

However, no direct investor-direct investment enterprise relationship exists in cases in which the entity is an associate of an associate of the direct investor. In this case, the ability of the investor to influence the management of the entity is considered to have become too diluted to be significant.

(These principles are illustrated in Box 6.1.)

**6.17 Affiliates** of an enterprise consist of:

- (a) *its direct investor(s), both immediate and indirect;*
- (b) *its direct investment enterprises, whether subsidiaries (including branches and other quasi-corporations), associates, and subsidiaries of associates, both immediate and indirect; and*
- (c) **fellow enterprises**, *that is, those enterprises that are under the control or influence of the same immediate or indirect investor, but neither fellow enterprise controls or influences the other fellow enterprise. Often the direct investor and fellow enterprises are all in different economies, but sometimes the direct investor is in the same economy as one of the fellow enterprises (in which case, it is not a direct investor in that fellow enterprise). This situation is more likely to arise in economies that do not use a local enterprise group as the statistical unit for direct investment purposes.*

All affiliates are in a direct investment relationship with each other. The term affiliated enterprises is also used, because affiliates are almost always enterprises (the exception is a direct investor that is an individual, household, or government).

6.18 Some practical difficulties may be encountered in applying the FDIR in full, and thus similar methods—such as the participation multiplication method and the direct influence and indirect control method—may be adopted. For details, see *OECD Benchmark Definition of Foreign Direct Investment* and the IMF's *Coordinated Direct Investment Survey Guide*.

*e. Requirements for a direct investment relationship*

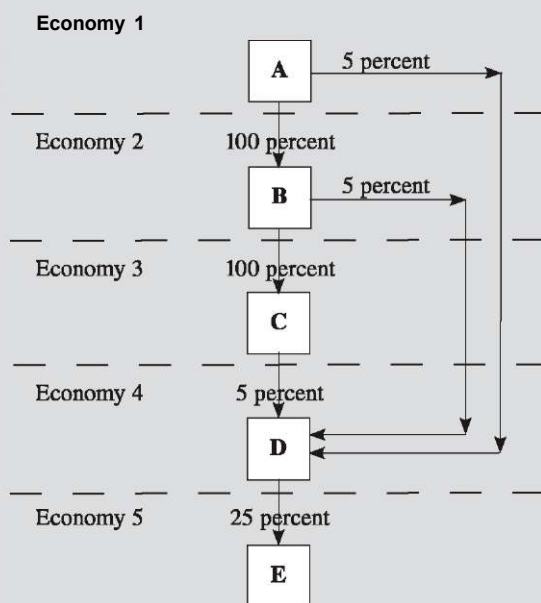
6.19 Voting power is obtained as a result of ownership of equity. When decisions are made on a one-share one-vote basis, voting power is in the same proportion as the ownership of ordinary shares. In some cases, voting power can be exercised without commensurate ownership of shares. For instance, for unincorporated entities, including foundations, there are no shares in the sense of a tradable instrument. Additionally, voting power may be greater or less than percentage of shares held when there are "golden shares" or dual classes of shares (i.e., in cases in which nonvoting shares or some shares have higher weights that allow one or more parties to exercise voting power disproportionately to their share ownership). However, voting power is not recognized if temporarily obtained through repurchase agreements (because no change in the economic ownership of the shares has occurred) or through the holding of warrants (because the warrant holder does not possess voting power until the warrants are exercised). In addition, as elaborated in the FDIR, one entity may obtain voting power indirectly in an enterprise by owning shares in an intermediate entity or through chains of intermediate entities that, in turn, own shares in the enterprise.

6.20 A direct investor could be:

- (a) an individual or household;
- (b) an enterprise, incorporated or unincorporated, public or private;
- (c) an investment fund;
- (d) a government or international organization. Special treatments for governments that have direct investment enterprises for fiscal purposes are discussed in paragraphs 8.24-8.26;
- (e) a nonprofit institution in an enterprise that operates for profit; however, the relationship between two nonprofit institutions is excluded from direct investment;
- (f) an estate, trustee in bankruptcy, or other trust; or
- (g) any combination of two or more of the above.

6.21 For two or more individuals or other entities to be considered a combination, and thus be regarded as a single direct investor, they must be in a direct investment relationship or have a family relationship (in the case of individuals). The different individuals or other entities must be resident in the same economy as each other. They cannot include any investor that is

**Box 6.2. Direct Investment Relationships with Combination of Investors**



A is a direct investor in D because its own immediate ownership of voting power in D, in combination with its control over B and C's stakes in D, means that A has 15 percent of the voting power in D.

For the same reason, B is also a direct investor in D (10 percent of voting power).

C is not a direct investor in D; however, it is a fellow enterprise of D (because C and D have A and B as direct investors in common).

D is a direct investor in E, however E is not in a direct investment relationship with A, B, or C, because in combination, they do not control D, and D does not control E.

If A's voting power in B were only 49 percent, A would not be a direct investor in D, because it does not have control over B, so A's and B's stakes in D are not combined.

a resident of the same economy as the direct investment enterprise. Equity ownership in an enterprise held by a group of related investors acting in combination can be summed to establish either control or influence. However, equity held by an associate is not summed with that from any other enterprise to establish either control or influence because influence is not able to be passed unless there is control of the next affiliate (this concept is illustrated in Box 6.2).

**6.22** A government may be a direct investor. Special treatments of positions and transactions apply when a government has a direct investment enterprise that is used for fiscal purposes, discussed further in paragraphs 8.24-8.26. If a government equity holding could qualify as both direct investment and reserve assets, it is included in direct investment, whereas debt instruments are classified as reserve assets provided that the reserve asset criteria are met (see also paragraph 6.98).

**6.23** A nonprofit institution may not be a direct investment enterprise, as it is not created with the intention of repatriating earnings to its investor. However, a nonprofit institution may be a direct investor in a for-profit entity.

**6.24** A direct investment enterprise is always a corporation, which as a statistical term includes branches, notional resident units, trusts, other quasi-corporations, and investment funds, as well as incorporated entities. Because a direct investment enterprise is owned by another entity, households or governments can be direct investors, but they cannot be direct investment enterprises. A public corporation, as defined in paragraphs 4.108-4.112, in some instances also may be a direct investment enterprise.

## 2. Coverage of direct investment flows and positions

**6.25** Direct investment covers most financial transactions and positions between affiliates resident in different economies. Investment income associated with direct investment positions is also included in direct investment. The exceptions are noted in paragraphs 6.28-6.32.

### a. Coverage of debt between affiliates

#### Definition of intercompany lending

**6.26** *Intercompany lending* is used to describe direct investment debt positions between affiliated enterprises. It includes debt instrument transactions and positions other than those excluded by paragraph 6.28; it is not limited to loans. As shown in Tables I and III in Appendix 9, Standard Components and Selected Other Items, and *External Debt Statistics: Guide for Compilers and Users*, intercompany lending is identified separately from other debt for debt analysis, because this lending has different implications for risk and vulnerability compared with debt between unrelated parties. Splits of intercompany lending by type of instrument and maturity are supplementary

items that allow comparability with national accounts and financial statistics.

6.27 Although debt and other claims that do not involve voting power are not relevant to defining a direct investment relationship, they are included in direct investment transactions and positions if a direct investment relationship exists between the parties. Debt instruments other than monetary gold, SDRs, currency, interbank positions, and pension and related entitlements potentially can be included in direct investment. However transactions between affiliates in financial assets issued by an unrelated third party are not direct investment transactions. Insurance technical reserves are included in direct investment when the parties are in a direct investment relationship. For example, reserves may arise from reinsurance contracts between affiliated insurance corporations. They also arise with captive direct insurance. (A captive insurance company writes insurance policies largely or entirely with its owners and other affiliates.)

***Coverage of debt between selected affiliated financial corporations***

6.28 Debt between selected affiliated financial corporations is not classified as direct investment because it is not considered to be so strongly connected to the direct investment relationship. The financial corporations covered by this case are:

- (a) deposit-taking corporations (both central banks and deposit-taking corporations other than the central bank);
- (b) investment funds; and
- (c) other financial intermediaries except insurance corporations and pension funds.

In other words, the usual direct investment definitions apply for captive financial institutions and money lenders, insurance corporations, pension funds, and financial auxiliaries. (These subsectors are defined in Chapter 4, Section D; debt instruments are defined in paragraphs 5.31-5.33.) All debt positions between the selected types of affiliated financial corporations are excluded from direct investment and are included under portfolio or other investment. Both affiliated parties must be one of the selected types of financial corporations, but they need not be the same type.

***b. Coverage of other financial instruments***

6.29 Financial derivatives and employee stock options are excluded from direct investment and

included in the functional category financial derivatives (other than reserves) and employee stock options.

6.30 Investment funds may be direct investors or direct investment enterprises. A "fund of funds" is an investment fund that invests in other investment funds and thus may become a direct investor in one of the funds. In a master-feeder fund arrangement, one or more investment funds (feeder funds) pool their portfolio in another fund (the master fund). In this case, a feeder fund that has 10 percent or more of the voting power in the master fund would meet the FDIR definition of a direct investor. Similarly, retail funds that hold 10 percent or more of voting power in an enterprise are direct investors.

6.31 Direct investment may include real estate investment, including investment properties and vacation homes. As discussed in paragraphs 4.26-4.40, branches or notional units are identified when nonresidents own real estate and other natural resources. The normal ownership threshold for influence or control under the FDIR is applied. Because it may have different motivations and economic impact from other direct investment, if real estate investment is significant, compilers may wish to publish data on such investment separately on a supplementary basis.

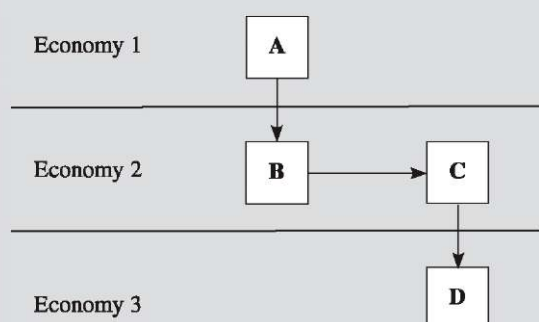
6.32 Equity in international organizations is excluded from direct investment, even in cases in which voting power is 10 percent or more, so equity contributions are included in portfolio investment (if in the form of securities) or other investment—equity (if not in the form of securities). Equity in international organizations would not generally qualify as reserve assets because of the lack of ready availability (see paragraph 6.69).

***c. Pass-through funds***

**6.33** *"Pass-through funds" or "funds in transit" are funds that pass through an enterprise resident in an economy to an affiliate in another economy, so that the funds do not stay in the economy of that enterprise.* These funds are often associated with direct investment. Such flows have little impact on the economy they pass through. Special purpose entities, holding companies, and financial institutions that serve other nonfinancial affiliates are particularly associated with funds in transit, but other enterprises may also have pass-through funds in direct investment flows.

6.34 Pass-through funds are included in direct investment in standard presentations because:

**Box 6.3. Direct Investment Relationship Involving Domestic Link**



A wholly owns B, which wholly owns C, which wholly owns D.

In this example, despite the domestic link between B and C, A and B are each in a direct investment relationship with D.

- they are an integral part of a direct investor's financial transactions and positions with affiliated enterprises;
- the exclusion of these funds from direct investment would distort and substantially understate direct investment financial flows and positions at aggregate levels; and
- the inclusions of these data in direct investment promotes symmetry and consistency among economies.

However, for the economies through which the funds pass, it is useful to identify inflows and outflows not intended for use by the entity concerned. At the time of writing, there are no standard definitions or methods to distinguish pass-through funds from other direct investment flows. Compilers in economies that have large values of pass-through funds should consider the compilation of supplementary data on funds in transit, based on national definitions.

**d. Effect of domestic ownership links on direct investment relationships**

6.35 To identify direct investment relationships, the FDIR does not exclude ownership links between enterprises resident in the same economy. Although any transactions and positions between enterprises in the same economy are not included in international accounts, it is possible that a direct investor may have

a chain of control or influence in which one link in the chain is a resident-to-resident relationship. Such a relationship does not preclude a direct investment relationship between two enterprises that are resident in different economies from each other. (This case is illustrated in Box 6.3.)

**e. Beginning and ending direct investment relationships**

6.36 The whole of the transaction that reaches or surpasses the threshold of 10 percent or more of voting power is included under direct investment. Any transactions before that point are not generally classified as direct investment (with the exception of reverse investment—defined in paragraph 6.37(b)—and investment in other affiliates). Any prior positions are shown as being reclassified at the time that the direct investment relationship comes into existence (reclassifications are discussed in paragraphs 9.13-9.20). For example, if the direct investor previously had 9 percent of voting power, then acquired 2 percent more, there would be a direct investment transaction by the purchaser involving 2 percent of voting power, and the reclassification entries in the other changes in financial assets and liabilities account would show a reduction of portfolio investment involving the previously held 9 percent and a corresponding increase in direct investment. Subsequent transactions up to and including a transaction that takes the voting power below 10 percent are classified as direct investment. Once the direct investment equity threshold has been crossed (either upward or downward), any debt positions between the parties should also be changed by a reclassification entry in the other changes in volume account.

**3. Types of direct investment transactions and positions**

6.37 In the standard components, direct investment is classified according to the relationship between the investor and the entity receiving the investment, namely:

- investment by a direct investor in its direct investment enterprise (whether in an immediate relationship or not);
- reverse investment by a direct investment enterprise in its own immediate or indirect direct investor, as explained in paragraphs 6.39-6.40; and
- investment between resident and nonresident fellow enterprises, as explained in paragraph 6.17.

6.38 These three categories reflect different types of relationships and motivations. For example, the interpretation of a direct investor acquiring direct investment assets is different from a direct investment enterprise acquiring direct investment assets. While the first type of investment involves influence or control, this may not be the case for the other two types, because the investor is not a direct investor. It is important for compilers to monitor trends in the second and third types to identify if they are becoming significant.

*a. Reverse investment*

6.39 A direct investment enterprise may acquire an equity or other claim on its own immediate or indirect direct investor. These transactions may occur as a way of withdrawing investment, or as a way of organizing finance within a transnational group. For example, for an enterprise that borrows on behalf of its parent company and in cases in which treasury functions are concentrated in a subsidiary (see paragraphs 4.83(d) and 4.86), the subsidiary may lend money to its direct investor.

**6.40** *Reverse investment arises when a direct investment enterprise lends funds to or acquires equity in its immediate or indirect direct investor, provided it does not own equity comprising 10 percent or more of the voting power in that direct investor.* In contrast, if two enterprises each have 10 percent or more of the voting power in the other, there is not reverse investment, rather there are two mutual direct investment relationships. That is, each enterprise is both a direct investor and direct investment enterprise of the other.

6.41 Data on reverse investment and investment between fellow enterprises should be separately published, where significant, to assist users in understanding the nature of direct investment. Issues associated with income on reverse investment and investment between fellow enterprises are covered in paragraphs 11.99-11.100.

*b. Presentation of data according to the directional principle*

**6.42** *The directional principle is a presentation of direct investment data organized according to the direction of the direct investment relationship. It can be contrasted with the asset and liability presentation of aggregates used in standard components in this Manual, which are organized according to whether the investment relates to an asset or liability. The difference*

between the asset-liability and directional presentations arises from differences in the treatment of reverse investment and some investment between fellow enterprises. The directional principle can be applied to the IIP, financial account, and investment income. Under the directional principle, direct investment is shown as either direct investment abroad or direct investment in the reporting economy:

- (a) *Direct investment abroad covers assets and liabilities between resident direct investors and their direct investment enterprises. It also covers assets and liabilities between resident and nonresident fellow enterprises if the ultimate controlling parent is resident.* Direct investment abroad is also called outward direct investment.
- (b) *Direct investment in the reporting economy includes all liabilities and assets between resident direct investment enterprises and their direct investors. It also covers assets and liabilities between resident and nonresident fellow enterprises if the ultimate controlling parent is nonresident.* Direct investment in the reporting economy is also called inward direct investment.

6.43 The treatment of fellow enterprises under the directional principle is as follows:

- In principle, all assets and liabilities between fellow enterprises are shown in direct investment abroad when the ultimate controlling parent is a resident. In that case, control and influence is exercised from the economy of the resident, so it is useful to view an investment in a fellow enterprise abroad in the same way as outward investment.
- In principle, all assets and liabilities between fellow enterprises are shown in direct investment in the reporting economy when the ultimate controlling parent is a nonresident. In this case, control and influence are exercised from another economy, so it is useful to view investment with the fellow enterprise abroad in the same way as inward investment.
- However, if the residence of the ultimate controlling parent is unknown, assets are treated as direct investment abroad and liabilities are treated as direct investment in the reporting economy. This treatment is allowed for practical reasons. It is recognized that, in some cases, economies may not be able to implement the preferred or "in principle" basis of presentation in their direct investment data, because they cannot identify ultimate controlling parents.

c. *Analytical use of the different presentations of direct investment*

6.44 Data on both the asset and liability presentation and the directional principle presentation are useful for different kinds of analysis.

- Data on an asset and liability basis are consistent with monetary, financial, and other balance sheet data, and thus facilitate comparison between the data sets. These data are needed on an immediate counterparty basis to adequately monitor flows and positions. For instance, if a jurisdiction of convenience that is the home to large SPEs were to experience a currency or other financial crisis, data users would find data sets that look through the SPEs (or that net data for SPEs without separate identification of gross levels) to be of limited help. SPEs and other entities may transform debt to equity, a long-term instrument to short-term, local currency to foreign currency, fixed to variable rates, and so on, and these transformations alter risk characteristics in important ways.
- Data on a directional principle basis assist in understanding the motivation for direct investment and take account of control and influence. In the directional presentation, reverse investment can be seen as equivalent to the withdrawal of investment. The directional principle may be particularly useful for an economy with large values of pass-through funds or round tripping, because the large investment flows into and out of an economy may not be of primary interest to analysts of direct investment.

6.45 The calculations and relationship between the asset and liability and the directional presentations are shown in Box 6.4. In this *Manual*, the directional presentation appears as supplementary items. Under the directional principle, direct investment abroad and direct investment in the reporting economy include both assets and liabilities, and thus, negative values may arise.

#### 4. Other issues concerning direct investment transactions, positions, and income

a. *Round tripping*

6.46 *Round tripping involves funds from an entity in one economy being invested in an entity resident in a second economy, that are then invested in another entity in the first economy.* The entity in the second economy often has limited operations of its own. (There

may be two or other intermediate economies with round tripping.) Its special nature means that, where it is significant, compilers should consider publishing supplementary information on the extent of round tripping. (Round tripping results in an economy being its own ultimate host economy or ultimate investing economy in partner data.)

b. *Relationships other than direct investment*

6.47 Some relationships involve cooperation between enterprises that resemble direct investment relations. However, such cases should not be classified as direct investment unless they meet the definition involving control or influence through voting power. For example, there may be representation on the board of directors, a common board of directors but no formal relationship, participation in policymaking processes, material intercompany transactions, interchange of managerial personnel, provision of technical information, or provision of long-term loans at lower than existing market rates. Creditors of an insolvent company may exercise influence or even effectively control it, but they would not qualify as direct investors unless their debt is converted to equity with voting power. Furthermore, an enterprise may have substantial foreign ownership but no individual investor or group of related investors may have a direct investment stake.

c. *Additional detail for direct investment*

6.48 The financial instrument, maturity, and currency classifications in Chapter 5 can be used for direct investment. Compilers should break down debt instruments relating to direct investment relationships according to the *SNA/MFSM* instrument classification on a supplementary basis. The split by type of instrument is necessary for reconciliation with financial account, flow of funds, and sector balance sheets, because these data use the instrument classification and not the international accounts functional classification. However, because of the relationship between the two parties, the strictness of terms, and risks and vulnerability aspects of direct investment-related debt may differ from those of other debt. For those reasons, intercompany lending is identified separately in *External Debt Statistics: Guide for Compilers and Users* (see also paragraph 6.26).

6.49 Classification by partner economy is discussed in paragraphs 4.146-4.164, with paragraphs 4.156-4.157 dealing with direct investment. Partner data for direct investment can be classified according to either the immediate or ultimate investor or host economy. The

### Box 6.4. Derivation of Data under the Directional Principle

The standard components for direct investment positions and transactions are shown in the table below. They

may be rearranged to support different kinds of presentation and analysis.

#### Components of Direct Investment (Asset/Liability Presentation)

Assets	Liabilities
<p><b>Of direct investors in direct investment enterprises</b></p> <p>A1 Equity</p> <p>A2 Debt instruments</p> <p><b>Of direct investment enterprises in direct investor—Reverse investment</b></p> <p>A3 Equity</p> <p>A4 Debt instruments</p> <p><b>Of resident fellow enterprises in fellow enterprises abroad</b></p> <p><b>A5 Equity</b></p> <p>A5.1 Equity (if ultimate controlling parent is resident<sup>1</sup>)</p> <p>A5.2 Equity (if ultimate controlling parent is nonresident<sup>2</sup>)</p> <p><b>A6 Debt instruments</b></p> <p>A6.1 Debt instruments (if ultimate controlling parent is resident<sup>1</sup>)</p> <p>A6.2 Debt instruments (if ultimate controlling parent is nonresident<sup>2</sup>)</p>	<p><b>Of direct investment enterprises to direct investor</b></p> <p>L1 Equity</p> <p>L2 Debt instruments</p> <p><b>Of direct investor to direct investment enterprises—Reverse investment</b></p> <p>L3 Equity</p> <p>L4 Debt instruments</p> <p><b>Of resident fellow enterprises to fellow enterprises abroad</b></p> <p><b>L5 Equity</b></p> <p>L5.1 Equity (if ultimate controlling parent is nonresident<sup>2</sup>)</p> <p>L5.2 Equity (if ultimate controlling parent is resident<sup>1</sup>)</p> <p><b>L6 Debt instruments</b></p> <p>L6.1 Debt instruments (if ultimate controlling parent is nonresident<sup>2</sup>)</p> <p>L6.2 Debt instruments (if ultimate controlling parent is resident<sup>1</sup>)</p>

<sup>1</sup>That is, resident in the compiling economy.

<sup>2</sup>That is, not resident in the compiling economy.

#### Asset/liability presentation

##### Direct investment assets:

Equity:  $A1 + A3 + A5$ ;

Debt instruments:  $A2 + A4 + A6$

##### Direct investment liabilities:

Equity:  $L1 + L3 + L5$ ;

Debt instruments:  $L2 + L4 + L6$

#### Directional principle presentations

##### In principle:

##### Direct investment abroad (outward direct investment):

Equity:  $A1 - L3 + A5.1 - L5.2$ ;

Debt instruments:  $A2 - L4 + A6.1 - L6.2$

##### Direct investment in the reporting economy (inward direct investment):

Equity:  $L1 - A3 + L5.1 - A5.2$ ;

Debt instruments:  $L2 - A4 + L6.1 - A6.2$

##### Acceptable practical alternative:

##### Direct investment abroad:

Equity:  $A1 - L3 + A5$ ;

Debt instruments:  $A2 - L4 + A6$

##### Direct investment in the reporting economy:

Equity:  $L1 - A3 + L5$ ;

Debt instruments:  $L2 - A4 + L6$

institutional sector classification (described in Chapter 4, Section D) may also be applied to direct investment. These issues are discussed further in the *OECD Benchmark Definition of Foreign Direct Investment*.

6.50 Classification by kind of economic activity (industry) may be of interest for direct investment. The *ISIC* or some regional or national equivalent can be used to compile data on the kind of economic activity. Although this classification is not used for other functional categories, it is useful for direct investment. It is preferable to prepare estimates on both inward and

outward direct investment on a dual basis, based on the industry of the direct investment enterprise and the industry of the direct investor. If data on only one basis can be prepared, the preferred industry classification is that of the direct investment enterprise. Industrial classification applies to units, rather than transactions. Often in direct investment data, the industry classification is applied to economy-specific enterprise groups, or to economy-specific enterprise groups in a single institutional sector. If a direct investment enterprise or enterprise group is involved in different economic activities, it is classified according to the predominant activity.



**d. Further issues concerning direct investment**

6.51 In addition to the classification issues in this chapter, direct investment is discussed in the chapters concerning positions, financial account transactions, and primary income (Chapters 7, 8, and 11, respectively). The cross-cutting issues and links are shown in Appendix 6a.

6.52 Some aspects of direct investment—other than those directly related to balance of payments and international investment position data—may be of interest, particularly in the host economy, from analytical and policymaking points of view. While the international accounts data show the cross-border flows and stocks, another aspect of the impact of direct investment is on domestic variables such as employment, sales, value added, and gross fixed capital formation. These statistics are called Activities of Multinational Enterprises and are discussed in Appendix 4.

6.53 The foreign-controlled corporations subsector in the *SMA* overlaps with direct investment. The foreign-controlled corporations subsector includes all subsidiaries and branches resident in the economy, as well as any associates or other enterprises resident in the economy that are under de facto foreign control.

**C. Portfolio Investment**

6.54 *Portfolio investment is defined as cross-border transactions and positions involving debt or equity securities, other than those included in direct investment or reserve assets.* Securities are defined in paragraph 5.15. The negotiability of securities is a way of facilitating trading, allowing them to be held by different parties during their lives. Negotiability allows investors to diversify their portfolios and to withdraw their investment readily. Investment fund shares or units (i.e., those issued by investment funds) that are evidenced by securities and that are not reserve assets or direct investment are included in portfolio investment. Although they are negotiable instruments, exchange-traded financial derivatives are not included in portfolio investment because they are included in their own separate category.

6.55 Equity not in the form of securities (e.g., in unincorporated enterprises) is not included in portfolio investment; it is included in direct or other investment. Equity in time-share accommodation evidenced by a security is usually portfolio investment (although holdings that provided 10 percent or more of voting power would be direct investment, and holdings not in the form

of securities and not included in direct investment would be other investment). In a few cases identified in paragraph 6.28, debt securities representing claims on affiliated enterprises are included in portfolio investment.

6.56 Portfolio investment covers, but is not limited to, securities traded on organized or other financial markets. Portfolio investment usually involves financial infrastructure, such as a suitable legal, regulatory, and settlement framework, along with market-making dealers, and a sufficient volume of buyers and sellers. However, acquisition of shares in hedge funds, private equity funds, and venture capital are examples of portfolio investment that occurs in less public and more lightly regulated markets. (However, shares in these funds are included in direct investment when the holdings reach the 10 percent threshold, and in other equity in other investment when investment is not in the form of a security and not included in direct investment or reserve assets.) Portfolio investment is distinctive because of the nature of the funds raised, the largely anonymous relationship between the issuers and holders, and the degree of trading liquidity in the instruments.

6.57 Portfolio investment may be presented by instrument, original or remaining maturity, or institutional sector. Further information on portfolio investment is included in Chapter 7 (concerning positions), Chapter 8 (concerning financial account transactions), and Chapter 11 (concerning primary income).

**D. Financial Derivatives (Other Than Reserves) and Employee Stock Options**

6.58 The definition of the functional category financial derivatives and employee stock options (other than reserves) largely coincides with the corresponding financial instrument class, which is discussed in detail in paragraphs 5.79-5.98. The difference in coverage between the functional category and the financial instrument is that financial derivatives associated with reserve asset management are excluded from the functional category and included in reserve assets (see paragraph 6.91). This category is identified separately from the other categories because it relates to risk transfer, rather than supply of funds or other resources.

6.59 Unlike other functional categories, no primary income accrues on financial derivatives. Any amounts accruing under the contract are classified as revaluations and are included in the other changes in assets and liabilities account. (These entries are discussed in paragraphs 9.30-9.31.) In addition, as noted in the foot-

note to paragraph 10.121, an intermediary may provide services associated with transactions in derivatives.

6.60 Recording of financial derivatives separately for both assets and liabilities is encouraged for both positions and transactions. However, it is recognized that measuring transactions on a gross basis may not be feasible, in which case net reporting is acceptable. Information on financial derivatives (other than reserves) and employee stock options is included in Chapter 7 (concerning positions), Chapter 8 (concerning financial account transactions), and Chapter 9 (concerning revaluations); no investment income arises (see paragraph 11.95).

## E. Other Investment

6.61 *Other investment is a residual category that includes positions and transactions other than those included in direct investment, portfolio investment, financial derivatives and employee stock options, and reserve assets.* To the extent that the following classes of financial assets and liabilities are not included under direct investment or reserve assets, other investment includes:

- (a) other equity;
- (b) currency and deposits;
- (c) loans (including use of IMF credit and loans from the IMF);
- (d) nonlife insurance technical reserves, life insurance and annuities entitlements, pension entitlements, and provisions for calls under standardized guarantees;
- (e) trade credit and advances;
- (f) other accounts receivable/payable; and
- (g) SDR allocations (SDR holdings are included in reserve assets).

6.62 Other equity is included in other investment, when it is not direct investment or reserve assets. Other equity, as defined in paragraph 5.26, is not in the form of securities, so it is not included in portfolio investment. Participation in some international organizations is not in the form of securities and so it is classified as other equity. In most cases, equity in quasi-corporations for branches and notional units for ownership of land is included in direct investment; however, it is included in other investment if the share of voting power is less than 10 percent.

6.63 Other investment may be split by financial asset or liability class, original or remaining maturity, or institutional sector. Information on other investment is included in Chapter 7 (concerning valuation of posi-

tions, particularly loans), Chapter 8 (concerning financial account transactions), and Chapter 11 (concerning primary income).

## F. Reserves<sup>3</sup>

Reference:

IMF, *International Reserves and Foreign Currency Liquidity: Guidelines for a Data Template*.

### I. Reserve assets

#### a. General definition

6.64 *Reserve assets are those external assets that are readily available to and controlled by monetary authorities for meeting balance of payments financing needs, for intervention in exchange markets to affect the currency exchange rate, and for other related purposes (such as maintaining confidence in the currency and the economy, and serving as a basis for foreign borrowing).* Reserve assets must be foreign currency assets and assets that actually exist. Potential assets are excluded. Underlying the concept of reserve assets are the notions of "control," and "availability for use," by the monetary authorities.<sup>5</sup> The composition of reserve assets and reserve-related liabilities is shown in Box 6.5.

#### b. Residence

6.65 In accordance with the residence concept, reserve assets, other than gold bullion, must be claims on nonresidents. Conversely, the authorities' foreign currency claims on residents, including claims on resident banks, are not reserve assets. Nonetheless, foreign currency claims on resident banks can be at the disposal of the monetary authorities and can be readily mobilized to meet demand for foreign exchange. Such claims are presented as a supplementary item to the IIP. For the explanation of residence, see Chapter 4, Section E.

<sup>3</sup>A more complete picture of monetary authorities' international liquidity position is given in *International Reserves and Foreign Currency Liquidity: Guidelines for a Data Template (Guidelines)*. The *Guidelines* address a number of key issues, and are drawn on in this text.

<sup>4</sup>For dollarized economies, the need to hold reserves for the purpose of intervention in exchange markets is not relevant for defining the reserve assets of these economies. Dollarization and euroization are defined in paragraph A3.10.

<sup>5</sup>Monetary authorities may sometimes employ fund managers to manage reserve assets. In such arrangements, the fund managers are acting as agents and are paid a fee for their services.

### Box 6.5. Components of Reserve Assets and Reserve-Related Liabilities

<b>Reserve assets</b>
<b>Monetary gold</b>
Gold bullion
Unallocated gold accounts
<b>Of which: Monetary gold under swap for cash collateral<sup>1</sup></b>
Special drawing rights
Reserve position in the IMF
<b>Other reserve assets</b>
Currency and deposits
Claims on monetary authorities
Claims on other entities
Securities
Debt securities
Short-term
Long-term
Equity and investment fund shares or units
<b>Of which: Securities under repo for cash collateral<sup>1</sup></b>
Financial derivatives
Other claims
<b>Reserve-related liabilities to nonresidents (memorandum items)</b>
Short-term (on a remaining maturity basis)
Credit and loans from the IMF
Debt securities
Deposits
Loans
Repo loans
Other loans
<b>Other short-term foreign currency liabilities to nonresidents</b>

(See also Appendix 9 Table V for additional supplementary items for reserve-related liabilities.)

<sup>1</sup>In the IIP only.

#### c. Definition of monetary authorities

**6.66** *The functional concept of monetary authorities is essential for defining reserve assets. Monetary authorities encompass the central bank (which subsumes other institutional units included in the central bank subsector, such as the currency board) and certain operations usually attributed to the central bank but sometimes carried out by other government institutions or commercial banks, such as government-owned commercial banks. Such operations include the issuance of currency; maintenance and management of reserve assets, including those resulting from transactions with the IMF; and operation of exchange stabilization funds. In economies in which extensive reserve assets are held outside of the central bank, supplementary information*

should be provided on the institutional sector of holdings of those reserve assets.

#### a. Control

**6.61** In general, only external claims actually owned by the monetary authorities can be classified as reserve assets. Nonetheless, ownership is not the only condition that confers control. In cases in which institutional units (other than the monetary authorities) in the reporting economy hold legal title to external foreign currency assets and are permitted to transact in such assets only on terms specified by the monetary authorities or only with their express approval. In such cases, the assets can be considered reserve assets because they are under the direct and effective control of the monetary authorities. To be counted in reserve assets, the conditions to be met are that:

- the resident entity can transact only in those claims with nonresidents on the terms specified by the monetary authorities or only with their express approval; and
- the authorities have access on demand to these claims on nonresidents to meet balance of payments financing needs and other related purposes; and
- a prior law or an otherwise legally binding contractual arrangement confirms this agency role of the resident entity that is actual and definite in intent.

**6.68** If such assets are included under reserve assets, to avoid double counting, they should not also be classified as assets, or transactions in assets, in other components of the IIP and balance of payments. They are classified within reserve assets depending on their nature (e.g., deposits and securities are classified as such). Except in unusual circumstances, direct and effective control is not to be construed as extending beyond assets owned by deposit-taking corporations.

#### e. Availability for use

**6.69** Reserve assets must be readily available in the most unconditional form. A reserve asset is liquid in that the asset can be bought, sold, and liquidated for foreign currency (cash) with minimum cost and time, and without unduly affecting the value of the asset.<sup>6</sup>

<sup>6</sup>No time limit is provided, but to qualify as reserves, an asset should be available in a very short period of time given the speed at which experience suggests a foreign exchange need can arise in adverse circumstances.

This concept refers to both nonmarketable assets, such as demand deposits, and marketable assets, such as securities for which there are ready and willing sellers and buyers. The ability to raise funds by using the asset as collateral is not sufficient to make an asset a reserve asset. Some deposits and loans can be liquid and included in reserve assets, although they are not necessarily marketable.

6.70 To be readily available to the authorities to meet balance of payments financing needs and other related purposes under adverse circumstances, reserve assets generally should be of high quality.

*f. Further clarifications on reserve assets*

6.71 As a consequence of their purpose of meeting balance of payments financing needs, and supporting the exchange rate, reserve assets must be both denominated and settled in foreign currency. Denominated is defined to mean the currency in which the contract is specified. (Currency of denomination and currency of settlement are discussed in paragraphs 3.98-3.103.)

6.72 Furthermore to be liquid, reserve assets must be denominated and settled in convertible foreign currencies, that is, currencies that are freely usable for settlements of international transactions.<sup>7</sup> In addition, assets denominated in gold and SDRs may qualify as reserve assets.

6.73 In some instances, economies may hold assets denominated in the currency of a neighboring economy because the economy's risk exposures are closely related to their neighbor given the composition of their international trade, even though the currency may not be widely traded. These assets should be excluded from reserve assets (and included under the appropriate functional category and instrument) if the currency does not meet the definition of a convertible foreign currency set out in paragraph 6.72, but supplementary data can be provided. Such circumstances are envisaged when an economy is highly dependent on a larger regional neighbor for its international trading activity.<sup>8</sup>

6.74 Assets that are denominated in or indexed to the domestic currency but settled in foreign currency cannot be reserve assets, because the value of such assets would decline along with the domestic currency in the circumstance of a domestic currency crisis.

6.75 An existing asset that is committed for a future use but not encumbered can be included provided that the asset is readily available to meet a balance of payments financing need (and other related purposes stated in paragraph 6.64). An asset should not be denied as a reserve asset simply because the use to which the asset is to be put is a foreseeable one. However, when an asset is not readily available—such as an asset whose use is blocked—the asset should not be counted as reserve assets.

*g. Classification of reserve assets*

6.76 Reserve assets consist of monetary gold, SDR holdings, reserve position in the IMF, currency and deposits, securities (including debt and equity securities), financial derivatives, and other claims (loans and other financial instruments).

6.77 Monetary gold, SDR holdings, and reserve position in the IMF are considered reserve assets because they are assets readily available to the monetary authorities in unconditional form. Currency and deposits, securities, and other assets in many instances are equally available and therefore qualify as reserve assets.

6.78 *Monetary gold is gold to which the monetary authorities (or others who are subject to the effective control of the monetary authorities) have title and is held as reserve assets.* It consists of gold bullion (including gold coins, ingots, bars with a purity of at least 995/1,000, and gold bullion held in allocated gold accounts, regardless of the location of the account)<sup>9</sup> and unallocated gold accounts with nonresidents that give title to claim the delivery of gold.<sup>10</sup> Gold bullion is usually traded on organized markets or through bilateral arrangements between central banks. To qualify as reserve assets, gold accounts must be readily available upon demand to the monetary authorities.

6.79 **Allocated and unallocated gold accounts are** to be distinguished from accounts that are linked to gold (accounts indexed to gold) but do not give title to claim delivery of gold. The latter are classified as currency and deposits and are included within reserve assets provided they meet the criteria of reserves.

6.80 If the monetary authorities deposit gold bullion in an unallocated gold account, the gold bullion is

<sup>7</sup>The term "freely usable" is not used in a restrictive sense to cover the currencies in the SDR basket only.

<sup>8</sup>It is possible but unlikely that such dependence could arise with an economy that is not a neighbor.

<sup>9</sup>However, transactions with residents in gold bullion are not recorded in the balance of payments (see paragraph 9.18).

<sup>10</sup>See paragraphs 5.76-5.77 for definitions of allocated and unallocated gold accounts.

demonetized (see paragraph 9.18) and this is recorded in the other changes in assets account of the monetary authorities. If the account is with a nonresident, a transaction in nonmonetary gold is recorded in the goods and services account. However, transactions in gold bullion as reserve assets between monetary authorities and with international financial institutions are recorded as transactions in gold bullion and are not recorded as other changes in assets. If the unallocated gold account is with a nonresident and available on demand, a transaction in currency and deposits is recorded and then reclassified to monetary gold (unallocated gold accounts) if held as a reserve asset.<sup>11</sup> However, if the deposit is with another monetary authority or an international financial institution, a transaction in unallocated gold accounts is recorded.

6.81 To minimize risks of default in gold lending transactions,<sup>12</sup> monetary authorities can require adequate collateral instead of cash (such as securities) from the depository. Such securities collateral received should not be included in reserve assets, thereby preventing double counting as the gold lent remains an asset of the monetary authorities.<sup>13</sup>

6.82 Allocated and unallocated gold accounts with nonresidents out on swap by the monetary authorities for cash collateral are either (a) included as reserve assets of the original owner with the loan generated reported as a reserve-related liability (a memorandum item) if a liability is to a nonresident,<sup>14</sup> or (b) excluded from reserve assets and either demonetized (gold bullion) or reclassified as other investment, currency and deposits, assets (unallocated gold accounts). In either case, any loan liability to a nonresident is recorded within "other investment," with the foreign currency received (provided it is a claim on a nonresident), and recorded as an increase in currency and deposits within reserve assets.<sup>15</sup> The value of allocated and unallocated

gold accounts included in reserve assets and out on swap (see paragraphs 7.58-7.59) for cash collateral is identified in the IIP to facilitate an assessment of the level of reserves adjusted for the swap activities.

6.83 Any unallocated gold account liabilities of resident entities to nonresident monetary authorities are to be classified as other investment, currency and deposits.

6.84 SDR holdings are reserve assets created by the IMF and are equivalent to liquid balances in convertible currencies in nearly every respect. Further information on SDRs is provided in paragraphs 5.34-5.35.

6.85 Reserve position in the IMF is the sum of (a) the "reserve tranche," that is, the foreign currency (including SDRs) amounts that a member country may draw from the IMF at short notice;<sup>16</sup> and (b) any indebtedness of the IMF (under a loan agreement) in the General Resources Account that is readily available to the member country, including the reporting country's lending to the IMF under the General Arrangements to Borrow (GAB) and the New Arrangements to Borrow (NAB). While a member country must present a declaration of balance of payments-related need to make a purchase in the reserve tranche (reduction in reserve position), the IMF does not challenge a member's request for reserve tranche purchases. Convertible currencies from a reserve tranche purchase may be made available within days.

6.86 Deposits refer to those available on demand; deposits with a fixed term that are redeemable on demand or at very short notice without unduly affecting the value of the deposit can be included. Deposits included in reserve assets are those held in foreign central banks, the BIS, and other nonresident deposit-taking corporations, and deposit agreements with IMF Trust Accounts that are readily callable to meet a balance of payments financing need. Because short-term loans provided by the monetary authorities to other central banks, the BIS, and other deposit-taking corporations are much like deposits, it is difficult

<sup>11</sup>Similarly, interest accruing on unallocated gold accounts is recorded as a transaction in currency and deposits within reserve assets by the monetary authority. If national practice is to include such interest under monetary gold, the amount of interest accruing is reclassified in the other changes in assets account.

<sup>12</sup>Sometimes known as gold deposits or gold loans.

<sup>13</sup>If the securities received as collateral are repoed out for cash, a repo transaction should be reported, as discussed below under "securities."

<sup>14</sup>If the liability is to a resident, the liability is not in the balance of payments or IIP, but it is reported under repo loans in other foreign currency liabilities (see Table V in Appendix 9).

<sup>15</sup>If the foreign currency received from a nonresident is a claim on a resident entity, the corresponding entry to the loan liability to the nonresident is a reduction in currency and deposit liabilities of the resident entity, as the transaction reduces the claim of the nonresident on the resident entity.

<sup>16</sup>Reserve-tranche positions in the IMF are liquid claims of members on the IMF that arise not only from the reserve asset payments for quota subscriptions but also from the sale by the IMF of their currencies to meet the demand for use of IMF resources by other members in need of balance of payments support. Repayments of IMF resources in these currencies reduce the liquid claim of the member whose currency was supplied. In Table A9-I-1 in Appendix 9 on currency composition, the reserve tranche positions in the IMF should be classified in the "SDR basket." The domestic currency component of the quota is considered in economic terms to be of a contingent nature and so is not classified as an asset or liability in the international accounts.

in practice to distinguish the two. For this reason, by convention, and consistent with the treatment of interbank positions (see paragraph 5.42), the reporting of deposits in reserve assets should include short-term foreign currency loans that are redeemable upon demand, made by the monetary authorities to these nonresident deposit-taking corporations. Short-term foreign currency loans that are available on demand without unduly affecting the value of the asset, and made by the monetary authorities to nonresident non-deposit-taking corporations, and long-term loans to IMF Trust Accounts that are readily repayable to meet a balance of payments financing need can qualify as reserve assets ("other claims"). But other long-term loans by the monetary authorities to nonresidents not readily available to meet balance of payments financing needs are not reserve assets.

**6.87 Securities** include liquid and marketable equity and debt securities issued by nonresidents; long-term securities (such as 30-year U.S. Treasury bonds) are included. Unlisted securities (i.e., securities not listed for public trading) are, in principle, excluded unless the securities are liquid.

6.88 Securities that have been transferred under repurchase agreements, or similar agreements by the monetary authorities for cash collateral are assets of the original authorities and are either (a) included as reserve assets of the original owner with the loan generated reported as a reserve-related liability (a memorandum item) if a liability is to a nonresident,<sup>17</sup> or (b) excluded from reserve assets and reclassified as portfolio investment assets. In either case, any loan liability to a nonresident is recorded within "other investment," with the foreign currency received, provided it is a claim on a nonresident, and is recorded as an increase in currency and deposits within reserve assets. The value of securities included in reserve assets and out on repo (or similar arrangements, see paragraph 7.58) for cash collateral is identified in the IIP to facilitate an assessment of the level of reserves adjusted for the repo activities.

6.89 In the case of reverse repos, the funds provided to the counterparty should be recorded as a decrease in currency and deposits within reserve assets, but if the claim (i.e., repo asset) is liquid and available upon demand to the monetary authorities, then it is considered part of the reserve assets in "other claims" (or "deposits" if classified in national measures of broad money).

<sup>17</sup>If the liability is to a resident, the liability is not in the balance of payments or IIP, but it is reported under repo loans in other foreign currency liabilities (see Table V in Appendix 9).

6.90 When securities are lent or borrowed in exchange for other securities and no cash is exchanged, no transaction should be reported. Securities lent are the assets of the original authorities, and securities collateral received are not included as reserve assets of the receiving monetary authorities.

**6.91 Financial derivatives** are recorded in reserve assets only if the derivatives pertain to the management of reserve assets, are integral to the valuation of such assets, and are under the effective control of the monetary authorities. Because they pertain to the management of assets, these transactions and positions are recorded on a net basis (assets less liabilities) at market value.

**6.92 Other claims** include loans to nonresident non-deposit-taking corporations, long-term loans to an IMF Trust Account that are readily repayable to meet a balance of payments financing need (see paragraph 6.86), loans arising from a reverse repo (unless classified as deposits) (paragraph 6.89), and other financial assets not included previously but that are foreign currency assets that are available for immediate use (such as nonnegotiable investment fund shares or units as described in paragraph 6.101).

#### *h. Selected cases*

##### *Special purpose government funds*

6.93 Some governments create special purpose government funds, usually called sovereign wealth funds (SWFs). *Created and owned by the general government for macroeconomic purposes, SWFs hold, manage, or administer assets to achieve financial objectives, and employ a set of investment strategies which include investing in foreign financial assets. The funds are commonly established out of balance of payments surpluses, official foreign currency operations, the proceeds of privatizations, fiscal surpluses, and/or receipts resulting from commodity exports.* The establishment of a special purpose government fund raises the issue of whether or not the external assets held in the fund should be included in reserve assets.

6.94 A key determination is whether some legal or administrative guidance results in the assets being encumbered in a way that precludes their ready availability to the monetary authorities.

6.95 If the special purpose government fund's external assets are on the books of the central bank, or an agency of the central government, that allows the monetary authorities control over the disposition of funds,

then the presumption is that the assets are reserve assets (provided all other criteria for being a reserve asset are met). On the other hand, if the funds are held in a long-term fund with a separate legal identity, the presumption is that they should not be included in reserve assets, not least because the ready availability criterion is less likely to be met.

6.96 In some cases, while assets are invested in a separate investment corporation, there may be an agreement that such assets can be readily called back if needed. In other cases, funds could be withdrawn during the annual budgetary process.

6.97 Any final determination of whether an asset can be classified as a reserve asset or not, depends on an examination of the circumstances: namely, is the asset readily available to the monetary authorities and is there a liquid claim of a resident entity on a nonresident in foreign currency? But in the absence of legal or administrative impediments, and given the fungibility of assets, even assets that had been earmarked as part of a special purpose government fund—but that could be used to meet balance of payments financing needs and other related purposes—are reserve assets (subject to the other criteria being met, including, importantly, the control of the monetary authorities over the disposition of the funds).

6.98 Assets held in special purpose government funds that meet the definition of reserve assets are classified within reserve assets depending on their nature. So, if the special purpose government funds hold deposits, securities, and other reserve assets, these are classified as such within reserve assets. Assets held in a resident special purpose government fund that are claims on nonresidents but do not meet the criteria to be classified as reserve assets are classified in the financial account and IIP under the appropriate instrument and functional category. If special purpose government funds own direct investment equity and debt securities that could be classified in either direct investment or reserves assets, as general guidance, in the hierarchy of the balance of payments and IIP between direct investment and reserve assets, the equity securities should be classified as direct investment ahead of reserve assets, and debt securities should be classified as reserve assets ahead of direct investment.

#### *Pooled assets*

6.99 As a means of reserve assets management, monetary authorities from different economies might cooperatively invest through an asset pool. Such pooled asset arrangements are collective investment schemes

under which funds provided by participants are held in an investment vehicle (usually nonresident of the participants' economies) that conducts investments. The participants have a claim on the collective investment scheme. Some pooled asset arrangements may have features that constrain the use of the claim as a reserve asset. To determine whether the claim on the pooled asset arrangement meets the definition of reserve assets, as with special purpose government funds, an examination of the legal and institutional framework of the arrangement is needed.

6.100 As with other reserve assets, the claim on the asset pool needs to be readily available to the monetary authorities and to be a liquid claim in foreign currency on nonresidents. In addition, other factors should be considered in determining whether the claim is a reserve asset. These include the following:

- **The ability to use pooled assets to raise external liquidity in foreign currency.** Even if the claim is in foreign currency, a high concentration of the underlying assets in claims on the domestic economy that constrains the ability of that economy to generate external liquidity or that results in the foreign currency value of the instrument being significantly affected in a time of crisis (such as a high concentration in domestic currency assets) would cause considerable doubt as to whether the instrument could be included in reserve assets.
- **Whether the assets are truly foreign currency claims.** An asset pool might be structured such that, while the assets are denominated in foreign currency, the monetary authority has a de facto claim in the domestic currency. In this instance, it is inappropriate to classify the asset as a reserve asset for the reasons described in paragraph 6.74.

6.101 Pooled assets are classified within reserve assets depending on their nature. For instance, if the participant can readily transact in these claims only by selling its claim back to the investment vehicle, the claim might need to be classified as a nonnegotiable investment fund share (an "other claim"). Pooled assets that are claims on nonresidents but that do not meet the criteria to be classified as reserve assets are classified in the financial account according to their nature (most probably an equity asset) under the appropriate functional category.

#### *Central bank swap arrangements*

6.102 Assets created under reciprocal facilities (swap arrangements) for the temporary exchange of deposits

between the central banks of two economies warrant mention. Deposits (in foreign exchange) acquired by the central bank initiating the arrangement are treated as reserve assets because the exchange provides the central bank with assets that can be used to meet the economy's balance of payments financing needs and other related purposes. Reciprocal deposits acquired by the partner central bank also are considered reserve assets, as long as they meet the general criteria for being reserve assets, if they are denominated and settled in a convertible currency.

6.103 Reciprocal currency arrangements between central banks may also take the form of a securities repurchase agreement. In this case, one central bank transfers securities (sometimes denominated in its domestic currency) to another central bank in exchange for foreign currency, with the transactions later reversed, typically three months in the future. Such transactions should be treated as collateralized loans, with the central bank that initiated the transaction paying corresponding interest on the foreign currency received. The cash-taking central bank can therefore include the foreign currency received in its reserve assets if the criteria for reserve assets are met. The cash-providing central bank should not include the securities received as collateral in its reserve assets as the securities are treated as not having changed economic ownership (see paragraph 5.54). See also paragraph 6.90 on securities lending or borrowing transactions in reserve assets.

6.104 When a central bank acquires or disposes of a liquid foreign currency claim on a nonresident from a domestic bank (e.g., through an exchange of foreign and domestic currency deposits, a change in reserve requirements on foreign currency deposits, or other domestic transactions that increase or change the composition of reserve assets), this is recorded through the other changes in volume account. It is not recorded in the balance of payments, however, given that the transaction is between two residents (see paragraph 3.6).

*i. Foreign assets that do not qualify as reserve assets*

6.105 Lines of credit that could be drawn on and foreign exchange resources that could be obtained under swap agreements are not reserve assets because they do not constitute existing claims. Real estate owned by the monetary authorities is not to be included in reserve assets because real estate is not considered a liquid asset. Silver bullion, diamonds, and other precious metal and

stones are not included in reserve assets because they are considered goods and not financial assets.

6.106 Capital subscriptions to international organizations that are not readily available to the monetary authorities do not meet the definition of reserve assets. These subscriptions are included in other investment, unless they are in the form of securities, in which case they are classified as portfolio investment.

6.107 Pledged assets are typically not readily available. Those pledged assets that are encumbered and therefore are not readily available should be excluded from reserve assets. Encumbered assets are distinguished from reserve assets that are pledged under securities lending arrangements and repurchase agreements.

6.108 An example of pledged assets is collateral used for third-party loans and third-party payments. If these assets are encumbered, they should be excluded from reserve assets. However, assets may be pledged as collateral to provide guarantees in the event of default by another entity, or for lines of credit, and may not be encumbered until events occur to trigger the pledge. Such assets can be included in reserve assets until encumbered. Other examples of pledged assets that are to be excluded from reserve assets include (a) assets pledged by the monetary authorities to investors as a condition for the investors to invest in securities issued by domestic entities (such as central government agencies), if such pledged assets are considered encumbered; and (b) assets lent by the monetary authorities to a third party that are not available until maturity.

6.109 The pledged assets should be excluded only to the extent of the value of the pledge; in other words, if the pledge is valued at 100, the maximum amount to be excluded from reserve assets is 100.

6.110 In some circumstances, assets held as reserve assets may be "frozen," such as by a foreign government within whose jurisdiction the assets are located, restricting their availability. In such circumstances, the reserve assets that are affected are to be reclassified to the relevant functional category, such as "other investment" if bank deposits are "frozen."

6.111 Foreign currency claims that are transferred to the monetary authorities by other institutional units in the reporting economy just prior to certain accounting or reporting dates, with accompanying reversals of such transfers soon after those dates (commonly known as "window dressing"), should not be counted as reserve assets.



6.112 Net creditor positions in regional payments arrangements that involve reciprocal lines of credit—a characteristic of loan arrangements (see paragraph 5.51)—are classified as loans in other investment<sup>18</sup> and are not included in reserve assets, except in circumstances in which they are considered readily available to the monetary authorities to meet a balance of payments need and other related purposes. Net asset balances in bilateral payments agreements have much in common with other types of tied loans that authorities make to stimulate exports, provide aid, or further other aspects of government policy. Such bilateral payments agreement balances are therefore conventionally excluded from reserve assets. Also, owing to their nature, working balances of government agencies are not included in reserve assets.

*j. Other issues*

6.113 Assets owned by the monetary authorities that do not meet the criteria to be classified as reserve assets are classified in the financial account under the appropriate instrument and functional category.

6.114 Currency unions and economies that adopt another currency (such as dollarization and euroization) raise specific issues for the concept of reserve assets. These issues are discussed in Appendix 3.

## 2. Reserve-related liabilities

**6.115** *Reserve-related liabilities are defined as foreign currency liabilities of the monetary authorities that can be considered as direct claims by nonresidents on the reserve assets of an economy. Though not identified as such in the standard components of the balance of payments and IIP, where they are included in other categories (notably portfolio*

<sup>18</sup>Net debtor positions in such arrangements are also classified as loans.

and other investment), reserve-related liabilities are important to monitor. Reserve-related liabilities can be presented by instrument and maturity (see Appendix 9, Table V). Short-term reserve-related liabilities on a remaining maturity basis are a memorandum item to the IIP (as shown in Box 6.5). Some economies may choose to present the full table of foreign currency assets and liabilities in Appendix 9, Table V, separately identifying the short-term reserve-related liabilities.

6.116 The value of the SDR allocation and loans from the IMF to monetary authorities are included in reserve-related liabilities. Other liabilities covered include:

- Foreign currency loan and deposit liabilities of the monetary authorities to nonresidents, including those arising from foreign currency swaps with other central banks, loans from BIS, and from other deposit-takers;
- Foreign currency loan liabilities to nonresidents associated with securities that the monetary authorities have repoed out;
- Foreign currency securities issued by the monetary authorities and owed to nonresidents; and
- Other foreign currency liabilities to nonresidents, including foreign currency accounts payable and financial derivatives—recorded on a net basis (liabilities less assets)—settled in foreign currency and associated with, but not within the definition of, reserve assets (see paragraph 6.91). Such financial derivatives could include those that are not sufficiently liquid or are not integral to the valuation of reserves assets.

Liabilities to residents and liabilities that are both denominated and settled in domestic currency are not included.

# 7 International Investment Position

## A. Concepts and Coverage

References:

2008 SNA, Chapter 13, The Balance Sheet.

IMF, *Monetary and Financial Statistics Manual 2000*.

IMF, *International Investment Position: A Guide to Data Sources*.

IMF and others, *External Debt Statistics: Guide for Compilers and Users*.

7.1 *The international investment position (IIP) is a statistical statement that shows at a point in time the value and composition of*

- (a) *financial assets of residents of an economy that are claims on nonresidents and gold bullion held as reserve assets, and*
- (b) *liabilities of residents of an economy to nonresidents.*

The difference between an economy's external financial assets and liabilities is the economy's net IIP, which may be positive or negative.

7.2 The IIP is a subset of the national balance sheet. The net IIP plus the value of nonfinancial assets equals the net worth of the economy, which is the balancing item of the national balance sheet. The classification of nonfinancial assets is shown in Table 5.1 and linked to corresponding income items in Table 5.2.

7.3 The IIP relates to a point in time, usually at the beginning of the period (opening value) or end of the period (closing value).

7.4 This chapter explains the coverage, presentation, classification, timing, and valuation issues for the IIP, and its relationship to transactions accounts and other changes in assets and liabilities account.

7.5 The content of the IIP can be presented in several different ways. Table 7.1 shows an overview of the structure and components of the IIP by functional category and broad financial instruments. This presen-

tation emphasizes how changes in the IIP result from financial account transactions (discussed in Chapter 8) and other changes in financial assets and liabilities (discussed in Chapter 9) during a period.

7.6 Table 7.2 provides another presentation that emphasizes the breakdown of the IIP by institutional sector and functional category. Institutional sectors in the IIP refer to the resident sector, not the counterpart sector (i.e., the sector of the domestic holder or lender for assets, and the sector of the domestic issuer or borrower for liabilities).

### Additional detail

7.7 This edition of the *Manual* reflects the increasing emphasis on the IIP in international accounts compilation and analysis. There has been growing recognition of the role of balance sheet analysis in understanding sustainability and vulnerability, including currency mismatches, the implications of sector and interest rate composition of debt, and the effect of the maturity structure on liquidity. IIP data are useful for other purposes, such as measuring rates of return, analyzing economic structure, and studying the relationship to domestic sources of financing.

7.8 Consequently, a currency composition and remaining maturity analysis of the IIP are encouraged as additional information. To meet this goal, memorandum and supplementary tables have been introduced in Appendix 9, and are shown after the standard components. These tables provide a presentation of currency composition of assets and liabilities by sector with a distribution by principal foreign currencies, including the U.S. dollar, euro, yen, and others, together with a breakdown by original maturity. The tables also provide information on the remaining maturity of long-term debt liabilities, with a breakdown by sector. These tables are consistent with the standard components of the IIP and with the presentation adopted in *External Debt Statistics: Guide for Compilers and Users*.

**Table 7.1. Integrated International Investment Position Statement**

(Including functional categories, instruments, and link to financial and other changes accounts)

	Beginning of period IIP	Financial account Transactions	Other changes in financial assets and liabilities account			End of period IIP
			Changes in position due to:			
			Other changes in volume	Exchange rate changes	Other price changes	
<b>Assets</b>						
By functional category						
Direct investment						
Portfolio investment						
Financial derivatives (other than reserves) and ESOs						
Other investment						
Reserve assets						
By instrument						
Equity and investment fund share/units						
Debt instruments						
Special drawing rights						
Currency and deposits						
Debt securities						
Loans						
Insurance, pension, standardized guarantee schemes						
Other accounts receivable/payable						
Other financial assets and liabilities						
Monetary gold						
Financial derivatives and ESOs						
<b>Total assets</b>						
<b>Liabilities</b>						
By functional category						
Direct investment						
Portfolio investment						
Financial derivatives (other than reserves) and ESOs						
Other investment						
By instrument						
Equity and investment fund share/units						
Debt instruments						
Special drawing rights						
Currency and deposits						
Debt securities						
Loans						
Insurance, pension, standardized guarantee schemes						
Other accounts receivable/payable						
Other financial assets and liabilities						
Financial derivatives and ESOs						
<b>Total liabilities</b>						
<b>Net IIP</b>						

Note: This table is expository; for Standard Components, see Appendix 9.  
 ESO = employee stock option; IIP = International Investment position.

**For additional information**

7.9 Several other guides provide specialized guidance on particular aspects of the IIP and related statistics, namely:

- **BIS**, *Guide to the International Financial Statistics* (BIS Paper No. 14, February 2003);

- **IMF**, *Coordinated Direct Investment Survey Guide*;
- **IMF**, *Coordinated Portfolio Investment Survey Guide*;
- IMF and others, *External Debt Statistics: Guide for Compilers and Users*;



liabilities) or the full breakdown, as defined in Chapter 5;

- (c) Institutional sector of resident party—at least, central bank, deposit-taking corporations except the central bank, general government, and other sectors; other sectors is split between other financial corporations and the remaining non-financial subsectors (nonfinancial corporations, households, and NPISHs), as defined in Chapter 4, Section D. Additional subsectoring of the financial and nonfinancial sectors may be undertaken when analytically relevant;
- (d) Maturity (in the case of debt instruments)—short-term or long-term, by original and remaining maturity, as defined in paragraphs 5.103-5.105;
- (e) Currency—domestic or foreign currency, as defined in paragraphs 3.95-3.97 for debt and 3.100 for equity; and (in the case of financial derivatives) to receive or pay foreign currency, as defined in paragraph 5.108; and
- (f) Interest rate structure (in the case of debt instruments)—variable- or fixed-rate, as defined in paragraphs 5.109-5.114.

Sector, maturity, and currency are relevant to studies of sustainability, vulnerability, and exposure to exchange rate changes (after taking into account any hedging). The remaining maturity is important to the debtor, but it is less relevant for the creditor with liquid instruments, in that the assets can be sold before maturity. In addition to the institutional sector of the resident party, as in (c), the institutional sector of nonresident counterparty may also be of interest in some cases (e.g., governments may wish to distinguish between other governments, international organizations, and other sources of their borrowing).

7.13 A consistent classification should be used as far as possible for IIP and other related accounts. The stock of assets and liabilities, financial account transactions, and other changes in financial assets and liabilities all relate to the same instruments, so a consistent classification is necessary for a comprehensive analysis of relationships between them. Similarly, a consistent level of detail for income (and possibly holding gains or losses, for some purposes) and positions allows the estimation of rates of return. Although the international accounts functional classification of assets and liabilities is not used in the *SNA* or financial statistics, the instrument and institutional sector classifications are the same. The inclusion of instrument and sector detail in IIP data facilitates understanding and checking the

linkages with other data sets such as monetary and financial statistics.

## B. Direct Investment

7.14 Direct investment is defined in paragraphs 6.8-6.24. Other aspects of direct investment are covered in paragraphs 6.25-6.41. The directional principle presentation of direct investment can be used in the IIP on a supplementary basis, as discussed in paragraphs 6.42-6.45 and Box 6.4. Other specific issues concerning direct investment in the IIP are discussed in the following paragraphs.

### I. Valuation of unlisted and other equity

References:

OECD, *OECD Benchmark Definition of Foreign Direct Investment*, fourth edition.

IMF, *Coordinated Direct Investment Survey Guide*.

7.15 Shares and other equity can be readily valued at their current prices when they are regularly traded on stock exchanges or other financial markets. However, there may be no observable market prices for positions in equity not listed on a stock exchange (i.e., items (b) and (c) in paragraph 5.24). This situation often arises for direct investment enterprises, private equity, equity in unlisted and delisted companies, listed but illiquid companies, joint ventures, and unincorporated enterprises.

7.16 When actual market values are not available, an estimate is required. Alternative methods of approximating market value of shareholders' equity in a direct investment enterprise include the following:<sup>1</sup>

- (a) Recent transaction price. Unlisted instruments may trade from time to time, and recent prices, within the past year, at which they were traded may be used. Recent prices are a good indicator of current market values to the extent that conditions are unchanged. This method can be used as long as there has been no material change in the corporation's position since the transaction date. Recent transaction prices become increasingly misleading as time passes and conditions change.

<sup>1</sup>These are not ranked according to preference, and each would need to be assessed according to the circumstances and the plausibility of results.

- (b) Net asset value. Appraisals of untraded equity may be conducted by knowledgeable management or directors of the enterprise, or provided by independent auditors to obtain total assets at current value less total liabilities (excluding equity) at market value. Valuations should be recent (within the past year) and should preferably include intangible assets.
- (c) Present value and price-to-earnings ratios. The present value of unlisted equity can be estimated by discounting the forecast future profits. At its simplest, this method can be approximated by applying a market or industry price-to-earnings ratio to the (smoothed) recent past earnings of the unlisted enterprise to calculate a price.<sup>2</sup> This method is most appropriate in which there is a paucity of balance sheet information but earnings data are more readily available.
- (d) Market capitalization method. Book values reported by enterprises can be adjusted at an aggregate level by the statistical compiler. For untraded equity, information on "own funds at book value" (see paragraph 7.16(e)) can be collected from enterprises, and then adjusted with ratios based on suitable price indicators, such as the ratio of market capitalization to book value for listed companies in the same economy with similar operations. Alternatively, assets that enterprises carry at cost (such as land, plant, equipment, and inventories) can be revalued to current period prices using suitable asset price indices.
- (e) Own funds at book value. This method for valuing equity uses the value of the enterprise recorded in the books of the direct investment enterprise, as the sum of (a) paid-up capital (excluding any shares on issue that the enterprise holds in itself and including share premium accounts); (b) all types of reserves identified as equity in the enterprise's balance sheet (including investment grants when accounting guidelines consider them company reserves); (c) cumulated reinvested earnings; and (d) holding gains or losses included in own funds in the accounts, whether as revaluation reserves or profits or losses. The more frequent the revaluation of

assets and liabilities, the closer the approximation to market values. Data that are not revalued for several years may be a poor reflection of market values.

- (f) Apportioning global value. The current market value of the global enterprise group can be based on the market price of its shares on the exchange on which its equity is traded, if it is a listed company. Where an appropriate indicator may be identified (e.g., sales, net income, assets, or employment), the global value may be apportioned to each economy in which it has direct investment enterprises, on the basis of that indicator, by making the assumption that the ratio of net market value to sales, net income, assets, or employment is a constant throughout the transnational enterprise group. (Each indicator could yield significantly different results from the others.)

7.17 In cases in which none of the above methods are feasible, less suitable data may need to be used as data inputs. For example, cumulated flows or a previous balance sheet adjusted by subsequent flows may be the only sources available. Because these sources use the prices of previous periods, they should be adjusted for subsequent price developments, for example, by using aggregate share price or asset price indexes and by taking into account exchange rate movements, where relevant. The use of unadjusted summing of past transactions is not recommended. Equity represents owners' funds. The means through which equity can be generated may take various forms, such as share issues, equity injections without any commensurate issue of shares (sometimes called "contributed surplus" or "capital contributions"), share premiums, accumulated reinvested earnings, or revaluation. Although these categories should be taken into account when cumulated flows are used to measure the value of equity, the different categories are all components of equity and need not be identified separately.

7.18 If the current market price is not directly observable, the decision about the methods to adopt should take into account the availability of information as well as judgments as to which available method best approximates market values. Different methods may be suitable for different circumstances and a standard ranking of the alternative methods is not proposed for valuing instruments when current market prices are not directly observable. Compilers should be transparent and should state clearly the method(s) used. Methods

<sup>2</sup>The earnings measure and earnings in the price-to-earnings ratio should be defined in the same way. It is preferable that measures of earnings and ratios exclude one-off factors, such as asset sales, as such factors could distort the calculation.

for valuation of direct investment equity positions are discussed in more detail in the *OECD Benchmark Definition of Foreign Direct Investment*. These methods may also be useful for valuation of other unlisted equity securities and other equity.

7.19 The value of a direct investment enterprise's nonequity liabilities may exceed its assets—this situation can occur most commonly in the early or final stages of its existence.

## 2. Entities that borrow on behalf of their affiliates

Reference:

OECD, *OECD Benchmark Definition of Foreign Direct Investment*, fourth edition.

7.20 An entity resident in one economy may borrow funds on behalf of affiliated enterprises in one or more other economies. The affiliates may include holding companies, parent companies, direct investment enterprises, and fellow enterprises. Examples include SPEs, sometimes called conduits, which may be used to undertake the borrowing, or an entity with substantial activities of its own may do the borrowing. In these cases, the liability is often guaranteed by the parent or a fellow enterprise. Alternatively, the affiliated enterprise may commit future revenue streams. Regulatory or taxation benefits may be factors behind such arrangements. In these cases, the creditor records a claim on the entity that directly undertakes the borrowing. That is, the creditor does not show its claim as being on the enterprise that ultimately receives the funds or makes the guarantee.

7.21 When funds raised are passed on by the borrowing entity to an affiliated enterprise, the initial borrowing entity has a claim on the affiliated enterprise. This arrangement can be assumed to give rise to a loan, unless there is evidence that it is a debt security or equity. This borrowing can arise for pass-through funds (discussed in paragraphs 6.33-6.34), conduits (paragraph 4.86), and SPEs and similar legal structures (paragraph 4.87). In many cases, such investment is reverse investment or investment between fellow enterprises, as discussed in paragraphs 6.39-6.41 and 6.43, respectively.

7.22 Special rules apply to an entity owned or controlled by general government when that entity is resident in another territory and is used for fiscal purposes. These rules are discussed in paragraphs 8.24-8.26.

## 3. Quasi-corporations

7.23 The identification of institutional units for branches, notional resident units for ownership of land and natural resources, some joint ventures, and preparatory operations prior to incorporation and other quasi-corporations is discussed in paragraphs 4.26-4.49. The effect of the identification of such institutional units is that owners are shown as having a claim on the institutional unit, rather than as directly owning the various individual assets.

7.24 Owners' claims on quasi-corporations that are resident in other economies are usually classified as direct investment. In the rare cases in which the proportion of equity in land or a joint venture is less than 10 percent, the claim is classified as other investment—other equity.

7.25 Equity in quasi-corporations should be valued as equal to the market value of the quasi-corporations' assets less the market value of liabilities other than equity to both residents and nonresidents. (This method would mean that quasi-corporations have no residual net worth.) Alternatively, equity in quasi-corporations may be valued using the same methods as used for direct investment equity, discussed in paragraphs 7.16-7.17.

## C. Portfolio Investment

### 1. Equity with dividends declared payable but not yet paid

7.26 In market quotations, dividends declared payable but not yet paid are taken into account in the share price. After the point of time when ownership of shares is determined for the purposes of payment of dividends, the shares go "ex dividend." (Ex dividend is the point at which the shares no longer carry the right to the most recently declared dividend; so the dividend becomes separated from the share and the price falls to reflect that.) After that time, dividends declared should be included in accounts receivable/payable until payment is made.

### 2. Debt instruments with accrued interest

7.27 Accrued interest not yet paid on debt securities should be included in the outstanding amount of the financial asset or liability. Accrued interest not yet paid includes interest that has accrued and that is not yet due for payment or that is due for payment

but in arrears. Accrued interest not yet paid should not be reported separately (such as in other accounts receivable/payable). In market quotations, a value including interest that has accrued but is not yet payable is called the "dirty price" and is suitable for valuation of items in the IIP (provided interest due and not yet paid is also included). In contrast, the "clean price" requires accrued interest not yet paid to be added for use in the IIP. Methods of calculating the accrual of interest are discussed in paragraphs 11.48-11.76.

### 3. Short positions

7.28 Short positions occur when an institutional unit sells securities for which it is not the economic owner. For example, a security subject to a repurchase agreement may be on-sold by the security-receiving party (see paragraphs 5.52-5.54 on repurchase agreements). Delivery to the purchaser is made through the use of a borrowed security. The party with the short position records a negative value for the holding of the asset. The short position is shown as a negative asset, rather than a liability. (Short positions have been included on the research agenda for further work; see paragraph 1.43.)

### 4. Unlisted debt and equity securities

7.29 Positions in unlisted portfolio investment equity securities without an observable market price may be valued using methods discussed in paragraphs 7.16-7.17 for direct investment equity. Some listed debt securities also may have no quoted prices, for example, if the market is illiquid or the security ceases trading due to suspension, default, or bankruptcy. A market price can be estimated for such debt securities by discounting future cash flows using a discount rate that takes into account the risk of default (present value approach).

### 5. Debt securities at nominal values

7.30 Whereas the basic valuation method for debt securities is the market value, the nominal value is encouraged as a supplementary item. *External Debt Statistics: Guide for Compilers and Users* recommends that both valuations be used. The nominal value of debt securities is a useful measure of value from the viewpoint of the debtor, because at any moment, it is the amount that the debtor owes to the creditors.

### 6. Zero-coupon and deep-discount bonds

7.31 A zero-coupon bond has a single payment at maturity and no coupon payments. The bond is sold at a discount from face (or par) value, and at maturity, an amount equal to face value is repaid. The difference between the discounted issue price and the face value reflects the market rate of interest at the time of issue—the longer the maturity of the bond and the higher the market interest rate, the greater the discount against the face value. The accrual of interest on zero-coupon bonds is discussed in paragraph 11.55 and is illustrated in Box 11.2.

7.32 A deep-discount bond is a bond that has a low coupon compared with the market rate of interest, so that it is issued at a considerable discount to face value. Like the zero-coupon bond, the difference between the issue price and face value accrues as interest over the life of the bond, and the market value of the bond increases as the interest accrues. The accrual of interest on deep-discount bonds is discussed in paragraph 11.56.

### D. Financial Derivatives (Other Than Reserves) and Employee Stock Options

7.33 Financial derivatives and ESOs are valued at market prices prevailing on balance sheet recording dates. If market price data are unavailable, other fair value methods (such as option models or present values) may be used to value them. Compilers are generally constrained to use the parties' own accounts.

7.34 For an option (including warrants), the market value recorded is the current value of the option—that is, the prevailing market price. In the absence of a prevailing market price, the estimated cost of buying out the rights of the option holder should be used. The counterpart liability is attributable, by convention, to the writer of the option and is valued at the current cost of buying out the rights of the option holder. For a warrant, the counterpart liability of the issuer is the current outlay required to buy out the exercise rights of the holder. A forward-type contract is recorded at market value; when payments are effected, a transaction is recorded and the change in the value of the asset and associated liability is reflected in the position (see paragraph 5.81 for discussion of offsetability).

7.35 A key characteristic of many derivative contracts is that the counterparties make commitments to transact, in the future and at agreed-on prices, in underlying items. The present value (or market price)



of a financial derivative is derived from the difference between the agreed-on contract price of an underlying item and the prevailing market price (or the market price expected to prevail), appropriately discounted, for that item. For options, the price depends on the potential price volatility of the underlying instrument, the time to maturity, interest rates, and the difference between the strike price and the market price of the underlying item. The value of a swap contract is derived from the difference, appropriately discounted, between expected gross receipts and gross payments.

7.36 The market value of a forward-type contract can switch from an asset position to a liability position (and vice versa) between reporting dates. The switch is a result of movement in the price of the underlying item(s) from which the value of the forward-type contract is derived. When a switch in position occurs (and there are no settlement payments), the market value of the gross asset or liability position at the close of the previous accounting period is revalued to zero, and the gross liability or asset position is revalued from zero to the market value at the end of the present accounting period.

7.37 Gross asset and gross liability data should be compiled by summing, respectively, the values of all individual contracts in asset positions and the values of all individual contracts in liability positions. Financial derivatives, by preference, should be reported separately for both assets and liabilities, as discussed in paragraphs 3.119 and 6.60. Notional values of financial derivatives are presented according to the formats shown in Appendix 9, Tables I-III. *The notional value (sometimes called notional amount or nominal amount) of a financial derivative is the amount underlying a financial derivative contract that is necessary for calculating payments or receipts on the contract.* This amount may or may not be exchanged. The notional values are useful for analysis because they provide information about the risk exposure and assist in understanding the link between financial derivatives and the underlying to which they relate.

7.38 Cumulation of transactions should never be used to estimate financial derivative positions. Transactions relate largely to those in options and to settlements. Settlements eliminate positions, while the value of derivatives positions emerges largely from revaluation.

7.39 ESOs are valued consistently with the cumulated compensation of employees until the vesting date (see paragraphs 11.20-11.21); thereafter, they are valued at market prices (see paragraph 9.30). ESOs can be measured from a market value of equivalent options or

according to an options-pricing model, such as Black-Scholes. International accounting standards give guidance on methods, and recording in the international accounts normally will follow business accounts.

## E. Other Investment

### I. Valuation of nonnegotiable instruments

#### a. Nominal value

7.40 Nonnegotiable instruments include loans, deposits, and other accounts receivable/payable. The primary valuation for positions in these instruments is nominal value, which is defined in paragraph 3.88. In the case of other equity included in other investment, valuation methods for unlisted direct and portfolio investment equity may be used, as discussed in paragraphs 7.16-7.17 and 7.25.

7.41 Accrued interest not yet paid should be included in the outstanding amount of the financial asset or liability, rather than being classified separately (such as in other accounts receivable/payable). Accrued interest not yet paid also includes FISIM accrued and not yet paid.

7.42 Nominal values are not adjusted for expected losses or for changes in interest rates. The market value may differ from the nominal value primarily due to changes in market interest rates and the possibility that some liabilities may not be repaid. The possible divergence between nominal and market values arises for loans, but it can also arise for deposits and other accounts receivable/payable.

7.43 The use of nominal values for some nonnegotiable instruments, instead of market-equivalent values, in the HP is partly influenced by pragmatic concerns about data availability and also by consistency in reporting by debtors and creditors. Nominal valuation is also useful in its own right, however, because it shows actual legal liability and the starting point of creditor recovery behavior.

7.44 The nominal value can be reduced by a write-off, restructuring, or debt forgiveness:

- Liabilities are canceled or written off, in part or in full, by the creditor as uncollectible, usually because of the bankruptcy or liquidation of the debtor, as discussed in paragraphs 9.8-9.11.
- In a formal debt reorganization, the old liability is regarded as being extinguished and a new liability created. (See Appendix 2, Debt Reorganization and Related Transactions.)

*b. Additional data on loans and other nonnegotiable instruments*

7.45 While nominal value is the primary valuation method for nonnegotiable instruments, it provides an incomplete view of the financial position of the creditor, particularly in cases in which the instruments are impaired. Consequently, additional items are included for loans to give additional information. The possible items are:

- (a) fair value,
- (b) nonperforming loans, and
- (c) loan loss (bad debt) provisions.

These items are discussed in paragraphs 7.48-7.53. Data on debt in arrears are discussed in paragraphs 5.99-5.102. These are alternative indicators that can be used to assess the effect of impairment and other variations between nominal values and market-equivalent values. Fair value expresses a market-equivalent valuation of the position. Nonperforming loans indicate the value of the loans that are impaired, and loan loss (bad debt) provisions show amounts that are deducted from the nominal value to account for expected losses in business accounts.

7.46 The fair value of loans is shown as a memorandum item for creditors. If fair value data for loans are not available, the nominal value of nonperforming loans should be provided as a memorandum item. These memorandum items are included for assets but not liabilities. If fair value data are available, nonperforming loans is a supplementary item. Data on loan loss (or bad debt) provisions and arrears also may be provided on a supplementary basis.

7.47 The same issue of impairment arises for deposits and trade credit. For example, an insolvent bank may have closed its doors, so that its deposits may be worth less than their nominal value, so alternative measures for deposits and trade credit may be prepared, where relevant.

*c. Fair value*

Reference:

*International Financial Reporting Standards*, International Accounting Standard 39 Financial Instruments: Recognition and Measurement.

7.48 *Fair value is defined as the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's-length transaction. That is, fair value represents a market-equivalent value, namely, an estimate of what could have been realized if the creditor had sold the*

loan. It is the preferred indicator of the effect of loan impairment as it represents an attempt to measure the realizable value. The fair value of loan assets is shown as a memorandum item for assets, where available.

7.49 The calculation of fair value takes into account expected loan losses. In addition, in the case of fixed-rate loans, it takes into account changes in market interest rates. In practice, the availability of fair value estimates of loans is limited by business accounting practice. A recent transaction in the loan or one of similar term, credit risk, and so on provides a good guide to the fair value. As the time since the transaction becomes longer and conditions change, such transactions values become historic prices and not market-equivalent values.

*d. Nonperforming loans*

7.50 *Nonperforming loans are defined as those for which:*

- (a) *payments of principal and interest are past due by three months (90 days) or more, or*
- (b) *interest payments equal to three months' (90 days') interest or more have been capitalized (reinvested into the principal amount) or payment has been delayed by agreement,<sup>1</sup> or*
- (c) *evidence exists to classify a loan as nonperforming even in the absence of a 90-day past due payment, such as when the debtor files for bankruptcy.<sup>2</sup>*

7.51 Nonperforming loans are recorded at nominal value, which allows them to be compared with the total value of loans at nominal value. The value should include accrued interest not yet paid. Loans continue to be included in nonperforming loans until written off (see paragraphs 9.8-9.11), forgiven (see paragraphs 13.22-13.23), reorganized (see paragraph 9.29 and Appendix 2), or they become performing loans.

7.52 The three-month (or 90-day) criterion is the time period most widely used, although other periods are used. When the standard definition of nonperforming loans is not used, other definitions based on regulatory frameworks are acceptable. Because identification of nonperforming loans is a bank regulatory concept, it may not be used widely by other creditors. The nominal value of nonperforming loan assets is a memorandum

<sup>1</sup>If the loan is rescheduled, it is classified as a new instrument (see paragraph 7.53). Rescheduling interest arrears is not sufficient for the loan to have been considered rescheduled, see paragraph A2.12.

<sup>2</sup>See *Financial Soundness Indicators Compilation Guide*, paragraph 4.84.

item when loan assets at fair value are not available; otherwise, it is a supplementary item.

7.53 Information on replacement loans may be provided in addition to nonperforming loans. Replacement loans include loans arising from rescheduling or refinancing the original loan and loans provided to make payments on the original loan. Although these loans may be granted on "easier" than normal commercial terms, provided the terms and conditions of the replacement loan are complied with by the debtor, and subject to national supervisory guidance, the replacement loan is not classified as nonperforming.

*e. Loan loss provisions*

7.54 Loan loss provisions, also called bad debt provisions, are internal accounting entries made by creditors to take into account possible loan losses. These provisions may be used as an indicator of the difference between nominal values and fair values. International accounting standards allow for various approaches to derive these provisions, so procedures may differ between enterprises and between economies. Loan loss provisions may vary from the loss of value of nonperforming loans, for example, because there is adequate collateral for a nonperforming loan, or there is an expectation that a proportion of performing loans will default later.

*f. Deposits and other accounts receivable/payable*

7.55 Positions in deposits and other accounts receivable/payable give rise to the same issues of nominal and fair values as loans. For example, deposits may be held at a bank in liquidation, or trade credit liabilities may include those owed by insolvent debtors. These instruments should be recorded at their nominal value. However, if there is a significant difference between the nominal and fair value, indicators similar to those for loans should be shown as supplementary items.

*g. Metadata on indicators of impairment*

7.56 In view of the range of options concerning measures of impairment of loans and other nonnegotiable instruments, it is particularly important that metadata provide information on the definitions and sources used. As accounting procedures become more widely standardized, more prescriptive guidance may be given in statistical manuals for the adoption of particular indicators of impairment of loans.

## 2. Financial leases

7.57 A financial lease is defined in paragraph 5.56. The treatment of financial leases is designed to capture the economic reality of the arrangements. It moves away from the legal form by treating goods under a financial lease as if they were purchased and owned by the user. The financial lease is shown as a loan from the lessor to the lessee that is used to finance the acquisition of a fixed asset by the lessee. Financial leases affect goods, services, income, financial transactions, and positions.

## 3. Recording of positions associated with securities repurchase agreements and other reverse transactions

7.58 *Reverse transactions are arrangements that involve a change of legal ownership of securities or gold with a commitment to repurchase the same or similar securities or gold either on a specified date or with open maturity.* They include securities repurchase agreements, gold swaps, securities lending, and gold loans. The commitment to reverse the change in legal ownership in the future at a fixed price means that the original owner retains the risks and rewards of changes in the price of the asset. Accordingly, there is considered to be no change of economic ownership of the security or gold, so no transaction in that security or gold is recorded, and ownership of the asset as shown in the IIP is unchanged.

7.59 A reverse transaction may be with or without the supply of cash. If cash is supplied, as in a repurchase agreement (repo or securities lending with cash collateral), and in return the other party supplies securities, the arrangement is regarded as giving rise to a loan or deposit. (The classification of the cash supplied is discussed in paragraphs 5.52-5.54.) Analogously to repos, a gold swap for cash is treated as being a loan with the gold as collateral, and there is no change in the economic ownership of the gold.

7.60 There may be problems in attributing securities ownership when using custodians as a data source, because custodians may not know whether securities being held are under a repurchase agreement or not.

7.61 If a party that receives securities under a reverse transaction on-sells the securities to a third party, then it has a short position. The treatment of short positions is discussed in paragraph 7.28. Fees payable to one of the parties under a reverse transaction are discussed in paragraphs 11.67-11.68.

#### 4. Overnight deposits

7.62 *Overnight deposits (or sweep accounts) involve funds that are moved back and forth overnight. In some cases, these overnight accounts are held in another economy. The funds are returned at the beginning of the next working day and may then be moved back at the close of business. Positions should be measured after funds are moved at the end of the day. The calculation of major statistical aggregates—including external asset and liability positions and financial transactions—can differ substantially depending on whether they are measured before, or after, funds are moved. By measuring positions and transactions after the funds have been moved, consistency is ensured between the measure of interest flows and of positions. In addition, major data users are interested in the size and location of these stocks and flows for risk assessment and other purposes.*

#### 5. Insurance technical reserves, pension and annuity entitlements, and standardized guarantees reserves

7.63 These reserves include:

- (a) prepayment of premiums and reserves for outstanding claims for nonlife insurance (both reported claims and for claims incurred and not reported). Equalization reserves (explained further in paragraph 5.64(b)) for events that have occurred are included, whereas reserves for events that have not occurred are excluded;
- (b) entitlements of beneficiaries under life insurance policies and pension schemes; and
- (c) provisions for calls under standardized guarantees.

7.64 Insurance technical reserves are regarded as liabilities of the insurance companies and assets of the policyholders and beneficiaries. For economies that are major insurance service exporters or importers, cross-border insurance reserves may be significant. For economies that are major sources or destinations of temporary workers or that are sources or destinations for retirees who change residence, life insurance and pension entitlements may be important elements of the IIP. Insurance technical reserves may be classified as direct investment in the cases discussed in paragraph 6.27.

7.65 The nature of the pension entitlements liabilities of the pension fund and the corresponding asset of the beneficiaries depend on the nature of the pension plan:

- (a) *A defined contribution scheme is one in which the benefits are defined exclusively in terms of the level of the fund built up from the contri-*

*butions made over the employee's working life and the increases in value that result from the investment of these funds by the manager of the pension scheme. The entire risk of the scheme to provide an adequate income in retirement is thus borne by the employee. The liability of a defined contribution fund, and the corresponding assets of the beneficiaries, are equal to the current market value of the assets of the fund, including any claims on the employer. Defined contribution plans are always funded.*

- (b) *A defined benefit scheme is one in which the benefits payable to the employee on retirement are determined by the use of a formula, either alone or as a minimum amount payable. The liability of a defined benefit scheme, and the corresponding assets of the beneficiaries, are equal to the present value of the promised benefits. In defined benefit schemes, benefits to the policyholder are guaranteed, but the scheme may be funded or unfunded.*

7.66 The calculation of the value of pension entitlements may be direct or actuarial. Obligations of unfunded pension schemes are recognized as liabilities, based on actuarial estimates of the accrued liability to beneficiaries under the scheme. Potential payments by social security schemes are not recognized as financial assets or liabilities. (See paragraphs 5.66-5.67 for more detail about pension entitlements as a financial instrument.)

7.67 Provisions for calls under standardized guarantees are calculated in a similar way as described for nonlife insurance technical reserves. They are equal to the present value of expected calls under outstanding guarantees, net of any recoveries the guarantor expects to receive from the defaulting parties.<sup>5</sup>

7.68 To the extent that these reserves, entitlements, and provisions are measured from the accounts of insurance companies, pension schemes, and issuers of standardized guarantees, they may need to be split between liabilities to residents and nonresidents according to a suitable indicator such as premiums payable. The priority attached to the estimation of cross-border

<sup>5</sup>These amounts may represent an overstatement of the assets and liabilities. For example, financial institutions make 1,000 loans of 20 units each that are covered by standardized guarantees, of which estimated claims are 200. The combined assets (and combined liabilities) of all the parties involved would be shown as 20,200, consisting of 20,000 loans and 200 in expected calls under the guarantees, even though only a maximum of 20,000 could ever be realized. The overstatement arises because the loans are recorded at nominal value.

proportions of insurance reserves depends on their significance in each economy.

## F. Reserves

7.69 At the appropriate reference dates, reserve assets are valued in the main at current market prices. Monetary gold is valued at the prevailing market price, SDRs are valued at market rates calculated by the IMF, and deposits and loans are valued at nominal values.

7.70 SDR holdings are a reserve asset, while the allocation of SDRs to IMF members is shown as the incurrence of a liability by the recipient and included in other investment. Therefore, for an economy that holds only its original allocation, its reserve assets are increased by the value of SDR holdings, but its net IIP is unchanged.

7.71 Reserve-related liabilities are shown as a memorandum item to the IIP on a short-term (remaining maturity) basis (see Appendix 9, Table V). They are defined in paragraphs 6.115-6.116. A comprehensive picture of foreign currency assets and liabilities of monetary authorities and central government, including positions with residents as well as nonresidents, can be presented according to the format in Table V in Appendix 9.

7.72 Positions with the IMF include reserve assets, reserve-related liabilities, other investment, and off-balance-sheet liabilities (these are elaborated in Annex 7.1).

7.73 Some governments have large special purpose government funds—usually known as sovereign wealth funds—as discussed in paragraphs 6.93-6.98. Some of these assets may be included in reserve assets or possibly in other functional categories. Where such a fund is significant, the special purpose government fund's foreign assets not included in reserve assets can be shown separately as supplementary items.

## G. Off-Balance-Sheet Liabilities

7.74 As noted in paragraphs 5.10-5.14, some actual and potential obligations are not recognized as liabilities in the IIP. Examples include potential liabilities under one-off guarantees, unfulfilled loan commitments, and other explicit contingent liabilities (for further discussion, see Chapter 9, Contingent Liabilities, of *External Debt Statistics: Guide for Compilers and Users*). If such

obligations to nonresidents are significant, compilers should provide supplementary data in terms of the maximum exposure loss by type of contingent liability.

## Annex 7.1

### Positions and Transactions with the IMF

#### Quotas

7.75 IMF member countries are assigned a quota on joining the IMF. The subscription of the quota consists of two components:

- (a) Foreign exchange component. A member is required to pay 25 percent of its quota in SDRs or in foreign currencies acceptable to the IMF. This 25 percent portion is a component of the member's reserve assets. In the balance of payments, subscribing this portion is shown as a transaction involving a reduction in other reserve assets (credit) offset by an increase in the reserve tranche position in the IMF (debit).
- (b) Domestic currency component. The other 75 percent of the quota is payable in the member's own currency at a designated depository, normally the member's central bank. The payment is made either in domestic currency (IMF No. 1 and No. 2 Accounts) or by issuance of a promissory note (IMF Securities Account). The No. 1 Account is used for the IMF's operational transactions (e.g., purchases and repurchases), whereas the No. 2 Account is used for the payment of local administrative expenses incurred by the IMF in the member's currency. The promissory notes are encashable by the IMF on demand. The domestic portion of the quota payment is not recorded in the member's balance of payments or in the IIP (see paragraph 6.85), except for the No. 2 account (see below). No interest is payable on either the deposit account or the note.

7.76 There are periodic reviews of the size of member quotas. Recording transactions that reflect a change in a member's quota is the same as the recording that takes place when the quota is initially paid.

#### Reserve position in the IMF

7.77 *Reserve position in the IMF of a country equals the sum of the reserve tranche plus any indebtedness of the IMF (under a loan agreement) in*

*the General Resources Account that is readily available to the member country* (for further details, see paragraph 6.85). The reserve tranche represents the member's unconditional drawing right on the IMF, created by the foreign exchange portion of the quota subscription, plus increases (decreases) through the IMF's sale (repurchase) of the members' currency to meet the demand for use of IMF resources by other members in need of balance of payments financing. A member's reserve position in the IMF constitutes part of its reserve assets in the IIP.

7.78 To use its reserve tranche in the IMF, a member may purchase foreign exchange from the IMF with its own currency, provided that it has a balance of payments need. The domestic currency, equal to the value of the foreign exchange, is paid into the IMF's No. 1 Account with the member's central bank or through the issuance to the IMF of a promissory note recorded in the IMF's Securities Account. The transaction is recorded in the balance of payments as a reduction in the member's reserve tranche in the IMF, which is offset by an increase in the member's other reserve assets.

#### *Credit and loans from the IMF*

7.79 A member may make use of IMF credit or Poverty Reduction and Growth Facility (PRGF) loans to acquire additional foreign exchange from the IMF. Economically, the use of IMF credit and PRGF loans results in the same outcome—that is, the member entering into these agreements has access to foreign exchange in return for agreeing to meet a set of conditions. Both IMF credit and loans are classified as loans under other investment, although the two types of arrangements are executed in different ways:

- A PRGF loan results in the member borrowing foreign exchange with a commitment to repay. Such loans do not affect the IMF No. 1 Account.
- When a member country uses IMF credit, it "purchases" foreign exchange from the IMF in return for its domestic currency. Use of IMF credit is shown as the member's liability (in SDRs) in the balance of payments and IIP, whereas the sale of domestic currency to the IMF in the No. 1 Account is not shown as a balance of payments transaction or in the IIP. Liabilities under IMF credit arrangements are extinguished when the member uses foreign exchange to "repurchase" its domestic currency.

7.80 For use of IMF credit, if the value of the member's domestic currency changes in relation to the SDR, "maintenance of value payments" are made once a year in the No. 1 Account in domestic currency to maintain a constant SDR liability. Because the liability is denominated in SDRs, the maintenance of value payments are not entered as transactions in the balance of payments.

7.81 A member may also extend credit or make loans to the IMF that are not considered to be a part of the Reserve position in the IMF. Such a situation arises, for example, in the circumstance where a member's claim on the IMF is not immediately encashable at a time of balance of payments need.

#### *Remuneration*

7.82 The IMF pays its members "remuneration" quarterly on the basis of their reserve tranche position, except for a small portion related to prior quota payments in gold that are interest-free resources to the IMF. This remuneration is classified on an accrual basis as investment income-reserve assets-interest (credit), which is offset by an increase in reserve assets (debit).

#### *IMF No. 2 Account*

7.83 As discussed above, the IMF No. 2 Account is used by the IMF for administrative payments. Unlike the No. 1 Account, it is reflected in the balance of payments of a member as a liability. Transactions involving the No. 2 Account are recorded as increases or decreases in this liability and are offset by the source of funds (in the case of an increase) or the use of funds (in the case of a decrease). For example, when the IMF transfers funds from the No. 1 Account to the No. 2 Account in a member economy, the member's balance of payments shows an increase in its reserve tranche (debit). The increase reflects the reduction in IMF holdings of the member's currency in the No. 1 Account and is offset by an increase in the member's other investment liabilities relating to currency and deposits (credit). When the IMF uses funds from the No. 2 Account to pay for the acquisition of goods and services, the balance of payments of the member shows a reduction in this account (debit) and an offset (credit) under government goods and services n.i.e.

#### *Special drawing rights*

7.84 The SDR is an international reserve asset created by the IMF in 1969. It is administered by the SDR Department of the IMF, which is required by the IMF's

Articles of Agreement to keep its accounts strictly separate from the General Resources Account. The SDR is not a claim on the IMF. Rather, the membership of the SDR Department incurs the asset or liability position. Further information is covered in other chapters:

- SDRs are instruments as defined in paragraphs 5.34-5.35.
- SDR allocations received by a country are reported as liabilities under other investment

(paragraph 6.61) and reserve-related liabilities (paragraph 6.116).

- SDR holdings are classified as reserve assets (paragraph 6.84).

*Further information on IMF operations*

For more information on IMF operations, see the IMF's *Financial Organization and Operations of the IMF*, Pamphlet Series No. 45.

# 8 Financial Account

## A. Concepts and Coverage

Reference:

2008 SNA, Chapter 11, The Financial Account.

**8.1** *The financial account records transactions that involve financial assets and liabilities and that take place between residents and nonresidents.* The financial account indicates the functional categories, sectors, instruments, and maturities used for net international financing transactions. The financial account is classified according to the instrument and functional categories, as discussed in Chapters 5 and 6, respectively. Table 8.1 shows some main headings in the financial account. The left-hand column of Table 8.1 shows the net acquisition of financial assets and the right-hand column shows the net incurrence of liabilities. In the presentation in Table 8.1, assets are shown before liabilities, in accord with the order used in the IIP and general practice. (However, if the double-entry recording for the balance of payments as a whole needs to be emphasized, the liabilities could be shown in the first column. That presentation would be consistent with corresponding entries being on opposite sides of the accounts—e.g., a current account credit usually has an increase in financial assets or reduction in liabilities as its corresponding entry.)

**8.2** Entries in the financial account can be corresponding entries to goods, services, income, capital account, or other financial account entries. For example, the corresponding entry for an export of goods is usually an increase in financial assets, such as currency and deposits or trade credit. Alternatively, a transaction may involve two financial account entries. Sometimes, the financial account transaction involves the exchange of one asset for another, for example, a bond may be exchanged for currency and deposits. In other cases, the transaction may involve the creation of a new financial asset and corresponding liability.

**8.3** The overall balance on the financial account is called net lending/net borrowing. Net lending means that, in net terms, the economy supplies funds to the rest of the world, taking into account acquisition and disposal of financial assets and incurrence and repayment of liabilities. (Net borrowing means the opposite.) Despite the lending-oriented terms, net lending/net borrowing is a balance that takes into account equity, financial derivatives, and monetary gold, as well as debt instruments. Also, net lending includes reduction of liabilities and net borrowing includes reduction in assets. Net lending/net borrowing can be derived from either the sum of the balances on the current and capital accounts or from the balance on the financial account. In concept, the values should be equal. For a surplus of credits over debits in the current and capital accounts, there is a balancing net acquisition of financial assets or reduction of liabilities, which is shown in the financial account. Net lending/net borrowing of the international accounts is also equal to the net lending/net borrowing for the sum of the resident sectors of the national accounts.

**8.4** It may be of interest to show balances for components of the financial account. For example, analysts may be interested in net flows for each functional category—such as net direct investment derived as net acquisition of direct investment assets less net incurrence of direct investment liabilities.

**8.5** The financial account and the other changes in assets and liabilities account show the contribution to changes between the opening and closing stocks of financial assets and liabilities. (This relationship is also shown in Table 7.1.) These linkages of the financial account with the IIP and other changes accounts are made more transparent by the use of consistent classifications.

**8.6** As shown in Table 8.1, the financial account shows net acquisition of financial assets and net incurrence of liabilities. Net acquisition of financial assets can be labeled net changes in financial assets, which is



**Table 8.1 Overview of the Financial Account**

	Net acquisition of financial assets	Net incurrence of liabilities
Direct investment		
Portfolio investment		
Financial derivatives (other than reserves) and employee stock options		
Other investment		
Reserve assets		
<i>Total</i>		
Of which:		
Equity and investment fund shares		
Debt instruments		
Other financial assets and liabilities		
<b>Net lending/net borrowing (from financial account)</b>		

Note: This table is expository; for Standard Components, see Appendix 9.

wider in that it includes changes resulting from other flows, as well as transactions. Similarly, net incurrence of liabilities can be called net changes in liabilities.

### Net recording

8.7 Net recording in the financial account means aggregations whereby all debit entries of a particular asset or a particular liability are netted against all credit entries in the same asset type or in the same liability type. However, changes in financial assets should not be netted against changes in liabilities, with the possible exception for financial derivatives noted in paragraph 8.34 and in the balancing item. To illustrate the correct use of netting, acquisition of portfolio investment in equity is netted against the sales of that type of equity; new bonds issued are netted against redemption of bonds issued; but acquisition of bond assets is not netted against incurrence of bond liabilities. The net recording principle should be applied at the lowest level of classification of financial instruments, taking into account the functional category, institutional sector, maturity, and currency classifications, where applicable. In contrast to the net recording used in the financial account, the current and capital accounts are recorded on a gross basis, as explained in paragraph 3.113.

8.8 Net recording of flows in financial assets and liabilities are recommended in the international accounts for both analytical and pragmatic reasons. Financial markets are typified by large turnover. The focus of the financial account is on the net changes in each of external financial claims and liabilities due to transactions. Also, gross reporting of data may not be possible for certain classes of units and for some financial instruments.

### Gross recording on a supplementary basis

8.9 Data on gross flows are useful for analyzing market turnover and market behavior, and for measuring service fees generated. Often, a small net value may be the outcome of large gross flows. Where practical to do so, data on drawings and repayments on loans or acquisitions or disposals of other instruments could be made available to users on a supplementary basis. The data could be provided comprehensively or only for particular components.

### Timing and valuation

8.10 General principles for the time of recording for financial account entries are discussed in paragraphs 3.54-3.59. Transactions involving financial assets are recorded when economic ownership changes. Some financial liabilities, such as trade credit and advances, are the result of a transaction in nonfinancial items. In these cases, the financial claim is deemed to arise at the time the corresponding nonfinancial flow occurs.

8.11 In some cases, the parties to a transaction may perceive ownership to change on different dates because they acquire the documents evidencing the transaction at different times. This variation usually is caused by the time taken for delivery of documents and processing of transactions. The amounts involved in such "float" may be substantial in the case of transferable deposits and other accounts receivable or payable. If no precise date can be fixed, the date on which the creditor receives payment or some other financial claim can be adopted as a convention.

8.12 Financial account transactions in general are recorded at market values, as discussed in paragraphs 3.68-3.80. (Market values are defined in paragraph 3.70.)

8.13 The value of financial instruments should be recorded exclusive of any commissions, fees, service charges, regulatory levies, and taxes, whether charged explicitly, included in the purchaser's price, or deducted from the seller's proceeds. Commissions and dealers' margins, as discussed in paragraphs 10.120-10.123, are payable in return for the provision of financial services, so they should be excluded from the instrument price and included in services, where applicable. Therefore, the buyer and seller record financial account transactions, at the same mid-price, that is, the midpoint between the buyer's price and the seller's price.

## B. Direct Investment

8.14 Direct investment is defined in paragraphs 6.8-6.24. Specific issues in direct investment are discussed in the following paragraphs. Direct investment from direct investor to direct investment enterprise, reverse investment, and between fellow enterprises are identified separately. Presentation of direct investment financial flows according to the directional principle is discussed in paragraphs 6.42-6.45 and Box 6.4.

### I. Reinvestment of earnings

8.15 Reinvestment of earnings arising from a direct investor's equity in its direct investment enterprise is recorded as an imputed financial account entry. It is the corresponding entry and equal to reinvested earnings, which is an item in the primary income account (defined in paragraphs 11.33-11.36; it is the direct investor's share of the retained earnings or net saving of the direct investment enterprise, before reinvested earnings payable are deemed distributed). The financial account entry is shown separately under direct investment equity.

8.16 Reinvestment of earnings may be negative in some cases, for example, in case of losses by the direct investment enterprise or if dividends payable in a period are larger than net earnings in that period. Just as positive reinvested earnings are treated as being an injection of equity into the direct investment enterprise by the direct investor, negative reinvested earnings is treated as a withdrawal of equity.

### 2. Direct investment flows in kind

8.17 Goods, services, and other resources may be supplied by or to affiliated enterprises at above or below market prices, or with no payment. For example, a direct investor may supply machinery and equipment to its direct investment enterprise. As discussed in paragraphs 3.77-3.78, 10.35, and 11.101-11.102, when such flows are able to be valued, in principle there is a corresponding entry for direct investment. When goods and services are supplied below cost by a direct investor to a direct investment enterprise, if there is no other indication about the motivation, it can be assumed to be for the purposes of building up the direct investor's equity in the direct investment enterprise.

### 3. Mergers and acquisitions

8.18 Mergers arise when two or more companies agree to combine into a single operation. Acquisitions involve the purchase of one company or group of companies by another company or group of companies (though not all the shares may be acquired by the purchaser). Mergers and acquisitions data are not identified as standard components within direct investment. Nonetheless, there may be interest in such data because the nature of mergers and acquisitions may differ from other direct investment—for example, they may not provide any new financing for the firms involved but rather represent a change in investors. See *OECD Benchmark Definition of Foreign Direct Investment*, Annex 9, which discusses the definition and collection of data on merger and acquisition transactions.

### 4. Corporate inversion and other restructuring

8.19 *Corporate inversion describes the corporate restructuring of a transnational enterprise group such that the original parent company in one economy becomes a subsidiary of the new parent in another economy. In addition, ownership of a group of enterprises may be shifted to the new parent company.* Such arrangements may be called corporate relocations, headquarters relocations, or corporate restructuring. The process may take place over more than one period. Although corporate inversion has a similar economic effect to a change of residence of the parent company (as discussed in paragraphs 4.167 and 9.21), it differs in that inversion is achieved by transactions in assets between different entities, rather than by a single entity changing its residence. So, corporate inversion results in financial transactions being recorded in the financial account. However, some other types of restructuring

may involve other changes in volume, for example, the appearance or disappearance of entities.

8.20 While the economy of the direct investor is changed by corporate inversion, the operational structure and ultimate shareholders remain effectively unchanged, but the new parent company has the benefit of the taxation and regulatory environment of its economy of incorporation. Because inversions can involve large values in the financial account but with little or no movement in resources, there may be analytical interest in separating them from other direct investment. If not prevented by confidentiality, supplementary data could be provided.

8.21 In these cases, the assets of the original parent company are treated as having been returned to the shareholders of the parent company through the withdrawal of equity and then as being reinvested in the new parent company at the same value. That is, there is a rearrangement of balance sheets through transactions in equity in the financial account of equal value with no change in net lending or borrowing. (These entries may include both portfolio and direct investment.) With some forms of restructuring, the direct investment enterprises of the old parent may become the direct investment enterprises of the new one.

8.22 As noted, assets may be shifted from one enterprise to a second enterprise because of restructuring within an enterprise group. As with other stock swaps, the owners are selling securities in the first enterprise and buying securities in the second enterprise. (These are financial account entries, not capital transfers or other changes.)

## 5. Superdividends

8.23 Superdividends and liquidating dividends are defined in paragraphs 11.28 and 11.30. They are treated as a withdrawal of equity, rather than as income payable to the owners. Accordingly, these amounts are excluded from dividends and are shown as a reduction in equity in the financial account, just as any other withdrawal of equity. They also arise for equity other than direct investment.

## 6. Borrowing for fiscal purposes

8.24 Special rules apply to an entity owned or controlled by general government when that entity is resident in another territory and is used for fiscal purposes. Such entities are resident in their economy of incorporation or registration, and not in the economy of their

owner (as discussed in paragraphs 4.134-4.135). For example, a government may use a special purpose or other entity to issue securities to fund its expenditure. Fiscal purposes refers to the distinctive motivation of the general government sector, as discussed in paragraphs 4.91-4.92. Fiscal purposes can be distinguished from commercial purposes, because fiscal purposes are always oriented to serving the objectives for the government's home territory.

8.25 When an entity resident in one economy borrows on behalf of the government of another economy, and the borrowing is for fiscal purposes, the following entries are made:

- (a) At the time of borrowing: a transaction creating a debt liability of the government to the borrowing entity is imputed equal to the amount of the borrowing. (The corresponding entry is an increase in the government's equity in the borrowing entity.)
- (b) At the time funds (or resources acquired with the funds) are passed to the government (as applicable): the flow of funds is shown as a transaction, matched by a reduction of the government's equity in the borrowing entity by the same amount.
- (c) At the time expenses are incurred or resources or funds are provided by the borrowing entity to a third party (i.e., are not passed to the government), where applicable: a current or capital transfer between the government and the entity is imputed, with the matching entry of a reduction in the value of the government's equity. (For a wholly owned government entity, this imputation has the same value as the reinvestment of earnings that would have been imputed if the general treatment for direct investment enterprises was applicable.)

These entries are made symmetrically for both the government and the borrowing entity. These entries do not affect the transactions or positions between the borrowing entity and its creditors or other third parties, which are recorded as they occur with no imputations.

8.26 The reason for having a special approach for government entities is that, unlike in the private sector, the nonresident entity undertakes functions at the behest of general government for public policy, not commercial purposes. Without this approach, a misleading picture of government expenditure and debt could arise.

## C. Portfolio Investment

8.27 Portfolio investment is defined in paragraphs 6.54-6.57.

### 1. Reinvestment of earnings in investment funds

8.28 Unlike other portfolio investment, the undistributed earnings of portfolio investment in investment funds are imputed as being payable to the owners and then as being reinvested in the fund. The financial account entry for reinvestment of earnings is the corresponding entry to the reinvested earnings of investment funds in the primary income account item (which is covered in paragraphs 11.37-11.39). The treatment and calculation of earnings are the same as for reinvested earnings of direct investment enterprises. Reinvestment of earnings may be negative, for example, when a fund has paid dividends out of realized holding gains, or when earnings accrued over previous periods are paid as dividends.

### 2. Convertible bonds

8.29 The classification of convertible bonds is discussed in paragraph 5.45. When the option to convert the bond into shares is implemented, two entries are shown: (a) redemption of the bond and (b) the issue or acquisition of shares.

### 3. Debt defeasance

8.30 Debt defeasance allows a debtor (whose debts are in the form generally of debt securities and loans) to remove certain liabilities from the balance sheet by pairing irrevocably assets of equal value to the liabilities.

8.31 Defeasance may be carried out (a) by placing the paired assets and liabilities in a trust account within the institutional unit concerned, or (b) by transferring the assets and liabilities to another institutional unit. In the former case, there are no transactions with respect to defeasance, and the assets and liabilities should not be excluded from the balance sheet of the unit. In the latter case, the transactions by which the assets and liabilities are moved to the second statistical unit are recorded in the financial account of the economies concerned, provided the units are resident of different economies, and are reported in the balance sheet of the unit that holds the assets and liabilities. Therefore, debt defeasance sometimes leads to a change in the institutional unit that records those liabilities.

## 4. Share and debt buybacks

8.32 If a corporation buys its own shares, the transaction is classified as being a reduction in the equity liability, rather than an acquisition of an asset. Because a corporation cannot have a claim on itself, the liability is deemed to be extinguished, even if the shares are not canceled. Similarly, purchase of a debt security by its issuer is treated as redemption of the debt.

## 5. Bonus shares

8.33 Sometimes corporations restructure their shares and may offer shareholders a number of new shares for each share previously held. This can be called stock splits or the issue of bonus shares. In contrast to when new shares are issued in return for additional funds, in these cases, no new resources are provided and no transaction is recorded.

## D. Financial Derivatives (Other Than Reserves) and Employee Stock Options

### I. Financial derivatives

8.34 Financial derivatives (other than reserves) and ESOs are defined in paragraphs 6.58-6.60. Transactions involving financial derivatives may arise at inception, on secondary markets, with ongoing servicing (such as for margin payments), and at settlement. Financial account entries for derivatives preferably should be shown separately for each of assets and liabilities, wherever possible, but net settlements are acceptable when gross reporting is impractical. Any explicit or implicit service charges should be deducted from the value of the financial derivative. However, distinguishing implicit service charges is not usually possible, in which case, the entire value of the financial derivative is classified as being for the financial asset.

#### 8.35 At inception:

- (a) The creation of a forward-type contract does not generally require the recording of a transaction in a financial derivative because risk exposures of equal value are usually being exchanged. That is, there is usually zero exposure and zero value for both sides. In some cases, however, there may be a nonzero transaction value at issue. (In addition, there may be a service charge for the issue, as mentioned in paragraph 10.121.)
- (b) The purchaser of an option pays a premium to the seller, which is the acquisition price of the

instrument. Sometimes a premium is paid after the inception of the contract. In that case, the value of the premium is recorded at the inception of the contract in the same manner as if it had been paid then, but is shown as being financed by accounts receivable/payable between the writer and the purchaser.

8.36 Subsequent changes in the prices of derivatives are recorded as holding gains or losses, not as transactions (included as revaluation, see paragraphs 9.30-9.31).

8.37 Sales of options in **secondary markets**—whether exchanges or over the counter—are valued at market prices and recorded in the financial account as transactions in financial derivatives.

8.38 When a contract requires **ongoing servicing** (such as an interest rate swap, where each party meets the servicing obligations that were originally held by the other) and a cash payment is received, there is a decrease (increase) in a financial derivative asset (liability) if, at the time of the payment, the contract is in an asset (liability) position. If compilers are unable to implement this approach because of market practice, all cash receipts should be recorded as reductions in financial assets, and all cash payments should be recorded as decreases in liabilities.

8.39 **Margins** are payments of cash or deposits of collateral that cover actual or potential obligations incurred through financial derivatives—especially futures or exchange traded options. (As discussed in paragraph 5.94, repayable margins in cash are classified as deposits or other accounts receivable/payable, and nonrepayable margins are classified as financial derivatives.)

8.40 **At settlement**, either a cash payment is made or an underlying item is delivered.

- (a) When a financial derivative is settled in cash, a transaction equal to the cash value of the settlement is recorded for the derivative. In most instances, when a cash settlement payment is received, a reduction in a financial derivative asset is recorded. When a cash settlement payment is made, a reduction of a financial derivative liability is recorded.
- (b) When an underlying item is delivered, two transactions are recorded:
  - The transaction involving the underlying item is valued at the market price at the time. The entry for the underlying item is recorded under the relevant heading (goods, financial instrument, etc.).

- The transaction involving the derivative is valued as the difference, multiplied by the quantity, between the market price for the underlying item and the strike price specified in the derivative contract.

- (c) When more than one contract is settled—in cash, at the same time, and with the same counterparty—some of the contracts being settled are in asset positions and some are in liability positions. In this situation, transactions involving assets should be recorded separately from those involving liabilities, wherever possible, but net settlements are acceptable when gross reporting is impractical.

## 2. Employee stock options

8.41 An ESO is created on a given date (the "grant" date), providing that an employee may purchase a given number of shares of the employer's stock at a stated price (the "strike" price) either at a stated time (the "vesting" date) or within a period of time (the "exercise" period) immediately following the vesting date. Transactions in ESOs are recorded in the financial account as the corresponding entry to the compensation of employees (as discussed in paragraph 11.20) or direct investment (paragraph 11.21). When the option is exercised, the transaction in the ESO is recorded in the financial account at a value that reflects the difference between the market price of the equity and the price paid by the buyer for the equity (see also paragraph 8.40(a) and (b)). Cancellation of ESOs is discussed in paragraph 9.12, while revaluations are discussed in paragraph 9.30. ESOs do not generally raise separate issues to those for financial derivatives, but one special case occurs when an employee of a subsidiary is issued options for stock in the parent company. Because the parent is not the employer, the subsidiary is shown as acquiring the option from the parent. (If the subsidiary pays nothing or an unrealistic value to the parent, a value may be imputed, possibly direct investment, as discussed in paragraph 11.101 on transfer pricing.)

## E. Other Investment

### I. One-off guarantees and other debt assumption

8.42 *Debt assumption means that one party takes on the liability of another party.* Debt may be assumed under a preexisting guarantee, or without a guarantee, such as when a government wants to assist a project

or a direct investor assumes the liabilities of its direct investment enterprises for reputational reasons. One-off guarantees are defined in paragraph 5.68. One-off guarantees are recognized only as financial assets and liabilities from the time they are activated.

8.43 The assumption of the debt may not require repayment at once. According to the accrual principle for time of recording, the assumption of the debt should be recorded at the time the guarantee is activated, rather than when actual payments are made by the guarantor. Repayments by the new debtor and interest accrued on the assumed debt should be recorded as these flows occur.

8.44 The recording in the international accounts of debt assumption through the activation of a one-off guarantee or for other reasons varies depending on the circumstances, as discussed in paragraph 8.45.

8.45 In all cases, the debt-assuming party records the creation of a new liability to the creditor (financial account entry). In addition:

- (a) If the debt-assuming party does not acquire a claim on the (original) debtor because the original debtor no longer exists (e.g., the original debtor has been liquidated), a capital transfer from the debt-assuming party to the creditor is recorded as the corresponding entry to the creation of the liability. The original debt of the debtor to the creditor is written off in the accounts of both the original debtor and the creditor (other changes in financial assets and liabilities account).
- (b) If the debt-assuming party does not acquire a claim on the (original) debtor because the debt assumer seeks to give a benefit to the debtor (as is sometimes the case when governments assume debts), then unless the guarantor is in a direct investment relationship with the original debtor (see (c)), a capital transfer from the debt-assuming party to the original debtor is recorded. The claim on the original debtor by the creditor is extinguished (financial account entries).
- (c) In other cases, the debt-assuming party acquires a claim on the original debtor as a result of the assumption of the debt (financial account entry). Such a claim may be on the original debtor as a debt<sup>1</sup> or as an increase in the guarantor's equity

<sup>1</sup>If the value of the debt claim received by the debt assumer is less than the value of the debt liability assumed, as in (b) a capital transfer for the difference is recorded, unless the parties are in a direct investment relationship (see also paragraph A2.52).

in the original debtor (e.g., assumption of debt owed by a subsidiary will improve the balance sheet of the subsidiary and, hence, the direct investor's equity in the subsidiary). In this case, the claim on the original debtor by the creditor is extinguished (financial account entry).

(The entries are shown in Box 8.1.)

## 2. Insurance technical reserves, pension fund entitlements, and provisions for calls under standardized guarantees

8.46 Insurance, pension fund, and standardized guarantee transactions need to be broken down into their service, income, transfer, and financial account elements. An overview of the statistical treatment of insurance, pension schemes, and standardized guarantees is given in Appendix 6c. Insurance technical reserves sometimes may be classified as direct investment, as discussed in paragraph 6.27. The following paragraphs show the composition of the financial account entries.

8.47 For nonlife insurance, insurance technical reserves consist of prepayments of insurance premiums and outstanding claims. Prepayments of premiums result from the fact that, in general, insurance premiums are paid in advance. Technical reserves against outstanding claims are reserves that insurance enterprises hold to cover the amounts they expect to pay out for claims that have been reported and are not yet resolved and to cover estimates of claims incurred but not yet reported—including equalization reserves that relate to events that have occurred.

8.48 Similarly, for life insurance, pension schemes, annuity funds, and standardized guarantee schemes, the changes in technical reserves due to transactions are recorded in the financial account and consist of the amounts of the estimated obligations to beneficiaries and holders that accrued during the period. Pension entitlements include those under both funded and unfunded schemes, but do not include potential benefits under social security schemes (see paragraph 5.67). The increase in pension entitlements shown in the financial account matches the entry in the use of income accounts for the adjustment for change in pension entitlements plus any change in pension entitlements due to capital transfers.

8.49 Totals for insurance technical reserves, pension fund entitlements, and provisions for calls under standardized guarantees and related investment income

**Box 8.1. Entries Associated with Different Types of Debt Assumption***(Showing different situations, recording party, entry, and counterparty)*

If debt-assuming party does not acquire a claim on the (original) debtor because the original debtor no longer exists (paragraph 8.45(a)):

<b>Original debtor:</b>	other change in volume of debt liability to creditor
<b>Assumer:</b>	increase in debt instrument liability (credit) to creditor capital transfer (debit) to creditor
<b>Creditor:</b>	capital transfer (credit) from assumer increase in debt instrument claim (debit) on assumer other change in volume of debt claim on original debtor

If debt-assuming party does not acquire a claim on the (original) debtor because the debt assumer seeks to give a benefit to the debtor (paragraph 8.45(b)):

<b>Original debtor:</b>	capital transfer (credit) from assumer reduction in debt instrument liability (debit) to creditor
<b>Assumer:</b>	increase in debt instrument liability (credit) to creditor capital transfer (debit) to original debtor
<b>Creditor:</b>	reduction in debt instrument claim (credit) on original debtor increase in debt instrument claim (debit) on assumer

If debt-assuming party acquires a claim on the original debtor (paragraph 8.45(c)):

<b>Original debtor:</b>	increase in equity or debt liability (credit) from assumer reduction in debt instrument liability (debit) to creditor
<b>Assumer:</b>	increase in debt instrument liability (credit) to creditor increase in equity or debt claim (debit) on original debtor
<b>Creditor:</b>	reduction in debt instrument claim (credit) to original debtor increase in debt instrument claim (debit) on assumer

In cases in paragraphs 8.45(b) and (c), three parties are involved in the transaction, so the treatment differs from the standard double-entry system.

usually can be identified only in the accounts of insurers, funds, and guarantee providers, rather than in the accounts of their customers. For liabilities, these totals relate to resident providers and need to be allocated among resident and nonresident policyholders. In the absence of specific data on the allocation of these values to policyholders, an indicator such as premiums payable may be used. For assets, the reserves, entitlements, and provisions are liabilities of nonresidents and are not observable by residents, so counterpart data or indicators such as ratios of premiums to technical reserves may be necessary. Changes in technical reserves resulting from holding gains or losses are not transactions and therefore are recorded in the revaluation account and not in the financial account.

### 3. Special drawing rights

8.50 The allocation of SDRs to IMF members is shown as the incurrence of a liability of the recipient under SDRs in other investment, with a corresponding entry under SDRs in reserve assets.

8.51 Other acquisitions and sales of SDRs are shown as transactions in reserve assets.

### 4. Securities repurchase agreements and other reverse transactions

8.52 These arrangements are defined in paragraphs 7.58-7.61. Because the risks and rewards of ownership stay largely with the original owner, no transaction in the security is recorded. If one party provides cash that is repayable when the security is returned, however, the provision of cash is classified as a loan (except when it is a liability of a deposit-taking corporation and part of broad money, in which case it is classified as other deposits).

### 5. Currency

8.53 Transactions in issued banknotes and coin are recorded under currency and deposits. Transactions by residents with nonresidents using domestically issued banknotes and coin are recorded as transactions in lia-

bilities, and transactions by residents with nonresidents using foreign-issued banknotes and coin are transactions in assets. As noted in paragraphs 3.7-3.8, transactions in domestic liabilities between nonresidents and transactions in foreign assets between residents are not recorded in the balance of payments.

## 6. Change of contractual terms

8.54 If the original terms of a debt (typically a loan or debt security, but also other debt items) are changed by renegotiation by the parties, then the treatment is that the original liability is repaid and a new liability is created. In contrast, if the original terms of the contract provide that the maturity or interest rate terms or both change as a result of an event such as a default or decline in credit rating, then this involves a reclassification. (This distinction has an effect on net values in practice in cases in which the original and new terms have a different principal, different instrument classification, or different maturity classification; otherwise, the entries cancel out.)

## F. Reserve Assets

8.55 Transactions involving monetary gold are recorded in the financial account only if they occur between two monetary authorities for reserve purposes or between a monetary authority and an international financial organization. (Monetary gold is discussed in paragraphs 5.74-5.78; and gold in the context of reserve assets is discussed in paragraphs 6.78-6.83.)

8.56 All transactions in gold bullion other than those included in monetary gold are recorded as non-monetary gold in the goods and services account (discussed in paragraphs 10.50-10.54). When a monetary authority acquires gold bullion from, or sells gold bullion to, an institutional unit other than a monetary authority or international financial organization, the gold is monetized or demonetized, as discussed in paragraphs 9.18-9.20.

8.57 Financial account transactions with the IMF involve reserve assets, reserve-related liabilities, other investment, and off-balance-sheet liabilities. They are dealt with in detail in Annex 7.1.

## G. Arrears

8.58 The accumulation of arrears related to exceptional financing (when it occurs) needs to be included as a memorandum item to the financial account. Exceptional financing is defined and discussed in Appendix 1. Incurring arrears does not involve a transaction, because it is a unilateral act of one party. Therefore, it is not shown as giving rise to entries in the standard presentation of the financial account. However, if the debt is renegotiated, then the original instrument is extinguished and a new instrument is created.

8.59 In addition to arrears related to exceptional financing, other arrears indicate potential, or actual, problems servicing debt, and so may be shown as supplementary items.



## Other Changes in Financial Assets and Liabilities Account

### A. Concepts and Coverage

Reference:

2008 SNA, Chapter 12, The Other Changes in Assets Accounts.

9.1 *In the international accounts, the other changes in financial assets and liabilities account shows changes in financial positions that arise for reasons other than transactions between residents and non-residents.* These changes are also called "other flows." Examples include the unilateral cancellation of debt by the creditor, holding gains and losses, and reclassifications (including arising from resident-to-resident transactions in financial assets issued by nonresidents). In international accounts, other changes are recorded only for financial assets and liabilities because the international investment position relates only to external financial assets and liabilities.

9.2 While sometimes derived as residual items, other changes are economic events that are important in their own right and should be shown separately from transactions. They serve to demonstrate significant changes to the value and composition of items in the balance sheet due to events that have important economic consequences.

9.3 Other changes differ from transactions in terms of their economic nature and accounting entries. A transaction is an interaction between two institutional units by mutual agreement or operation of the law, whereas other changes are changes in the value or volume of assets and liabilities that arise from other economic events. Each transaction involves two accounting entries for each party, as does reclassification, but other events recorded in this account involve a single entry for each party. For additional aspects of accounting for other changes, see also paragraphs 3.19-3.21 (types of other flows), 3.60 (timing), and 3.81-3.83 (valuation).

9.4 Table 9.1 shows an overview of the other changes in financial assets and liabilities account. The balancing item for the account is net changes in net IIP arising from other changes.

9.5 Together with the financial account, the other changes in financial assets and liabilities explain changes in the IIP. In other words, financial assets and liabilities gain or lose value and appear or disappear as a result of transactions, other volume changes, or revaluation. This relationship can be expressed as the following identity:

$$\begin{aligned}
 & \text{Beginning of period position} \\
 + & \text{ Transactions during the period} \\
 + & \text{ Other changes in volume during the period} \\
 + & \text{ Revaluation during the period:} \\
 & \text{Of which, due to:} \\
 & \quad \bullet \text{ exchange rate changes and} \\
 & \quad \bullet \text{ other price changes} \\
 = & \text{ End of period position.}
 \end{aligned}$$

(Table 7.1 also shows this relationship.)

9.6 The other changes in financial assets and liabilities account can be presented by the type of asset or liability as well as by the type of other flow. The classification by type of asset or liability should be consistent with that used in the IIP and financial account to facilitate analysis of particular assets and a comprehensive view of asset and liability positions. The other changes in assets and liabilities account can also be considered in conjunction with investment income from the income account, to obtain another view of the return on financial assets and liabilities. As noted in paragraph 9.32, some retained earnings affect the owners' equity through the other changes account, whereas others affect equity through an imputed transaction.

**Table 9.1. Overview of the Other Changes in Financial Assets and Liabilities Account**

	Other changes in volume	Revaluations	
		Exchange rate changes	Other price changes
<b>Net changes in financial assets due to other changes</b>			
Direct investment			
Portfolio investment			
Financial derivatives (other than reserves) and employee stock options			
Other investment			
Reserve assets			
Total			
Of which:			
Equity and investment fund shares			
Debt instruments			
Other financial assets and liabilities			
<b>Net changes in liabilities due to other changes</b>			
Direct investment			
Portfolio investment			
Financial derivatives (other than reserves) and employee stock options			
Other investment			
Total			
Of which:			
Equity and investment fund shares			
Debt instruments			
Other financial assets and liabilities			
<i>Changes in net IIP arising from other changes</i>			

Note: This table is expository; for Standard Components, see Appendix 9.

## B. Other Changes in the Volume of Financial Assets and Liabilities

9.7 *Other changes in the volume of financial assets and liabilities are any changes in the value of these assets that are due neither to transactions nor to revaluation. These changes include those due to cancellation and write-offs, economic appearance and disappearance of assets, reclassification, and the changes in financial assets arising from entities changing their economy of residence.* Because of the heterogeneous nature of other changes in volume, analysts may sometimes wish to identify the major components. Changes in volume can occur because of transactions or other changes in volume.

### I. Cancellation and write-offs

9.8 A number of circumstances may lead to reduction or cancellation, by other than normal repayment, of liabilities. Debt assumption and debt forgiveness involve transactions and are discussed in paragraphs 8.42-8.45 and 13.22-13.23, respectively. Valuation

changes associated with debt reorganization are dealt with in paragraph 9.29. Debt reorganization and related issues are discussed in more detail in Appendix 2.

9.9 Changes in claims resulting from write-offs are excluded from the financial account. Specifically, a creditor may recognize that a financial claim can no longer be collected because of bankruptcy or other factors and it may remove the claim from its balance sheet.<sup>1</sup> This recognition (by the creditor) should be accounted for as other changes in volume of assets. (The corresponding liability should also be removed from the balance sheet of the debtor.)

<sup>1</sup>Usually, debt is written off as uncollectible because of the bankruptcy or liquidation of the debtor; however, it may sometimes be written off for other reasons, such as a court order. The write-off may be full or partial; partial write-offs may arise, for example, under a court order, or if the liquidation of the debtor's assets will allow some of the debt to be settled. Recognition that the debt is uncollectible should be distinguished from internal accounting provisions of the creditor for the possibility of default (such as adjustments to fair value, nonperforming loans). Although such provisions may be useful for analysis, they do not mean that the debt should no longer be recognized as existing.

9.10 Unilateral cancellation of a financial claim by a debtor (debt repudiation) is not recognized. Debt forgiveness, which is a capital transfer, usually concerns government debt; most commercial situations where the impossibility of debt collection is recognized by the creditor are treated as write-offs.

9.11 Governments or other institutional units may take possession of the assets of other institutional units, including nonresident units, without full compensation for reasons other than the payment of taxes, fines, or similar levies. If the compensation falls substantially short of the values of the assets as shown in the balance sheet, the difference should be recorded in other changes in volume as an increase in assets for the institutional unit doing the seizing and a decrease in assets for the institutional unit losing the asset. Such actions are called uncompensated seizures of assets in the *2008 SNA*. For seizures between residents and nonresidents relating to nonfinancial assets, a supplementary item can be recorded.

9.12 If an employee stock option is extinguished between the grant and vesting dates (e.g., if the employee departs) without an agreed settlement between the parties, an other change in volume is recorded (namely, a loss of an asset by the employee and a reduction of liabilities by the employer).

## 2. Reclassifications

9.13 A reclassification entry is necessary when a financial asset or liability changes its characteristics or status without there having been a cross-border transaction. In contrast to reclassifications, other cases—such as changes such as conversion of a convertible bond (see paragraph 8.29) and exercise of a warrant (see paragraph 5.87)—are shown as transactions involving repayment of the original instrument and creation of a new one because they arise from bilateral agreements.

### *Tradable loans*

9.14 A loan may become a security in the circumstances discussed in paragraph 5.45. In that case, the deduction of nominal value of the old loan is a reclassification, as is the appearance of the new security at market prices.

### *Change in contractual terms*

9.15 The original terms of a contract may provide that the maturity and interest rate terms change as a result of an event such as a default or decline in credit

rating; then this involves a reclassification. In contrast, a change in the terms as a result of renegotiation by the parties is a transaction, and thus is shown as a repayment of the old instrument and issue of a new one in the financial account.

### *Transactions in existing assets*

9.16 Transactions in existing assets can result in changes in the composition of assets and liabilities in the IIP. As noted in paragraph 3.7, when a financial instrument issued by a nonresident is sold by a resident in one institutional sector to a resident in another sector, the composition of assets in the IIP is changed by a reclassification entry.

### *Changes in functional category*

9.17 As a result of a change in the relationship between the parties or change in the liquidity of assets, the functional category may be changed. For example, if the relationship between the parties changes to direct investment because an investor adds to its holdings and so qualifies as a direct investor, the previous holdings would be reclassified to direct investment. (See also paragraph 6.36.) Another example is a loan that is reclassified as securities (see paragraph 5.45) and so from other investment to portfolio investment.

### *Monetization and demonetization of gold bullion*

9.18 A special case of change in classification occurs for gold bullion. Gold bullion can be a financial asset (monetary gold) or a good (nonmonetary gold), depending on the holder and the motivation for holding. Monetization is the change in the classification of gold bullion from nonmonetary to monetary. Demonetization is change in the classification of gold bullion from monetary to nonmonetary. The treatment of particular transactions is as follows:

- (a) When a monetary authority sells gold bullion that is a reserve asset to a nonresident entity that is not a monetary authority or international financial organization, an entry for nonmonetary gold is recorded in the goods and services account. Demonetization of the gold bullion occurs immediately before the transaction and is shown in the other changes in assets and liabilities account of the monetary authority.
- (b) When a monetary authority sells gold bullion that is a reserve asset to a resident entity that is not a monetary authority, there is no interna-

tional transaction. As in case (a) above, demonetization of the gold bullion occurs immediately before the transaction.

- (c) When a monetary authority purchases gold bullion from a nonresident that is not a monetary authority or international financial organization, the transaction is recorded in nonmonetary gold in the goods and services account. Monetization of the gold bullion occurs immediately after the transaction and is shown in the other changes in assets and liabilities account of the monetary authority.
- (d) When a monetary authority purchases gold bullion from a resident for its reserve assets, there is no international transaction. As in case (c) above, monetization of the gold bullion occurs immediately after the transaction.
- (e) When buyer and seller are monetary authorities of different economies and both hold the gold bullion as part of their reserve assets, there is a transaction in gold bullion (recorded in the financial account; see paragraph 8.55). The same treatment applies for transactions in gold bullion between a monetary authority and an international financial organization.
- (f) If the monetary authorities deposit gold bullion that they own in an unallocated gold account, the gold bullion is demonetized immediately before the transaction. If the account is with a nonresident, a transaction in nonmonetary gold is recorded in the goods and services account with a corresponding entry in currency and deposits, and then a reclassification to monetary gold—unallocated gold accounts—if held as a reserve asset. However, if the deposit is with another monetary authority or an international financial institution, transactions in monetary gold are recorded (see paragraph 6.80).
- (g) Similarly, if the monetary authorities withdraw gold bullion from an unallocated gold account held as a reserve asset, a reclassification to currency and deposits is recorded before the transaction. As the account is with a nonresident, a transaction in currency and deposits is recorded with a corresponding entry in nonmonetary gold in the goods and services account. The gold bullion is monetized as monetary gold—gold bullion, if held as a reserve asset. However, if the deposit is with another monetary authority or an international financial institution, transactions

in monetary gold are recorded (see paragraph 6.80).

- (h) In other cases, gold bullion is nonmonetary at all times and any international transactions are recorded in nonmonetary gold under goods (as discussed in paragraphs 10.50-10.54).

(The above cases relating to a monetary authority also apply to an international financial organization.)

#### *Reclassification of unallocated gold accounts*

9.19 Unallocated gold accounts are classified as currency and deposits unless they are held by the monetary authorities as part of reserve assets. Unlike gold bullion, unallocated gold accounts have counterpart liabilities. To be classified as monetary gold, the unallocated gold accounts must be held as part of reserve assets, and so the counterpart liability is necessarily on a nonresident.

9.20 If a monetary authority acquires an unallocated gold account to be classified as reserve assets, it is recorded first as a transaction in currency and deposits and then reclassified to monetary gold (unallocated gold accounts) as a change of classification in the other changes in the volume of assets and liabilities account of the monetary authority. Removing an unallocated gold account from reserve assets is recorded as, first, a change in classification from monetary gold to a currency and deposit in the other changes in the volume account and then a transaction in currency and deposits. However, transactions between monetary authorities and with international financial institutions are recorded as transactions in unallocated gold accounts within monetary gold if the unallocated account is held as a reserve asset.

### **3. Financial assets and liabilities of persons and other entities changing residence**

9.21 The conditions under which entities can change their economy of residence were discussed in Chapter 4. When persons and other entities change their economy of residence, their existing financial assets and liabilities are added to or removed from the IIP through a reclassification, not by imputing transactions in the balance of payments. The change in the residence does not involve a transaction between two entities, but a change in the status of a single entity. Because of the treatment of ownership of land and buildings, as well as certain other cases (discussed in paragraphs 4.34-4.40), notional units may be created or eliminated

as a result of the change in residence status of an owner. The treatment of change in residence applies to all the financial assets and liabilities, not just those that are shifted to the new economy of residence.

9.22 In addition to change in the status of existing assets, new financial claims and liabilities may be created by transactions around the time of change of residence. For example, new bank accounts may be created in the new economy of residence. In those cases, the treatment is determined by the residence status of the owner at the time of the transaction. If the relation of the timing of the transaction and the change of residence is unknown or effectively simultaneous, a convention can be adopted, such as that the change of residence occurs first.

9.23 Corporations sometimes change residence. Most cases labeled as corporate migration involve moving assets between entities (see paragraph 8.19 on corporate inversion). However, in the exceptional case when corporate change of residence occurs (see paragraph 4.167), the change in the residence of the owner of financial assets and liabilities is treated as a reclassification, in the same way as a change of residence of individuals.

#### 4. Insurance reserves, pension entitlements, and provisions for standardized guarantee schemes

9.24 Changes in model assumptions can give rise to other changes in the volume of insurance reserves, pension entitlements, and provisions for standardized guarantee schemes. For an annuity, the relationship between premiums and benefits is usually determined when the contract is entered into, taking account of mortality data available at that time. Any subsequent changes will affect the liability of the annuity provider towards the beneficiary, with the consequent changes in provisions recorded as other changes in volumes. In contrast to changes in model assumptions, changes in pension entitlements negotiated between the parties are transactions, so would be classified as current or capital transfers.

### C. Revaluation

9.25 *Revaluations occur because of a change in the monetary value of a financial asset or liability due to changes in the level and structure of its price.* Revaluations may also be called holding gains or losses. As the term suggests, holding gains or losses are changes in the value of an asset that accrue purely as a result of

holding assets over time without transforming them in any way. A holding gain occurs when an asset increases in value or a liability decreases in value; a holding loss occurs when an asset decreases in value or a liability increases in value. Common causes of revaluation are, for equity, changes in expectations of future incomes and, for debt securities, changes in market yields and the creditworthiness of the debtor.

9.26 Because of the importance of instruments denominated in foreign currencies in the IIP and their different behavior, the values of revaluation are separated into those due to two factors:

- (a) exchange rate changes and
- (b) other price changes.

9.27 Exchange rate changes show all the changes that result from exposure to the effect of exchange rates, whereas the other price changes show other causes such as asset price volatility. Revaluation takes into account all price changes during the period, whether realized or not. Holding gains and losses are realized when the asset is sold or liability extinguished. Holding gains and losses on unsold assets and unpaid liabilities are unrealized, but are recorded as revaluation in the other changes in financial assets and liabilities account.

9.28 An exact measure of the factors could be made by tracking each instrument held, bought, or sold during the period. In practice, an approximation can be derived from balance sheet aggregates for each currency of denomination, to separate revaluation into exchange rate changes and other price changes, according to the following steps:

- Step 1: The effect of revaluation due to other price changes is derived for each class of instrument and currency of denomination by subtracting changes due to transactions and other changes in volume from the total change in positions. Because exchange rate changes are always zero in the currency of denomination, all revaluation when expressed in the currency of denomination is due to other price changes. (The currency of denomination is discussed in paragraphs 3.95-3.107.)
- Step 2: The beginning and end of period positions, and changes due to transactions, other volume changes, and revaluation due to other price changes (as derived in Step 1) are converted to the currency of international accounts compilation using the appropriate exchange rates. Positions are converted by the exchange rate at the relevant date.

Ideally, transactions and other flows would be converted at the exchange rate at the time of each event or flow. In the example in Box 9.1, flows are converted at the average exchange rate, which is an approximation that assumes that flows, price changes, and exchange rate movements occurred evenly through the period. If an average exchange rate is used, an average of daily exchange rates is preferable as an approximation. (An average of beginning and end of period rates could be misleading when rates did not move evenly through the period.) Currency conversion is discussed in paragraphs 3.104-3.108.

- Step 3: The effect of revaluation due to exchange rate changes is derived for each class of instrument and currency of denomination by subtracting changes due to transactions, other changes in volume, and revaluation due to other price changes from the total change in positions. The exchange rate effects are always zero on instruments denominated in the currency of international accounts compilation (with the exception set out in paragraph 9.31).

Step 1 needs to be calculated for each currency of denomination by type of instrument, although in practice currencies that represent a small proportion of the total may be combined. For instruments that are valued at nominal prices, there can be exchange rate effects, but no other price changes. A numerical example is given in Box 9.1.

### 1. Debt reorganization

9.29 A debtor and creditor may change the terms of a debt agreement. The terms may be changed such that the value of the new claim differs from the value of the old claim. In commercial situations, differences in values between old and new claims are generally treated as a valuation change. Debt cancellation and write-offs are other volume changes and were discussed in paragraphs 9.8-9.11. However, as noted in paragraph 13.23, if there is an intention to convey a benefit, the change may be treated as a capital transfer. Debt reorganization is discussed in further detail in Appendix 2.

### 2. Financial derivatives and employee stock options

9.30 The exchanges of claims and obligations at the inception of a derivative contract are financial transactions creating asset and liability positions that normally have, at inception, zero value if the instrument is a

forward-type contract and value equal to the total premium payable if the instrument is an option. Changes in the value of derivatives due to change in the underlying item are recorded as revaluation. (Changes in the value of derivatives to or from zero are classified as revaluation, not economic appearance or disappearance of assets.) The settlement of a financial derivative position is a transaction, recorded in the financial account. Changes in the values of employee stock options at or after the vesting date are revaluations (see paragraphs 3.59, 7.39, and 11.20). (In practice, it may be feasible to recognize the revaluation only at exercise date.)

9.31 Financial derivatives that include a foreign exchange risk are a case where the steps for separating exchange rate and other revaluation, as stated in paragraph 9.28, are not applicable. In those cases, a valuation change due to exchange rate changes can arise even in the currency of denomination of the instrument. In some cases, such as cross-currency swaps that are also interest rate swaps, it may not be practical to separate exchange rate changes from other revaluation, so a convention that all revaluation effects are due to exchange rate effects may be adopted.

### 3. Implications of different treatments of retained earnings

9.32 In cases where retained earnings are not imputed as being payable to the owners, these earnings contribute to revaluation. The *SMA* and international accounts have two treatments for retained earnings:

- For direct investors' equity in their direct investment enterprises and for investment fund shares, retained earnings are imputed as being payable to the owners and reinvested as an increase in their equity. (The primary income account entries are discussed in paragraphs 11.33-11.47; the corresponding financial account entries in paragraphs 8.15-8.16 and 8.28.) Similarly, insurance and pension fund reserves and provisions for calls under standardized guarantees include property income attributed to policyholders. (The primary income account entries are discussed in paragraphs 11.77-11.84.)
- In other cases of equity, there is no imputation of income or financial account transactions to the owners on account of retained earnings. The result is that the increase in the value of the equity caused by the accumulation of retained earnings is reflected in increased value in the IIP without a transaction and is, therefore, shown as a result of revaluation.

**Box 9.1. Example of Calculation of Revaluation Due to Exchange Rate Changes**

The steps are described in paragraph 9.28. The data in normal text are given; the data in bold are derived.

**Step 1. Derivation of other revaluation in terms of the currency of denomination of the instrument (in this case, €):**

Other revaluation can be derived as 8, i.e., 50 (end of period position) - 30 (beginning of period position) - 12 (net transactions) - 0 (other volume changes) = 8.

**Step 2. Conversion of currency of denomination to the currency used for compilation of international accounts statistics (in this case from € to domestic currency):**

Beginning of period positions are multiplied by 2; flows by 2.5 (rate derived as the average rate on the period); and end of period positions by 3.

**Step 3. Derivation of exchange rate changes in the currency used for compilation of international accounts statistics: For the bonds denominated in €, revaluation due to exchange rate changes can be derived as 150 (end of period position) - 60 (beginning of period position) - 30 (net change due to transactions) - 20 (net change due to other revaluation) = 40.**

	Beginning of period position	Net transactions during period	Other volume changes	Step 1 other revaluations	Revaluation due to exchange rate changes	End of period position
Values in currency of denomination:						
Bonds denominated in € (in €)	30	12	0	8	0	50
Exchange rate (domestic currency per €)	2	2.5		2.5		3
Values in currency of compilation:	<b>Step 2</b>	<b>Step 2</b>	<b>Step 2</b>	<b>Step 2</b>	<b>Step 3</b>	<b>Step 2</b>
Bonds denominated in € (in dom. curr.)	60	30	0	20	40	150

(Use of average exchange rates in Step 2 is an approximation, as discussed in Step 2 of paragraph 9.28. Preferably, exchange rates at the time of the event would be used.)

#### 4. Implications of trading of instruments that are recorded at nominal values in positions

9.33 Nominal valuation is used for positions in nonnegotiable instruments, namely loans, deposits, and other accounts receivable/payable (see paragraphs 7.40-7.44). However, when transactions in these instruments do occur, they are valued at market prices (see paragraph 8.12), with transaction prices often being less than the nominal values, because the market price takes account of the possibility of default. To account for the inconsistency between the market valuation of transactions and nominal valuation of positions, the seller records other price changes during the period in which the sale occurs, equal to the difference between the nominal and the

transaction value and the buyer records an opposite amount as other price changes.

#### 5. Implications of treatment of interest

9.34 Any indexation amounts not included in interest are classified as revaluation. The treatment of interest on index-linked instruments is discussed in more detail in paragraphs 11.59-11.65.

9.35 Revaluation arises from changes in market yields on fixed-interest debt securities. The value of interest is determined by the yield to maturity at inception (see paragraphs 11.52-11.53), so the effect of any subsequent change in the value of the security due to changes in market interest rates is classified as being due to revaluation.

# 10 Goods and Services Account

## A. Overview of the Goods and Services Account

References:

2008 SNA, Chapter 6, The Production Account.

United Nations, *International Merchandise Trade Statistics: Concepts and Definitions*.

United Nations and others, *Manual on Statistics of International Trade in Services*.

**10.1** *The goods and services account shows transactions in items that are outcomes of production activities.*

**10.2** The focus of this account is the point at which goods and services are exchanged between a resident and a nonresident. In contrast, the national accounts focus on other points, such as their production, consumption, or use in capital formation.

**10.3** *Production is an activity in which an enterprise uses inputs (intermediate inputs, labor, produced and nonproduced assets) in order to transform them to an output that can be supplied to other units.<sup>1</sup> (In a few cases, the output is supplied to the unit itself.) The term "product" is used in the SNA to cover both goods and services.*

**10.4** The corresponding entries to goods and services flows may be in the financial, current, or capital accounts. For items paid for at the same time as the provision of the good or service, the corresponding entry is in the financial account, such as in currency and deposits. When payment is not made at the time of change of ownership, trade credit or another form of financial instrument (such as a bill of exchange) is established. If payment is made before change of ownership, there is

<sup>1</sup>Putting a produced asset at the disposal of another unit is also considered to be production. It is an operating leasing service (for tangible assets, see paragraphs 10.153-10.156) or a charge for the use of intellectual property (for intangible assets, see Table 10.4).

an advance from the importer to the exporter. In some cases, goods and services are exchanged for something other than financial assets; for example, in the case of barter, there is a corresponding entry in goods and services. In the case of aid or gifts, the corresponding entries are under current or capital transfers.

**10.5** Table 10.1 shows the broad structure of the goods and services account. There are balancing items for goods, services, and the total of goods and services.

### Distinction between goods and services

**10.6** The distinction between goods and services and other entries is determined by the nature of economic value supplied. Goods and services represent outcomes of the production process. In contrast, when other resources, such as labor, land, or other natural resources, or financial resources, are supplied, they are shown in other accounts. The goods and services account can include transactions in products that were generated in previous periods (e.g., second-hand goods, software, research embodied in patents, and inventories) and goods and services that embody a large proportion of output of other economic territories (e.g., re-exports and goods under merchandising).

**10.7** *Goods are physical, produced items over which ownership rights can be established and whose economic ownership can be passed from one institutional unit to another by engaging in transactions. They may be used to satisfy the needs or wants of households or the community or used to produce other goods or services. The production of a good can be separated from its subsequent sale or resale. Goods are shown separately from services.*

**10.8** *Services are the result of a production activity that changes the conditions of the consuming units, or facilitates the exchange of products or financial assets. Services are not generally separate items over which ownership rights can be established and cannot generally be separated from their production. However, as seen*



**Table 10.1. Overview of the Goods and Services Account**

	Exports (Credits)	Imports (Debits)
General merchandise on a balance of payments basis		
<i>Of which: Re-exports</i>		
Net exports of goods under merchanting		
<i>Goods acquired under merchanting (negative exports)</i>		n.a.
<i>Goods sold under merchanting (exports)</i>		n.a.
Nonmonetary gold		
Total goods		
Balance on trade in goods		
Manufacturing services on physical inputs owned by others		
Maintenance and repair services n.i.e.		
Transport		
<b>Travel</b>		
Construction		
Insurance and pension services		
Financial services		
Charges for the use of intellectual property n.i.e.		
Telecommunications, computer, and information services		
Other business services		
Personal, cultural, and recreational services		
Government goods and services n.i.e.		
Total services		
Balance on trade in services		
Total goods and services		
Balance on goods and services		

**Note:** This table is expository; for Standard Components, see Appendix 9.

later in this chapter, some knowledge-capturing products, such as computer software and other intellectual property products, may be traded separately from their production, like goods. In the balance of payments goods and services account, the valuation of goods includes transport within the exporting economy as well as wholesale and retail services indistinguishably in the price of the goods. Furthermore, the value of some service items includes the values of some goods, in the cases of travel, construction, and government goods and services n.i.e. Some services, particularly manufacturing services, repairs, and freight transport, also relate to goods.

10.9 In practice, the distinction made between goods and services sometimes takes into account other considerations, such as data sources.

10.10 E-commerce is a method of ordering or delivering products at least partly by electronic means, such as through the Internet or other computer-mediated networks. In general, charges for electronically delivered products are usually included in services, whereas products supplied across the border are usually classified as goods (see Table 10.4 for further details). Shipping charges associated with e-commerce are allocated

in line with the FOB valuation principle. Financial services associated with e-commerce are included in financial services.

#### Transactions between affiliated enterprises

10.11 A high proportion of exchanges of goods and services are between affiliated enterprises. This situation gives rise to issues of treatment and valuation. For example, where a direct investor temporarily provides equipment to its direct investment enterprise, there may be an operating lease. Additional guidance on goods deliveries between affiliated enterprises is provided in paragraph 10.24. Management and ancillary services may also be provided, as discussed in paragraph 10.150. These cases may give rise to issues of valuation, as discussed in paragraphs 3.77-3.78 and 10.35. Consequential effects on income are discussed in paragraphs 11.101-11.102.

#### Price and volume data

10.12 Goods and services have price and volume dimensions, so it is useful for analysis and data validation to have volume and price data, as well as current price values.

## B. Goods

### References:

United Nations, *International Merchandise Trade Statistics: Concepts and Definitions*.

United Nations, *International Merchandise Trade Statistics: Compilers Manual*.

### I. General merchandise

#### a. Introduction

**10.13** *General merchandise on a balance of payments basis covers goods whose economic ownership is changed between a resident and a nonresident and that are not included in the following specific categories: goods under merchanting (see paragraphs 10.41-10.49), nonmonetary gold (paragraphs 10.50-10.54), and parts of travel (paragraph 10.94), construction (10.101), and government goods and services n.i.e. (paragraph 10.173).*

**10.14** International merchandise trade statistics (IMTS) are usually the main data source for general merchandise in the goods and services account. The international standards for merchandise trade data are set out in United Nations *IMTS: Concepts and Definitions*. These standards are closely linked to those in this *Manual*. In practice, the data used as sources for general merchandise include customs data, international transactions reporting systems, other administrative data (including value-added tax systems), surveys of traders, or combinations. Adjustments to source data may be needed to account for coverage, timing, valuation, and classification that do not meet balance of payments guidelines.

**10.15** General merchandise is shown as a single item in the standard components. This *Manual* does not propose standards for breakdowns of goods, but encourages presentations according to the priorities of the compiling economy. More detailed breakdowns could include major products (or commodities), major product groups, industry of origin, and broad economic categories. The international standard product (or commodity) classifications include the *Harmonized System (HS)*, ~~the~~ *Standard International Trade Classification*, ~~and the~~ *Central Product Classification (CPC)*.<sup>2</sup> In addition, or alternatively, cross-references could be made to additional details available in other publica-

tions, while noting coverage, timing, valuation, and classification differences.

**10.16** IMTS cover goods "which add to or subtract from the stock of material resources of a country by entering (imports) or leaving (exports) its economic territory" (United Nations *IMTS: Concepts and Definitions* 1998, paragraph 14). This basis differs from the change of ownership between residents and nonresidents required for balance of payments, so adjustments may be needed.

#### b. Items to be Included in general merchandise

**10.17** Because there is a change of ownership of goods between a resident and a nonresident, the following cases are included in the balance of payments definition of general merchandise:

- (a) Banknotes and coins not in current circulation and unissued securities. They are valued as commodities, rather than at face value. Banknotes and coins may be not in circulation because they have not yet been issued, or they have been withdrawn from circulation and demonetized. Sales of coins to or between collectors at a premium are valued at the transaction price, rather than the face value. (Banknotes and coins in circulation and issued securities are financial instruments and are excluded from goods.);
- (b) Electricity, gas, and water. However, charges invoiced separately for the transmission, transport, or distribution of these products are included in services under transport and other business services—see paragraphs 10.74 and 10.159. Allowing water to flow when that flow is required by international law on river flows is not an international transaction;
- (c) Noncustomized packaged software (systems and applications), and video and audio recordings, on physical media, such as disks and other devices, with a license for perpetual use are included in general merchandise. These products are included at their full transaction value (i.e., not at the value of the empty disks or other storage device). Software provided in this manner is included in goods; other software is included in services—see paragraphs 10.143-10.144.<sup>3</sup> (Noncustomized software is for general use, rather than being made to

<sup>2</sup>World Customs Organization, *Harmonized Commodity Description and Coding System*. United Nations, *Standard International Trade Classification*. United Nations, *Central Product Classification*.

<sup>3</sup>To assist in analyzing software as a whole, it may be useful to identify separately software included in goods so as to compare or combine it with software included in services.

order. For classification of customized software and other cases, see Table 10.4.);

- (d) Goods procured in ports by carriers. Goods such as fuels (bunkering), provisions, stores, ballast, and dunnage procured by nonresident transport operators in ports from resident providers are included in exports of general merchandise. Similarly, goods procured by resident transport operators from nonresident providers are included in imports. Ports are defined widely to include sea and ocean terminals, airports, inland waterways, and providers of goods and services used in a territory by road and rail transport service providers that are residents of another economy. Goods procured by ship's crew, drivers, etc. for their own use are included in travel. Maintenance and repair costs of transport operators are transport services covered in paragraph 10.72. Fuel costs of small-scale transport operators are goods procured in port by carriers rather than travel (see paragraph 10.81);
- (e) Goods supplied or acquired by carriers away from the territory of residence of the operator. For example, fish and other marine products caught by ships operated by residents of the compiling economy and sold abroad directly should be included. Similarly, oil and minerals retrieved from the ocean floor by resident operators and sold abroad directly should be included. The goods could be acquired or sold in foreign ports or at sea to foreign vessels;
- (f) Goods acquired by a lessee under a financial lease. Financial leases are defined in paragraph 5.56. Because the lessee is the economic owner, a change of ownership between the seller of the goods and the lessee is recorded at the start of the lease. The lessor has legal title but does not have economic ownership. In contrast, goods under operating leases do not change ownership to the lessee, and thus are not included in general merchandise when delivered to the lessee. (Operating leases are discussed in paragraphs 10.153-10.156.);
- (g) Goods sent abroad without a change of ownership, but later sold. Goods sent abroad on consignment or for storage, repair, exhibition, processing, and so forth without a change of ownership are not recorded at the time they are sent abroad, but if they are later sold to a resident of an economy different from that of the owner, they should be recorded in general merchandise. (See paragraph 10.29 for further information on goods on consignment.);
- (h) Equipment that is sold while outside the territory of residence of its original owner. For example, equipment originally taken out of the territory for temporary purposes, such as construction, exhibition, or fishing, may be subsequently sold or given away;
- (i) Illegal goods;
- (j) Smuggled goods that are otherwise legal;
- (k) Gifts;
- (l) Parcel post where there is a change of ownership;
- (m) Goods lost or destroyed after ownership has been acquired by an importer but before the goods have crossed a frontier. (However, goods lost or destroyed before ownership has been acquired by an importer are excluded from merchandise trade);
- (n) Livestock that changes ownership;
- (o) Government sales of goods to and purchases of goods from nonresidents. Acquisitions of military equipment from nonresidents should be included in general merchandise. Goods supplied by governments to their own embassies, military bases, and so forth involve resident-to-resident transactions and so are not covered in the international accounts. Expenditure by embassies, military bases, and so forth is included under government goods and services n.i.e. (see paragraph 10.175);
- (p) Goods where there is no associated payment, such as those financed by grants or loans;
- (q) Humanitarian aid in the form of goods;
- (r) Goods transferred to or from a buffer stock organization;
- (s) Goods acquired to be processed without passing through the territory of the owner (see paragraph 10.65) and goods sold after processing without passing through the territory of the owner (see paragraph 10.66); and
- (t) Any other goods where there is a change of ownership that was not identified from data sources.

10.18 When a customs system is used as a source of data on goods, there is a need to make adjustments to include any goods where there is a change of ownership not recorded in customs data or travel. Cases that sometimes arise include shuttle trade (see paragraph 10.19); acquisition of ships, aircraft, and satellites; trade between free trade zones of an economy and residents of other economies; goods in bonded warehouses in economies that use the special trade system; and amounts below customs thresholds.

10.19 Goods for resale acquired by travelers while on visits (sometimes called shuttle trade) are included in general merchandise. *Shuttle trade covers transactions involving the purchase of goods in an economy by travelers (nonresidents) who then transport these goods back to their economy of residence where they are to be sold; goods purchased by travelers in their home country for resale abroad; and goods purchased by travelers abroad in one economy and sold abroad in a second economy.* It is sometimes also called informal cross-border trade. Because the intent of this travel is not to acquire goods for personal use—recorded under travel—but to engage in a business and to make a profit, the goods acquired and sold are recorded under general merchandise. (Other expenses incurred by these traders are dealt with in paragraphs 10.17(d), 10.72, and 10.81.)

10.20 Goods for own use or to give away acquired by travelers in excess of customs thresholds and included in customs statistics are also included in general merchandise. For example, durable goods (such as cars and electrical goods) and valuables (such as jewelry) may be acquired in this way and be brought back to the territory of residence of the owner. This treatment is consistent with international merchandise trade statistics, but care is needed to avoid double counting such goods by including them also under travel. (See paragraphs 10.86-10.90 for goods included in travel.)

10.21 When an international transactions reporting system is used as a source of data on goods, there is a need to make adjustments to include any goods where there is a change of ownership but no associated payment. Examples include humanitarian goods as aid, goods as gifts, goods provided to affiliated enterprises, goods under barter transactions, goods under trade credit, and goods where payment involves residents' bank accounts held in other economies.

c. *Items to be excluded from general merchandise because there is no international transaction*

10.22 Because there is no change of ownership of goods between a resident and a nonresident, or because the goods have no value, the following cases are excluded from general merchandise:

- (a) Transit trade. These goods are admitted under special customs procedures that allow the goods to pass through the territory. They are excluded from the general merchandise of the territory of transit;
- (b) Migrants' personal effects. The personal property that accompanies people changing residence is not classified as a transaction because there is no change in ownership;
- (c) Goods consigned to embassies, military bases, and so forth from their home authorities and vice versa;
- (d) Goods sent to an enterprise's external operations where those operations are not sufficiently substantial to constitute a branch. A common example is goods sent abroad from the home base for use in a construction project not undertaken by a separate entity; these goods are not included in exports of general merchandise of the territory of the home base;
- (e) Goods temporarily exported or imported without a change of ownership. Examples include goods for repair, as part of an operating lease, and for storage, and animals or artifacts for participation in exhibitions or competitions. (Such movements of goods should be tracked, so as to identify cases where the goods are subsequently sold, rather than returned; see paragraph 10.17(g). Identification of these movements may help identify associated items, such as repair, operating leases, storage services, exhibition charges, and competition winnings.);
- (f) Goods for assembly, packing, labeling, or processing by an entity that does not own the goods concerned. (Both inward and outward movements of such goods should be tracked, to assist in identifying associated charges for assembly, etc., to be recorded in manufacturing services on physical inputs owned by others, as discussed in paragraphs 10.62-10.71. These values also help identify cases where the goods are subsequently sold, rather than returned, in which case they are identified as an export from the owner's economy at the time of sale.);

- (g) Goods acquired by a lessor under a financial lease. Financial leases are defined in paragraph 5.56. Although the lessor has legal title, it does not have economic ownership. (The goods are shown as being acquired by the lessee; see paragraph 10.17(f).);
- (h) Goods with no positive value (e.g., dangerous goods exported for disposal or storage). These goods are not general merchandise, but could give rise to associated disposal or storage services; see paragraph 10.152. However, waste and scrap with positive values are included in general merchandise;
- (i) Returned goods. In these cases, the goods were not accepted, or a change of ownership occurred but the parties later agreed to annul the change of ownership. It is recommended that revised entries should be made to exports and imports for the period when the goods were initially recorded, so as to remove the voided transaction especially for returns of occasional, high-value goods. However, for statistical convenience, deductions from exports and imports may be made in the periods when the goods are returned for minor cases;
- (j) Samples of no commercial value;
- (k) Trade in goods between free trade zones and residents of the same economy; and
- (l) Any other goods that have been included in the data source although there was no change of ownership.

*d. Items to be excluded from general merchandise because they are included elsewhere*

10.23 The following items are excluded from general merchandise because they are included in other components of goods and services:

- (a) Goods acquired or sold by residents but that do not enter the economic territory are shown separately as goods under merchandising, as discussed in paragraphs 10.41-10.49;
- (b) Nonmonetary gold, as bullion and other forms, is shown as a separate item within goods, as discussed in paragraphs 10.50-10.54;
- (c) Goods that are included in travel, as discussed in paragraphs 10.89-10.91;
- (d) Goods locally acquired for construction undertaken by enterprises that are nonresident in the territory of the location of the work. These goods are included under construction, as discussed in paragraph 10.104;
- (e) Devices, such as disks, with stored computer software or data, that have been customized to order are included under computer services, as discussed in paragraph 10.143;
- (f) Products such as packaged software (systems and applications), video and audio recordings, and so forth that are delivered on disks, magnetic media, or storage devices, but are obtained with a fixed-period license to use (so that they require ongoing periodic payments) rather than with change of economic ownership. (These products are included in computer or audiovisual and related services; see paragraphs 10.143 and 10.163, respectively. For related products included in goods, see paragraph 10.17(c).);
- (g) Licenses to reproduce or distribute (or both) audio and video that are conveyed by supply of the original recording are included under charges for the use of intellectual property n.i.e., as discussed in paragraph 10.137; and
- (h) Customized blueprints and nonbulk newspapers and periodicals sent on the basis of direct subscription are included in information services. (However, the bulk provision of newspapers and periodicals is included in general merchandise.)

*e. Deliveries between affiliated enterprises*

10.24 Many cross-border movements in goods are between affiliated enterprises. The goods may be moved for processing, resale, and other purposes. The question may arise as to whether there has been a change of economic ownership. (For example, paragraph 10.22(f) covers the treatment of goods delivered for processing without a change of ownership.) Whether there has been a change in economic ownership is determined according to the usual principle that the economic owner is the party that bears the risks and rewards of ownership. In cases where there has been a change of possession of goods between affiliated enterprises, but it is not known whether there has been a change in ownership, the following factors should be considered:

- When affiliated enterprises are separate legal entities, their transactions should be treated according to the parties' own arrangements as to whether there is a change of ownership or not.

- Between a quasi-corporation and its owner, legal title is not usually available as evidence of the nature of the movement of goods. The preferred treatment in this case is to identify which part of the legal entity assumes the risks and rewards of ownership, based on evidence such as which location has the goods recorded in its accounts and is responsible for the sale of the goods. The treatment should be consistent with reporting by the branch in business accounts and enterprise or establishment surveys.

#### f. General and special trade

10.25 International merchandise trade statistics may be prepared on either a general or special trade basis:

- The general trade basis covers goods registered to enter the economic territory, including bonded warehouses and free trade zones. The general trade system is preferred in the United Nations *IMTS: Concepts and Definitions*. It is also preferable for international accounts statistics because it captures transactions involving goods for the whole economy and is more consistent with the coverage of the corresponding financing entries.
- The special trade basis in the strict sense covers goods cleared to enter the free circulation area only. If only special trade system data are available, adjustments are needed for goods movements into and out of bonded warehouses, export processing zones, and commercial free zones.

#### g. Time of recording

10.26 Transactions involving general merchandise should be recorded at the time of the change of ownership of the goods. Maximizing consistency in the time of recording between the exporter and importer, the change of ownership matches the time when the corresponding financial account entries are made (such as currency and deposits or trade credit). Goods are considered to change ownership when the parties enter the goods in their books as a real asset and make a corresponding change to their financial assets and liabilities.

10.27 *IMTS: Concepts and Definitions* recommends that the time of recording be based on when the goods enter or leave the territory, with the date of lodgment of the customs declaration a suitable approximation. In practice, some data sources may be based on the time of processing the declarations, which is unsatisfactory

if there are either long or variable lags in the time taken to process records. There will be lags between the time of export of a good and the time of its corresponding import arising from the period in which the goods are at sea or in transit through other countries. Ideally for international accounts statistics purposes, source data would be adjusted by:

- (a) removing recorded merchandise movements that did not involve a change of ownership in the period, and
- (b) adding merchandise that changed ownership during the period but was recorded in the source data in earlier or later periods.

In practice, the timing of the change of ownership is usually assumed to be approximately the same as the time of customs recording.

#### *High-value capital goods*

10.28 The production of high-value capital goods such as ships, heavy machinery, and other equipment may take several months or years to complete. As with other goods, the transaction should be recorded at the time that economic ownership is conveyed from the seller to the buyer. The time of ownership change is as arranged between the parties; for example, it could be a progressive change in line with stage payments, or in full on delivery. The timing in data sources may or may not coincide with the change of ownership; for example, payments data are on the basis of stage payments, whereas customs data are on the basis of the time that the completed item crosses the customs frontier. (If change of ownership differs from time of payment, accounts receivable/payable arise, as discussed in paragraph 5.71.)

#### *Goods on consignment*

**1029** *Goods on consignment are intended for sale, but their sale has not been arranged at the time they are dispatched.* Similarly, for goods sent for auction or for temporary storage before sale, the change of ownership may not occur until later. Such goods should not be included in the international accounts until ownership changes, to avoid a source of discrepancies between the goods flow and the corresponding financial entries. However, if it is impractical to record the transactions in this way, they can be approximated by the time of recording in international merchandise trade statistics. If there is a substantial delay in the sale of the goods, it is good practice in major cases to make adjustments to the actual time of change of ownership.

#### h. Valuation

10.30 The principle for valuation of general merchandise is the market value of goods at the point of uniform valuation. *The point of uniform valuation is at the customs frontier of the economy from which the goods are first exported, that is, free on board (FOB).* Market value is discussed in paragraphs 3.67-3.80.

10.31 The terms of delivery of goods are the responsibility of the buyer and seller of goods under each contract. The arrangements made between exporters and importers vary. As a result, transaction prices agreed between exporters and importers include varying amounts of distribution costs, including none, some, or all of wholesaling, transport, insurance, and taxes. An example is given in Box 10.2. Data from international transactions reporting systems and business surveys use transaction prices, and so have a variable mix of valuation bases.

10.32 IMTS use FOB-type valuation as the statistical value of exports and CIF-type for imports. FOB-type valuations include:

- (a) FOB—at port on the frontier of the exporting country (for goods dispatched by sea or inland waterway);
- (b) "free carrier" (FCA)—at terminal on the frontier of the exporting country (for goods dispatched by means of transport to which FOB is not applicable); and
- (c) "delivered at frontier" of the exporting country (for goods dispatched by means of transport to which FOB and FCA are not applicable; e.g., when goods are exported by railroad or pipeline).

(Where the customs frontier is not applicable, such as where there is a single market, the territorial frontier is used in its place. There may be cases where the application of FOB-type values is problematic, such as for goods under merchanting, nonmonetary gold changing ownership without delivery, or goods processed and sold in the economy of processing, so a transaction value is used.)

10.33 CIF-type valuations include:

- (a) "cost, insurance, and freight" (CIF) at the border of the importing country; and
- (b) "carriage and insurance paid" to the border of the importing country.

10.34 To convert imports from CIF to FOB valuation for international accounts purposes, the value

of freight and insurance premiums incurred from the frontier of the exporting country to the border of the importing country should be deducted. Ideally, CIF to FOB adjustment for imports should be obtained for each goods transaction, or at a detailed level. The relationship of FOB to CIF prices varies according to factors such as the type of good, weight, scale (bulk or not), special needs (such as refrigeration or careful handling), mode of transport, and the distance traveled. CIF to FOB ratios change over time, due to factors such as fuel prices, competition and technology in the transport industry, change in the proportion of different types of goods, and changes in source economies. For goods when the customs points of the exporting and importing territory are contiguous, the CIF and FOB values would be the same.<sup>4</sup> The FOB valuation point means that export taxes are treated as payable by the exporter and that import duties and other taxes of the importing economy are payable by the importer. To the extent that this is not the case, adjustments like those for freight and insurance are necessary.

10.35 In some cases an estimate of a market-price equivalent price may need to be made. (See paragraphs 3.71-3.79 for more details.) For example, barter trade, aid goods, provision of goods and services between affiliated enterprises, under- or overinvoicing, goods on consignment or for auction, or where goods change ownership but a final price is determined later may require adjustment to the goods value. Such adjustments may also require corresponding financial account items, such as trade credit; in the case of goods supplied by direct investors to their direct investment enterprise below cost or without charge, the corresponding entry is direct investment equity.

10.36 Compilers should verify that realistic valuations have been used in customs declarations, rather than notional figures, such as zero, or a price that is small or highly rounded. In the cases when the price is determined later, subsequent adjustments should be made to take into account the final price when it becomes available. The recording of possible adjustments is discussed further in paragraph 3.73.

<sup>4</sup>However, for some merchandise trade between neighboring territories, insurance and freight costs may be incurred between the customs frontiers, such as for air shipments, or in other cases when either customs frontier is away from the border, such as where goods are cleared for customs in sealed containers from the point of dispatch.

*i. Re-exports*

**10.37** *Re-exports are foreign goods (goods produced in other economies and previously imported) that are exported with no substantial transformation from the state in which they were previously imported.*<sup>5</sup> The price of the re-exported good may differ from its price at the time it was originally imported, due to factors such as transport costs, dealer's margins, and holding gains or losses. For goods to be included in re-exports for balance of payments statistics, a resident must acquire then resell the goods with the goods passing through the territory. Goods that are bought and resold but do not pass through the territory of the owner are included in goods under merchanting—see paragraph 10.41. Goods in transit are not recorded in imports or in re-exports—see also paragraph 10.22(a). As well, goods cleared by customs, but re-exported without coming into ownership by a resident of that economy, should not be included in re-exports for balance of payments statistics purposes. In contrast to re-exports, in the case of returned goods, there is no change of ownership or the parties later agree to annul the change of ownership (see paragraph 10.22(i)).

**10.38** In cases where the state of the imported goods is substantially transformed, which could be indicated by a change in HS code, goods are recorded as domestically produced exports rather than re-exports (e.g., goods that have been assembled or processed, or goods that have become rags, waste, scrap, antiques). Used goods that were previously imported and retain the same HS code, but have suffered wear and tear, could in most cases be included in re-exports depending on the rules of origin that the economy applies. Whereas international recommendations<sup>6</sup> on rules of origin exist, the origin of the goods will be determined at a national level. The case of imported goods processed without change of ownership is discussed in paragraphs 10.62-10.70. Goods temporarily imported or re-exported without a change of ownership, such as for repair or operating lease, are not included, as discussed in paragraph 10.22(e).

**10.39** Where possible, re-exports should be shown separately as a supplementary item, particularly in economies where re-exports are a significant proportion of exports. Because re-exported goods are not produced in the economy concerned, they have less connection to the economy than do other exports. Economies that are

major transshipment points and locations of wholesalers often have large values of re-exports. It may be of interest to derive the value of imports destined for re-export, calculated from re-exports with any timing adjustment.

**10.40** Re-imports are domestic goods imported in the same state as previously exported, without any substantial transformation occurring on the goods while they were outside the territory. Where significant, re-imports may be shown separately. Re-imports tend to arise in order to reverse a previous export, while re-exports generally arise because of transport, storage, or distribution through a territory other than that of the buyer or seller. For the goods to be included in re-imports, a nonresident must have acquired the goods, then resell them to a resident. (In cases where there was no change of ownership, they are omitted from imports; e.g., goods for repair or goods sent for processing.)

## 2. Other goods

### a. Goods under merchanting

**10.41** *Merchanting is defined as the purchase of goods by a resident (of the compiling economy) from a nonresident combined with the subsequent resale of the same goods to another nonresident without the goods being present in the compiling economy.* Merchanting occurs for transactions involving goods where physical possession of the goods by the owner is unnecessary for the process to occur. (If guidance is needed about the meaning of same goods, the criteria in paragraphs 10.37-10.38 can be used.)

**10.42** Merchanting arrangements are used for wholesaling and retailing. They may also be used in commodity dealing and for the management and financing of global manufacturing processes. For example, an enterprise may contract the assembly of a good among one or more contractors, such that the goods are acquired by this enterprise and resold without passing through the territory of the owner.<sup>7</sup> If the physical form of the goods is changed during the period the goods are owned, as a result of manufacturing services performed by other entities, then the goods transactions are recorded under general merchandise rather than merchanting. In other cases where the form of the goods does not change, the goods are included under merchanting, with the selling price reflecting minor processing costs as well as

<sup>5</sup>For treatment of re-exports in IMTS, see United Nations, *IMTS: Concepts and Definitions*, 1998, paragraphs 78 and 79.

<sup>6</sup>World Customs Organization, *International Convention on the Simplification and Harmonization of Customs Procedures (Revised Kyoto Convention)*.

<sup>7</sup>If there is no change of ownership of the goods, there is no merchanting transaction, but there may be manufacturing services on physical inputs owned by others for a fee, as discussed in paragraphs 10.62-10.64.



**Box 10.1. Examples of Goods under Merchanting and Manufacturing Services on Physical Inputs Owned by Others (Processing Services)**

**Example 1—Merchanting with manufacturing services that do not change the condition of the goods**

A resident of Economy A acquires books from a resident of Economy B for 10. The resident of Economy A has them sent to Economy C, without the books passing through Economy A, for a resident of Economy C to put in boxes, for a charge of 3 payable by the resident of Economy A. The books are then sold by the resident of Economy A to a resident of Economy D for 20.

Since the goods are in the same condition, the merchanting treatment applies.

The goods and services account entries for Economy A would be:

<i>Goods under merchanting (with Economy B)</i>	<i>-10 CR. (negative exports)</i>
<i>Goods under merchanting (with Economy D)</i>	<i>20 CR.</i>
Net exports of goods under merchanting	10 CR.
Manufacturing services on physical inputs owned by others (with Economy C)	3 DR.

(The counterpart entries in Economies B and D would appear as exports and imports, respectively, under general merchandise, because goods under merchanting is only used for the economy of the merchant.)

**Example 2—Manufacturing services that change the condition of the goods**

A resident of Economy A acquires oil from a resident of Economy B for 10. The oil is sent to Economy C, without passing through Economy A, for refining by a resident of Economy C, for a charge of 15; the oil continues to be owned by the resident of Economy A. The oil is then sold to a resident of Economy D for 30.

Since the goods are not in the same condition, the processing services treatment applies.

The goods and services account entries for Economy A would be:

General merchandise (with Economy B)	10 DR.
General merchandise (with Economy D)	30 CR.
Manufacturing services on physical inputs owned by others (with Economy C)	15 DR.

(See also paragraphs 10.62-10.71 on manufacturing services and related issues associated with processing.)

Economy B records goods exports to Economy A (10 CR.), Economy C records only manufacturing services exports A (not exports or imports of goods), and as noted above, Economy D records goods imports from Economy A (not goods imports from Economy C).

In both examples, Economy C may wish to identify the values of goods received and goods sent abroad as supplementary items.

wholesale margins. In cases where the merchant is the organizer of a global manufacturing process, the selling price may also cover elements such as providing planning, management, patents and other know-how, marketing, and financing. Particularly for high-technology goods, these nonphysical contributions may be large in relation to the value of materials and assembly.

10.43 Goods under merchanting are recorded in the accounts of the owner in the same way as any other goods it owns. However, the goods are shown separately in international accounts statistics of the economy of

the merchant because they are of interest in their own right and because they are not covered by the customs system of that economy.

10.44 The treatment of merchanting is as follows:

- The acquisition of goods by merchants is shown under goods as a negative export of the economy of the merchant;
- The sale of goods is shown under goods sold under merchanting as a positive export of the economy of the merchant;

- (c) The difference between sales over purchases of goods for merchanting is shown as the item "net exports of goods under merchanting." This item includes merchants' margins, holding gains and losses, and changes in inventories of goods under merchanting. As a result of losses or increases in inventories, net exports of goods under merchanting may be negative in some cases; and
- (d) Merchanting entries are valued at transaction prices as agreed by the parties, not FOB.

(Box 10.1 contrasts the entries for goods under merchanting with those for goods under processing.)

10.45 Merchanting items appear only as exports in the accounts of the economy of the territory of the merchant. In the counterpart exporting and importing economies, export sales to merchants and import purchases from merchants are included under general merchandise.

10.46 Wholesaling, retailing, commodity dealing, and management of manufacturing may also be carried out under arrangements where the goods are present in the economy of the owner, in which case they are recorded as general merchandise, rather than as merchanting. In cases where the goods do not pass through the economy of the owner, but the physical form of the goods changes, because they are processed in another economy, international transactions are recorded under general merchandise, rather than merchanting. (The processing fee is recorded as a manufacturing service paid for by the owner, as discussed in paragraph 10.62.)

10.47 Sometimes a purchaser may be uncertain whether the goods will be resold to residents of the same economy or others. In this case, intentions can be used as an indicator, with subsequent adjustment if intentions are not realized.

10.48 When a merchant resells goods to a resident of the same economy as the merchant, this does not meet the definition of merchanting. Accordingly, the purchase of goods is shown as imports of general merchandise to the economy in that case. If the entity that purchased from a merchant in the same economy subsequently resells the goods to a resident of another economy, whether or not the goods enter the economy of the merchant, the sales of goods are recorded in exports of general merchandise from the economy of the merchant. (Although such a case is very similar to merchanting, it does not meet the definition given above. In addition, it is impractical for the first merchant to record the purchases as merchanting because

that merchant may not know whether or not the second merchant will bring the goods into the economy.)

10.49 Merchanting of nonmonetary gold is included under the nonmonetary gold item, discussed in paragraphs 10.50-10.54. This treatment means that the nonmonetary gold item is comprehensive and conceptually symmetric.

b. *Nonmonetary gold*

10.50 Nonmonetary gold covers all gold other than monetary gold. Monetary gold, as defined in paragraphs 5.74-5.75, is owned by monetary authorities and held as a reserve asset. Nonmonetary gold can be in the form of bullion (i.e., gold bullion takes the form of coins, ingots, or bars with a purity of at least 995 parts per 1,000, including such gold held in allocated gold accounts), gold powder, and gold in other unwrought or semimanufactured forms. Jewelry, watches, and so forth that contain gold are included under general merchandise, not nonmonetary gold. Nonmonetary gold sales and purchases that are not shipped are valued at transaction prices, not FOB. The price should include any dealer's margins or commissions not billed separately.

10.51 Allocated gold accounts are treated as being arrangements for the storage of gold bullion. A change in ownership of an allocated gold account holdings is, therefore, treated in the same way as gold bullion (see paragraph 9.18). For the same reason, allocated gold accounts are not treated as deposits. If an entity puts gold it already owns into an allocated account, or withdraws gold from an allocated account without selling it, no change of ownership occurs so no transaction is recorded. In contrast, unallocated gold accounts are financial assets (included under monetary gold or deposits, depending on the holder). As a result, a deposit of bullion to an unallocated gold account is shown as an exchange of nonmonetary gold for a financial asset; and a withdrawal is the reverse unless both parties are monetary authorities or international organizations. (See also paragraphs 5.76-5.77 on gold accounts and 9.18 on transactions in gold bullion.)

10.52 When both parties to a gold transaction are either monetary authorities that hold the gold as reserve assets or international financial organizations, gold sales are recorded as monetary gold in the financial account, as discussed in paragraph 8.55. Otherwise, gold sales are recorded under nonmonetary gold.

10.53 Nonmonetary gold is shown separately from other goods because of the special role of gold in

financial markets, because gold sales and purchases largely relate to existing stocks, and because the values of sales and purchases may be particularly large in some cases, such as gold dealing centers. In many cases, there is no physical delivery to the new owner, because the gold is held at specialized bullion storage centers. However, change in ownership is the criterion for the recording of nonmonetary gold, so gold sales and purchases should be recorded even when there is no physical movement.

10.54 Nonmonetary gold may be held either as a store of value or for other (industrial) purposes, such as manufacturing of jewelry or for use in dental work. When feasible, nonmonetary gold can be subdivided into gold held as a store of value and other (industrial) gold as supplementary data.

### 3. Reconciliation between merchandise trade data and total goods on a balance of payments basis

10.55 It is a good practice for compilers to produce and publish a reconciliation table of the differences between merchandise trade statistics and goods on a balance of payments basis. A sample reconciliation table is shown in Table 10.2. Such a table ensures transparency and avoids confusion and doubts as a result of different sources, coverage, classification, valuation, timing, and so forth.

10.56 The table summarizes the steps taken in compilation. Some of the items are discussed in more detail in this chapter above. Annex E of *IMTS: Compilers Manual* lists differences between IMTS and *BPM5* standards. In addition to changes from *BPM5* in this *Manual*, other adjustments may arise if there are differences between IMTS and the national practices for coverage of international merchandise trade statistics.

## C. Services

References:

United Nations and others, *Manual on Statistics of International Trade in Services*, especially Chapter III, Services Transactions Between Residents and Non-residents.

United Nations World Tourism Organization, *International Recommendations on Tourism Statistics and The Tourism Satellite Account: Recommended Methodological Framework*.

## I. Concepts and coverage

10.57 Following the general principles in paragraph 3.47, the time of recording of service entries in the international accounts is the time at which the service is delivered. The provision of services should be recorded on an accrual basis in each accounting period, that is, they should be recorded as they are rendered. Payment may be made up front, at the end, or as progress payments. To the extent that the time of payment differs from the time of delivery, there may be trade advances (financial assets/liabilities that are extinguished as the service is provided) or trade credit (financial assets/liabilities that arise as the service is provided).

10.58 Services provided by a consultant, independent contractor, or employment agency are distinguished from compensation of employees. Paragraphs II.11-11.13 discuss the difference between an employee and a service provider.

10.59 Services that are "outsourced"—that is, where a company contracts another (specialist) company to provide services that were previously internal company functions, such as billing services or information "help" services—should be classified to the appropriate services item. Services supplied by "call centers" and similar types of operations should be classified according to the type of service provided. For example, call centers selling products are included in trade-related services, whereas call centers providing computer support are included in computing services.

10.60 The *Manual on Statistics of International Trade in Services (MSITS)* is a source of additional information for compilers of international trade in services data. *MSITS* uses the same conceptual framework as the *2008 SNA* and this *Manual*.<sup>7</sup> *MSITS* responds to information needs related to the General Agreement on Trade in Services (GATS) and other trade agreements, as well as growing information needs of governments, business, and analysts. It describes and clarifies the four modes through which services can be supplied internationally. Building on the services classification included in this *Manual*, *MSITS* provides a further breakdown of the classification of transactions by type of services through the Extended Balance of Payments Services (EBOPS) Classification. It also further extends the meaning of trade in services to cover services delivered through locally established enterprises (see Appendix 4, Statistics on the Activities of Multina-

<sup>7</sup>Details and presentation may differ. *MSITS* will be updated to incorporate the 2008 changes in the *SNA* and this manual.

**Table 10.2. Reconciliation between Merchandise Source Data and Total Goods on a Balance of Payments Basis**

	Exports	Imports
<b>Merchandise trade statistics as provided in source data</b>		
<b>Adjustments, as relevant<sup>1</sup></b>		
<b>For example (with paragraph reference):</b>		
+ Goods procured in ports by carriers (10.17(d))		
+ Fish catch, minerals from the seabed and salvage sold from resident-operated vessels (10.17(e))		
+ Goods changing ownership entering/leaving territory illegally (10.17(i)/(j))		
+/- Goods lost or destroyed in transit (10.17(m))		
+ Goods acquired from other economies for processing abroad (10.65(b))	n.a.	
+ Goods sold abroad after processing in other economies (10.66(b))		n.a.
+/- Goods changing ownership in customs warehouses or other zones (10.25)		
- Migrants' personal effects (10.22(b))		
- Goods imported for construction projects by nonresident enterprises (10.22(d))		
- Goods for repair or storage without change of ownership (10.22(e))		
- Goods sent abroad or returned after processing without change of ownership (10.22(f))		
- Returned goods (10.22(i))		
+/- High-value capital goods, if delivery differs from change of ownership (10.28)		
- CIF/FOB adjustment (10.34)	n.a.	
+ Net exports of goods under merchanting (10.44(c))		n.a.
+ Nonmonetary gold (10.50)		
<b>=Total goods on a balance of payments basis</b>		

<sup>1</sup>This list is not comprehensive, but indicative of commonly made adjustments. Some of the adjustments listed may be unnecessary because international merchandise trade statistics data for the economy may treat the item in the same way. For example, an adjustment for goods entering or leaving customs warehouses is not necessary if data are sourced from international merchandise trade on a general trade basis.

tional Enterprises). For more details, see *MSITS*, Chapter II, Conceptual Framework for the Development of Statistics on International Trade in Services.

## 2. Classification

10.61 An overview of the classification of services is shown in Table 10.1. The classification is mainly product-based, but is transactor-based for travel, construction, and government goods and services n.i.e. The classification is according to the type of service, rather than the unit that provides it; for example, if a bank provides pension fund services as a secondary activity, the service is classified as pension fund services. A reconciliation of the CPC and services classification is given in *MSITS*. The detailed listing of CPC items included in each service item in *MSITS* can be used to classify any services not specified in the following text to the appropriate international accounts service item.

### a. Manufacturing services on physical inputs owned by others

10.62 *Manufacturing services on physical inputs owned by others cover processing, assembly, labeling, packing, and so forth undertaken by enterprises that*

*do not own the goods concerned.* The manufacturing is undertaken by an entity that does not own the goods and that is paid a fee by the owner. In these cases, the ownership of the goods does not change, so no general merchandise transaction is recorded between the processor and the owner.

10.63 Examples of processes that are often undertaken under arrangements for manufacturing services on physical inputs owned by others include oil refining, liquefaction of natural gas, assembly of clothing and electronics, assembly (excluding assembly of prefabricated constructions, which are included in construction), labeling, and packing (excluding those incidental to transport, which are included in transport services).

10.64 Manufacturing services on physical inputs owned by others cover the transaction between the owner and processor, and only the fee charged by the processor is included under this item. The fee charged may cover the cost of materials purchased by the processor. Manufacturing services on physical inputs owned by others refer to all work done on goods by a resident of one economy for the owner of goods who is resident in another economy; the treatment of these services is not conditional on whether the goods were previously or subsequently in the physical possession of the

**Box 10.2. Recording of Global Manufacturing Arrangements**

With the trend toward a more globalized economy, there has been growth in cross-border production arrangements. These arrangements involve different aspects of production processes being partly or wholly undertaken by affiliates or outsourced to unrelated entities.

There are several types of arrangements, such as:

- (a) **Re-exports.** Re-exports can be very significant in economies that are international centers for trading, transshipment, and processing that does not change the physical form of the goods (such as packing and labeling). (See paragraphs 10.37-10.39.)
- (b) **Goods under merchanting.** While sometimes used for simple wholesaling, merchanting also arises when parent companies acquire ownership of goods from their own manufacturing affiliates for resale to wholesaling affiliates or other customers, without taking possession. (See paragraphs 10.41-10.49.)
- (c) **Manufacturing services on physical inputs owned by others and the associated movements of goods under these processing arrangements.** (See paragraphs 10.62-10.71.)
- (d) **Free trade and other special zones.** (See paragraphs 4.4 and 4.8.)

For economies where some or all of these arrangements are significant, it may be useful to use supplementary presentations that bring these processes together and/or provide more detail, such as presenting gross flows by type of activity, in order to enhance knowledge of economic developments.

owner or not. (Box 10.1 contrasts the entries for goods under processing with those for goods under merchanting. Box 10.2 discusses different types of arrangements used for global manufacturing.)

***Recording of related purchases and sales of goods***

10.65 Purchases of materials by the owner (i.e., goods to be processed) may be obtained from residents of the same economy as the owner, the same economy as the processor, or a third economy. The treatment is as follows:

- (a) when the goods are acquired from residents of the same economy as the owner, there is no international transaction; and
- (b) when the goods are acquired from residents of the same economy as the processor or a third economy, the owner of the goods to be processed records imports of general merchandise. (See also paragraph 10.42 for circumstances in which the sale could be recorded under merchanting.)

10.66 Sales of finished goods (i.e., goods after processing) are treated as follows:

- (a) when the goods are sold to residents of the same economy as the owner, there is no international transaction; and
- (b) when the goods are sold to residents of the same economy as the processor or a third economy,

the owner of the goods under processing records the sale as exports of general merchandise. (The seller could report merchanting in the case of minor processing; see paragraph 10.42.)

***Recording of related goods movements***

10.67 The gross values of goods associated with processing services can be identified as supplementary items in economies where they are significant. Whereas the manufacturing service is consistent with what is recorded in business accounts and actual transactions, the gross values of the physical movements of goods without a change of ownership are useful for analysis of processing activities. Values of the following items may be identified:

- (a) for customers of manufacturing services on goods processed abroad (with no change of ownership to the processor):
  - goods supplied for processing (goods sent); and
  - goods dispatched after processing (goods returned);
- (b) for providers of manufacturing services on goods processed in the compiling economy (with no change of ownership to the processor):
  - goods received for processing (goods received); and

- goods dispatched after processing (goods sent).

10.68 A market-equivalent valuation for goods supplied or received might be required. Gross values of the goods are shown after processing, and again a market-equivalent valuation might be required. The value of goods input and dispatched could be reported either by the customer or supplier of manufacturing services, or from customs data:

- If the values are reported by the customers, coverage should be irrespective of whether the input goods were supplied by the owner from the owner's territory, the processor's territory, or a third territory; or whether the goods are dispatched to the owner's territory, the processor's territory, or a third territory.
- If reported from customs, coverage may be incomplete to the extent that some inputs and some processed goods provided by the owner do not pass through customs. For example, goods sourced or sold locally will not be covered. Additionally, customs may not separately identify goods as being subject to processing, such as if there are no duty concessions.

There may be interest in breaking down these values by product or product groups.

10.69 Transport costs may be incurred on movements on goods undergoing processing. How these transport services are recorded is determined from the following factors:

- for goods included in general merchandise (i.e., in the cases mentioned in paragraphs 10.65-10.66), general principles for FOB valuation apply, so that transport costs up to the customs frontier are treated as being payable by the exporter and transport costs after the frontier are treated as payable by the importer; and
- for goods not included in general merchandise (such as materials delivered from the owner to the processor with no change of ownership), transport costs are shown as payable according to the arrangements of the parties; that is, the amount is payable by the party invoiced to pay the expense.

#### ***Other issues related to processing***

10.70 The value of manufacturing services on physical inputs owned by others is not necessarily the same as the difference between the value of goods sent for

processing and the value of goods after processing. Possible causes include holding gains or losses, the inclusion of overheads (such as financing, marketing, and know-how included in the finished good price), and measurement errors associated with the valuation of goods movements where there is no sale.

10.71 In contrast to manufacturing services on physical inputs owned by others, manufacturing of goods on own account means that the processor acquires ownership of the goods. When ownership is acquired from a nonresident, the gross values of the sale and purchase of these goods are included in general merchandise. Manufacturing on own account and manufacturing services on physical inputs owned by others are different arrangements for manufacturing, and it is desirable to show them separately because the role of the manufacturer in designing, marketing, and financing the goods is quite different. With globalization and outsourcing, it is becoming more common to have parts of a production process conducted in different economies. Showing these transactions on a change of ownership basis assists in identifying actual transactions and correctly attributing value added due to the owner for designing, marketing, financing, and so forth, rather than to the party that undertakes physical processes.

#### ***b. Maintenance and repair services n.i.e.***

10.72 Maintenance and repair services n.i.e. cover maintenance and repair work by residents on goods that are owned by nonresidents (and vice versa). The repairs may be performed at the site of the repairer or elsewhere. Repairs and maintenance on ships, aircraft, and other transport equipment are included in this item. Cleaning of transport equipment is included in transport services. Construction maintenance and repairs are excluded; they are included under construction. Maintenance and repairs of computers are included under computer services.

10.73 The value recorded for maintenance and repairs is the value of the work done—not the gross value of the goods before and after repairs. The value of maintenance and repairs includes any parts or materials supplied by the repairer and included in the charge. (Parts and materials charged separately should be included in general merchandise.) As noted in paragraph 10.22, goods leaving from, arriving in, and returning to a territory for repair, processing, or other activity without a change of ownership are excluded from general merchandise. Maintenance and repair services n.i.e. cover both minor repairs that maintain the good in working order and

major repairs that extend the efficiency or capacity of the good or extend its life. No distinction is made between those repairs included by the customer in intermediate consumption and those in capital formation.

c. *Transport*

**10.74** *Transport is the process of carriage of people and objects from one location to another as well as related supporting and auxiliary services. Also included are postal and courier services. Transport can be classified according to:*

- (a) mode of transport, namely, sea, air, or other ("other" may be further broken down into rail, road, internal waterway, pipeline, and space transport as well as electricity transmission); and
- (b) what is carried—passengers or freight.

In the standard components, transport is classified according to both dimensions. A breakdown of total transport services into freight transport, passenger transport, and other transport alone is proposed as simplified standard components for those countries that are unable (e.g., for reasons of confidentiality) to provide the full breakdown by mode of transport.

**10.75** A transport provider may subcontract to use the services of other operators to provide part of the final transport service. Such services should be recorded on a gross basis. For example, a courier service provider might contract separately to more than one transport operator. Any commissions payable by providers of transport services to an agent should be separately recorded, as described for travel in paragraph 10.98.

***Passenger services***

**10.76** Passenger services cover the transport of people. The category covers all services provided in the international transport of nonresidents by resident carriers (credit) and that of residents by nonresident carriers (debit). Also included are passenger services performed within a territory by nonresident carriers. The valuation of passenger transport should include fees payable by the carriers to travel agencies and other providers of reservation services. Passenger services provided within a territory by residents to nonresidents and provided or purchased separately from international transport are excluded from passenger transport; these services are included in travel.

**10.77** Passenger services include fares and other expenditure related to the carriage of passengers. They

also include any taxes levied on passenger services, such as sales or value-added taxes. Passenger services include fares that are a part of package tours. Cruise fares are included in travel. Passenger services include such items as charges for excess baggage, vehicles, or other personal accompanying effects and food, drink, or other items purchased on board carriers. Also included in passenger services are rentals, charters, and leases of vessels, aircraft, coaches, or other commercial vehicles with crews for the carriage of passengers. Excluded are rentals or charters that are financial leases (included in loans), and rentals and time charters without crew (included in operating leasing services).

***Freight services***

**10.78** Freight services cover the transport of objects other than people. The treatment of freight services is a consequence of adopting FOB as the uniform valuation principle for goods. As discussed in paragraphs 10.31-10.34, FOB valuation is as at the customs frontier of the exporting economy, so:

- (a) all freight costs up to the customs frontier are shown as incurred by the exporter, and
- (b) all freight costs beyond the customs frontier are shown as incurred by the importer.

In addition to freight on exports and imports, freight transport services may relate to goods where there is no change of ownership, such as goods sent for storage or processing and migrants' personal effects.

**10.79** When actual arrangements for paying freight costs differ from FOB terms of delivery, rerouting is needed, as defined in paragraph 3.16. Rerouting of freight services may mean that a transaction that is actually between two residents is treated as a transaction between a resident and a nonresident, and vice versa, as shown in Box 10.3. The timing of the provision of freight services may differ from the timing of the change of ownership of those goods, such as goods sent abroad on consignment where the sale occurs in a different accounting period from when the goods crossed the exporter's customs frontier. In principle, freight services should be recorded in the period they are rendered but are attributed to the importer in the period when the goods are purchased. However, in practice, the aggregated nature of recording of freight services and lack of information on individual freight movements means that timing adjustments to deal with this issue may not be feasible, material, or appropriate (e.g., if the importer pays for the service in the period it is rendered).

**Box 10.3. Numerical Examples of the Treatment of Freight Services**

A piece of equipment costs 10,000 units at the factory at which it was produced in Economy A. It costs 200 to transport it to the customs frontier of Economy A, 300 to transport it from the customs frontier of Economy A to the customs frontier of Economy B, where a customs duty of 50 is levied, and it costs 100 to deliver it from the customs frontier to the customer. (For simplicity, insurance of the equipment during transport is not covered in the example.)

Under all contractual arrangements between the parties, the FOB value is 10,200 and the CIF value is 10,500. However, how the services are recorded depends on the arrangements for paying the transport costs and the residence of the transport provider. A few of the possible arrangements are discussed below:

**Example 1:**

The parties contract on an FOB basis (i.e., the invoice price is 10,200; the exporter is responsible for costs up to the frontier of A and the importer is responsible for subsequent costs). In this case, no rerouting needed. All freight is shown as being provided by the actual provider and payable by the actual invoiced party.

**Example 2:**

The parties contract on an "ex works" basis (i.e., the invoice price is 10,000; the buyer pays for transport from the seller's premises).

- The freight from the factory to the customs frontier of Economy A is provided by a resident of Economy A. The 200 payable, which is actually a service provided by a resident of Economy A and payable by a resident of Economy B, must be rerouted to be shown as a resident-to-resident transaction within A, as all costs up to the frontier of the exporting economy are treated as being payable by the exporter and included in the price of the goods.
- The freight from the factory to the customs frontier of Economy A is provided by a resident of Economy B. The 200 payable, which is actually a domestic service

transaction within Economy B, must be rerouted as being a service provided from B to A, as all costs up to the frontier of the exporting economy are treated as being payable by the exporter.

**Example 3:**

The parties contract on a CIF basis (i.e., the invoice price is 10,500). The 300 payable for freight from the customs frontier of Economy A to that of Economy B is rerouted, because the contract makes it payable by the exporter, but it is treated as payable by the importer in balance of payments statistics (i.e., following FOB valuation). As a result, if the freight provider is a resident of A, a domestic transaction within A is treated as being a balance of payments transaction. Conversely, if the freight provider is a resident of B, an international transaction is treated as being a domestic transaction within B.

It is not normally possible to study every contract, so general patterns of freight cost arrangements need to be identified. When contract terms other than FOB are used, actual payment arrangements for freight may need adjustments to meet the FOB valuation convention.

In all cases where apparently domestic transactions are rerouted to be recorded as international transactions, or vice versa, goods trade must be recorded on a consistent basis, so that the financial payment from B to A equals the sum of its goods and services imports, both before and after re-routing adjustments. (If the goods are recorded at FOB values, the adjustments to freight bring them into consistency with goods; if the goods are recorded at transaction values, the goods values need corresponding adjustments.) Rentals, charters, or operating leases of vessels, aircraft, freight cars, or other commercial vehicles with crews for the carriage of freight are included in freight services. Also included are towing and services related to the transport of oil platforms, floating cranes, and dredges. Financial leases of transport equipment are excluded from transport services (see paragraphs 5.56-5.59 and 10.17(f)).

***Other transport services***

10.80 Other transport services include services that are auxiliary to transport and not directly provided for the movement of goods and persons. The category includes cargo handling charges billed separately from freight, storage and warehousing, packing and repackaging, towing not included in freight services, pilotage and navigational aid for carriers, air traffic control, cleaning performed in ports and airports on transport equipment, salvage operations, and agents' fees associated with passenger and freight transport (e.g., freight forwarding and brokerage services).

10.81 Some related activities are excluded from transport: freight insurance (included in insurance services); goods procured in ports by nonresident carriers (included in goods); maintenance and repairs on transport equipment (included in maintenance and repair services n.i.e.); and repairs of railway facilities, harbors, and airfield facilities (included in construction).

***Postal and courier services***

10.82 Postal and courier services cover the pick-up, transport, and delivery of letters, newspapers, periodicals, brochures, other printed matter, parcels, and



packages, including post office counter and mailbox rental services.

10.83 Postal services also include post office counter services, such as sales of stamps and money orders, poste restante services, telegram services, and so forth. Excluded are financial services rendered by postal administration entities, such as postal giro, banking and savings account services (recorded under financial services), mail preparation services (recorded under other business services), and administration services related to postal communication systems (included in telecommunication services). Postal services are subject to international agreements, and the service entries between operators of different economies should be recorded on a gross basis. Postal services provided to travelers are included in travel.

10.84 Courier services include express and door-to-door delivery. Express delivery services might include, for example, on-demand pick-up or time-definite delivery. Excluded are the movement of mail carried by air transport enterprises (recorded under transport, air, freight), storage of goods (recorded under transport, other, auxiliary and supporting services), and mail preparation services (recorded under other business services, other).

10.85 The principles for recording postal and courier services on exports and imports of merchandise are the same as for other freight services, as discussed in Box 10.3. This treatment is a consequence of the FOB valuation of the goods concerned. The principles for recording postal and courier services on other items, such as documents, personal effects, and goods for repair, are that the service is payable by the party responsible for payment. Courier services may encompass combinations of road, sea, air, and other methods of transport.

#### d. Travel

**10.86** *Travel credits cover goods and services for own use or to give away acquired from an economy by nonresidents during visits to that economy. Travel debits cover goods and services for own use or to give away acquired from other economies by residents during visits to these other economies.* The goods and services may be purchased by the persons concerned or by another party on their behalf. For example, business travel may be paid or reimbursed by an employer, tuition and living costs of a student may be paid by a government, or health costs may be paid or reimbursed by a government or insurer. Goods and services sup-

plied by the producer without charge are also included, such as tuition and board provided by a university.

10.87 The standard component breakdown of travel is between business and personal travel, with supplementary data for groups of special interest, such as border, seasonal, and other short-term workers. A separate supplementary breakdown of travel into types of goods and services is suggested (see paragraph 10.95).

10.88 Unlike most other service categories, travel is not a specific type of service, but a transactor-based component that covers an assortment of goods and services. In the case of travel, the consumer moves to another territory to consume the goods and services that he or she acquires. For these reasons, travel is not identified as a service in the CPC. Goods and services provided to visitors while on their trips that would otherwise be classified under another item such as postal services, telecommunications, local transport, hire of equipment, or gambling are included under travel.

10.89 Goods or services acquired by persons undertaking study or medical care while outside their territory of residence are included in travel. Acquisitions of goods and services by border, seasonal, and other short-term cross-border workers in their economy of employment are also included in travel.<sup>9</sup> Acquisitions of goods and services by diplomats, consular staff, military personnel, and so forth and their dependents (but not locally engaged staff and their dependents) in the territory in which they are posted are included under government goods and services n.i.e.

10.90 Travel excludes goods for resale, which are included in general merchandise. The acquisition of valuables (such as jewelry), consumer durable goods (such as cars and electric goods), and other consumer purchases for own use or to give away that are included in customs data in excess of customs thresholds is included in general merchandise. (The inclusion of these goods in general merchandise is discussed in paragraph 10.18.) Valuables and consumer durables that have not been included in general merchandise data should be included in travel (e.g., locally acquired goods kept in a vacation home). Travel includes local transport (i.e., transport within the economy being visited and provided by a resident of that economy), but excludes international transport (which is included in passenger transport; see paragraph 10.76).

<sup>9</sup>These acquisitions are not considered as tourism expenditure, so showing them separately as supplementary items allows travel data from the balance of payments to be reconciled with tourism statistics.

**Business travel**

**10.91** *Business travel covers goods and services acquired for personal use by persons whose primary purpose of travel is for business.* Examples include the expenditure of carrier crews stopping off or laying over; government employees on official travel; employees of international organizations on official business; employees traveling on behalf of their employer (except for diplomatic staff, etc., employed in government enclaves, whose expenditure in their territory of physical location is included in government goods and services n.i.e., as discussed in paragraph 10.178); self-employed nonresidents traveling for business purposes; and seasonal, border, and other short-term workers who are not resident in the economy in which they are employed. The business activities may include production or installation work, sales campaigns, market exploration, commercial negotiations, missions, conference, conventions, other meetings, or other business purposes on behalf of an enterprise resident in another economy.

**10.92** Business travel includes the goods and services acquired for personal use by persons whose main purpose of travel is for business (including goods and services for which business travelers are reimbursed by employers) but not the sales or purchases that they may conclude on behalf of the enterprises they represent.

**10.93** A supplementary item may be provided to show the total credits and debits for acquisition of goods and services by border, seasonal, and other short-term workers.

**Personal travel**

**10.94** *Personal travel covers goods and services acquired by persons going abroad for purposes other than business, such as vacations, participation in recreational and cultural activities, visits with friends and relatives, pilgrimage, and education- and health-related purposes.* Where important, there may be supplementary items to break down personal travel into subcomponents:

- (a) health-related (e.g., medical services, other health care, food, accommodation, local transport, acquired by those traveling for medical reasons);
- (b) education-related (e.g., tuition, food, accommodation, local transport, health services, acquired by nonresident students); and

- (c) all other personal travel. (This component includes health expenditure by those not traveling for health or educational purposes.)

The residence of international patients and students is discussed in paragraphs 4.120-4.121. Health and educational services not included in travel are discussed in paragraph 10.167.

**Other issues related to travel**

**10.95** A separate supplementary breakdown of travel may be provided according to product group, namely:

- (a) goods,
- (b) local transport services,
- (c) accommodation services,
- (d) food-serving services, and
- (e) other services.

This breakdown allows for closer links with tourism satellite accounts as well as supply and use tables. Further information on tourism statistics is presented in United Nations, *Tourism Satellite Account: Recommended Methodological Framework*<sup>10</sup> and United Nations World Tourism Organization, *International Recommendations for Tourism Statistics*. To highlight the link between travel and passenger transport services and tourism statistics, an approximation to tourism expenditure may be shown as a supplementary item that identifies relevant tourism-related goods and services in the travel and passenger transport items.<sup>11</sup>

**10.96** Travel covers stays of any length provided there is no change of residence. (Principles for determining residence of households are shown in paragraphs 4.116-4.130.) In some cases, it may be useful to break down travel by length of stay. For example, expenditure of those who do not remain overnight may be shown on a supplementary basis if this is significant.

**10.97** In line with the accrual principle, goods and services acquired during the visit but paid for earlier or later are included in travel. Goods and services may be

<sup>10</sup>The tourism satellite account has the concept of usual environment as an additional criterion to that of residence. As a result, acquisitions of goods and services by border, seasonal, and other short-term cross-border workers in their economy of employment can be identified separately in travel for compatibility with tourism statistics.

<sup>11</sup>This supplementary item includes all personal travel and that part of business travel that does not cover expenditure of border, seasonal, and other short-term workers, as well as passenger transport services.

**Table 10.3. Treatment of Alternative Time-Share Arrangements**

Type of Arrangement	Classification	Up-Front Payment	Transaction in Asset	Periodic Flow
Deeded ownership	Ownership of land and buildings	Direct investment in notional unit in economy where the time share is located	Equity of the time-share holder (direct investment)	Accommodation services in travel (imputed based on equivalent market prices) and investment income (income on equity)
Flight to use	Transferable right to use (amounts to economic asset)	Prepayment of accommodation + Contracts, leases, and licenses (only recognized when resold, difference between selling price and value of prepaid accommodation services, recorded in capital account)	Trade credit and advances + Nonproduced nonfinancial asset (capital account)	Accommodation services in travel
Membership system	Membership is non-transferable right to use (does not amount to asset)	Prepayment of accommodation	Trade credit and advances	Accommodation services in travel

acquired by being paid for by the person going abroad, paid for on his or her behalf, or provided without a quid pro quo (e.g., free room and board received, in such case there is also a corresponding transfer), or produced on own account (as in some cases of notional units for ownership of real estate and time-share accommodation).

10.98 Travel services may be arranged through a travel agent, tour operator, time-share exchange agent, or other provider. In some of these cases, the agent may pay the travel providers an amount that deducts a margin or commission. If the agent is a resident of the same economy as the customer, then the margin or commission is a resident-to-resident transaction, and the net amount payable to service providers resident in other economies (after the margin or commission receivable by the agent is deducted) is included in travel. In other cases, the nonresident provider of the services may pay the resident agent's commission and the gross amount is payable by the customer to nonresidents, and thus is included in travel. Fares for cruises provided by operators resident in economies other than that of the passenger are included in travel (not passenger transport).

10.99 In the case of a nonresident owner of land and buildings, any accommodation services provided by the identified notional unit to its owner (see paragraph 4.36) are shown in travel.

10.100 The term "time-share" covers a wide range of arrangements. They can be classified in the three categories, as described in Table 10.3:

- (a) The acquisition of deeded ownership, or a similar arrangement, is equivalent to the acquisition of a notional direct investment enterprise. In this case, after deeded ownership is acquired, accommodation services provided to the owner should be imputed based on market prices, which in turn gives rise to direct investment income on equity. (An example of a similar arrangement is a long-term lease that is of such duration that it represents an effective change in ownership.)
- (b) Payments for rights to use a property under a membership system time-sharing arrangement, where the right to use the time share is not transferable (the third category shown in the table), is equivalent to prepaying for accommodation services (recorded in trade credit and advances). After initial acquisition, the prepayment is drawn down, and imputed accommodation services should be recorded in travel.
- (c) A "right to use" time-share arrangement that carries a transferable right should be accounted for as prepaying for accommodation services (recorded in trade credit and advances), identical

to the recording of a membership system time-sharing arrangement discussed above. However, if the right is resold, the difference between the selling price and the amount remaining in trade credit and advances (reflecting the value of the remaining prepaid accommodation services) should be recorded as a transaction in a nonproduced nonfinancial asset, in the capital account.

e. *Construction*

**10.101** Construction covers the creation, renovation, repair, or extension of fixed assets in the form of buildings, land improvements of an engineering nature, and other such engineering constructions as roads, bridges, dams, and so forth. It also includes related installation and assembly work. It includes site preparation and general construction as well as specialized services such as painting, plumbing, and demolition. It also includes management of construction projects.

**10.102** Acquisition of goods and services by the enterprises undertaking that construction work from the economy of location of the construction work is also recorded under construction. Goods and services provided from the home economy are resident-to-resident transactions, and so should be excluded (see also paragraph 10.22). Goods and services acquired from third economies (i.e., neither the residence of the enterprise, nor the location of the construction work) are recorded under the appropriate general merchandise or service item for the economy of the enterprise.

**10.103** If the external operations of a construction enterprise are substantial enough, they constitute a branch resident in the economy of operations (see paragraphs 4.27-4.29). Therefore, a large-scale construction project contracted by a nonresident enterprise that takes a year or more to complete will usually give rise to a resident branch. Accordingly, there would be a direct investment relationship between the parent and the branch; there may also be goods and services supplied between the branch and the parent, such as for materials. As a result of this treatment, the construction contracts covered in international trade in services are generally of a short-term nature.

**10.104** Construction can be disaggregated into construction abroad and construction in the compiling economy. This disaggregation allows for the recording on a gross basis of both the construction work undertaken and the goods and services acquired from the economy in which the construction activity is being

undertaken by the nonresident enterprise that undertakes the construction.

*Construction abroad*

**10.105** Construction abroad consists of:

- (a) construction work for nonresidents by enterprises resident in the compiling economy (credit), and
- (b) the goods and services acquired from the economy in which the construction activity is being undertaken by these enterprises (debit).

*Construction in the compiling economy*

**10.106** Construction in the compiling economy consists of

- (a) construction work for residents of the compiling economy by nonresident construction enterprises (debit), and
- (b) the goods and services acquired in the compiling economy from resident enterprises by these nonresident construction enterprises (credit).

*Valuation*

**10.107** Construction is valued on a gross basis—that is, inclusive of all goods and services provided by the construction contractor as inputs to the work, and also inclusive of other costs of production and the operating surplus that accrues to the construction contractor. The transfer of ownership of construction under a contract may be deemed to occur in stages as value is put in place. In such cases, stage payments made by the owner can often be used to approximate the value of the gross fixed capital formation although stage payments may sometimes be made in advance or in arrears of the completion of the stage, in which case advances or trade credit are also extended. Construction can be undertaken in a similar way to manufacturing services on physical inputs owned by others. That is, a customer may provide goods and services as inputs to a construction project but the goods and services do not change ownership to the construction contractor. In such cases, the treatment, as with manufacturing services, is to record actual changes of ownership, not physical movements of goods. Repairs on embassies, bases, and so forth owned by the government that occupies them are included in government goods and services n.i.e. (see paragraph 10.177).

*Existing buildings*

**10.108** As noted in paragraph 4.34, because of the imputation of notional units for ownership of land, most

transactions involving acquisitions of existing buildings and land are treated as being between two resident units. International transactions of construction can arise when a building for an embassy, consulate, military base, or international organization changes hands with a resident of the economy in which the building is physically located. The ownership could change because of a sale or gift. Transactions in construction may also occur for buildings in an area that is exchanged between economies (see paragraph 4.9). The change in ownership of the land component is shown in the capital account (see paragraph 13.10); separate estimates should be made for the structure and land components. Transactions in existing buildings are included in construction in the same way as new buildings, to avoid having to distinguish new and existing buildings, and this treatment is analogous to the treatment in merchandise trade where both new and second-hand equipment are combined.

#### *f. Insurance and pension services*

**10.109** Insurance and pension services include services of providing life insurance and annuities, non-life insurance, reinsurance, freight insurance, pensions, standardized guarantees, and auxiliary services to insurance, pension schemes, and standardized guarantee schemes. More information on insurance and pensions is provided in Appendix 6c.

**10.110** The processes undertaken by insurers and pension funds include charging premiums, paying claims, and investing funds. To analyze the underlying economic nature of these operations, it is necessary to rearrange these processes to identify separately the service element. Appendix 6c provides some background to the way insurance and pension schemes operate and the value of their services is calculated. The usual starting point for deriving the exported and imported components is the value of premiums and claims, which are observable, rather than derived.

**10.111** In overview, the total value of insurance and pension services is derived as the margin between the amounts accruing to the companies (namely, premiums, contributions, and supplements) and the amounts accruing to the policyholders (namely, claims and benefits). That is, for nonlife insurance, the value of output of nonlife insurance services can be expressed with the following formula:

Gross premiums earned;  
+ Premium supplements;

- Claims payable plus adjustment for claims volatility, if necessary.

More elaboration is provided in Appendix 6c: nonlife insurance (paragraphs A6c.16-A6c.22), reinsurance (paragraph A6c.23), life insurance (paragraph A6c.31), and pension schemes (paragraph A6c.40).

**10.112** The supplementary breakdown of insurance and pension services is between direct insurance, reinsurance, auxiliary insurance services, and pension and standardized guarantee services. In addition, data on gross premiums earned (see paragraph A6c.17) and unadjusted claims (claims payable before adjustments for claims volatility; see paragraphs A6c.21-A6c.22) may be provided as supplementary items, with separate details on nonlife, life, pension, and standardized guarantee components, as considered appropriate.

**10.113** For exports of nonlife insurance services, the service charge can be estimated from total non-life insurance output by multiplying the gross premiums earned from nonresidents by the ratio of service charge to gross premiums earned for all nonlife insurance operations. (This calculation is illustrated in Box 10.4, Example 2.) The same prorating technique can be used for life insurance, annuities, pension funds, and standardized guarantees. To the extent that these ratios vary for different lines of business (reinsurance, marine, term life, etc.), the calculations should be made separately. Similarly, if it is known that there are different margins between resident and nonresident customers, data from the operations most relevant to nonresident policyholders should be used. The ratios should be calculated according to the formula for output in paragraph 10.111, so they take into account premium supplements and claims volatility. (See Box 10.4 for an example of calculations.)

**10.114** For imports of nonlife insurance services, the available information is less complete than that for exports. For reinsurance, the only customers are insurance companies, so data on premiums payable and claims receivable may be readily available from them. However, premium supplements are not observable. For direct insurance, there is a wider range of customers and, so, available data may be more limited, such as premiums paid and actual claims only. To derive a service charge from these values, ratios need to be obtained using the most suitable available indicator:

- (a) Ratios from other economies or from published accounts of large international insurance companies may be used. International trade in some

**Box 10.4. Numerical Examples of the Calculation of  
Nonlife Insurance Services**

*(This example is applicable to types of insurance not subject to fluctuations in claims; for an example with an adjustment for claims volatility, see Appendix 6c.)*

**Example 1. For resident insurers with separate data on policyholders abroad:**

Premiums earned from abroad	100 (premiums received 105)
Claims payable abroad	95 (claims paid 85)
Technical reserves relating to insurance with nonresidents	200 (beginning of period)
Income attributable to policyholders	20 (premium supplements)

The resulting entries are:

Services	Insurance service charge = 25 (derived as 100 + 20 - 95)
Primary Income	Income attributable to policyholders = 20
Current transfers	Net premiums receivable = 95 (premiums plus supplements less service = 100 + 20 - 25) Claims payable = 95 (actual; equal to net premiums receivable if no adjustment of claims for volatility)
Financial account	Increase in insurance technical reserves = 15 (for prepaid premiums 105-100; for unpaid claims 95 - 85)
International investment position	Insurance technical reserves 215 (end of period)

**Example 2. For resident insurers with separate data on policyholders abroad for premiums only:**

Total insurance services (to residents and nonresidents) combined	50
Total premiums	200
Of which: Premiums from residents	120
Premiums from nonresidents	80
Estimated insurance services provided to nonresidents	20 (=80/(200)* 50)

**Example 3. For nonresident insurers with resident policyholders:**

Premiums from residents	40
Ratio of service charge to premiums (average from data on insurers abroad)	= 25 percent
Estimated insurance services from nonresidents	10 (= 40 * 0.25)

types of nonlife insurance is dominated by relatively large, specialized companies;

- (b) Ratios from the resident insurance industry may be considered. In some economies, there may be equivalent lines of business; or
- (c) Ratios based on premiums payable abroad and claims receivable from abroad over a medium- to long-term period. International insurance trade includes direct insurance of large items (like ships and aircraft) and reinsurance, so claims receivable for a particular economy may be highly volatile. An adjustment for premium supplements would also be needed, or there could be an understatement of the value of services.

Such ratios should be calculated as consistently as possible with those for total services and exports outlined above, so they would also take into account premium

supplements and claim volatility. Although premium supplements are not readily observable for imports, some adjustment is needed, or there would be an understatement of the value of services and asymmetry with exports. Premium supplements to premiums ratios observed from other cases could be used to avoid this understatement. The same prorating techniques can be used for life insurance, annuities, pension funds, and standardized guarantee.

**10.115** Data on reinsurance imports can be collected from the policyholders, because they are all insurance companies. The value of direct insurance service produced relates to the whole of the risk that is insured, including any reinsured component. Thus, direct premiums and claims are recorded gross of reinsurance.

**10.116** Freight insurance is a form of nonlife insurance that raises particular issues. Freight insurance premiums payable on international traded goods before they

reach the customs frontier of the economy of the exporter are included in the FOB price of the good. Freight insurance premiums payable subsequent to the goods leaving the customs frontier of the exporter's economy are treated as payable by the importer. When the parties have not arranged the payment of insurance premiums in the same way as this methodology, partitioning and rerouting are needed (see paragraphs 3.16-3.17). These adjustments are of the same nature as those discussed for freight services. The service elements for freight insurance can be derived in the same way as other insurance.

**10.117** Auxiliary insurance services consist of the provision of services that are closely related to insurance and pension fund operations. Included are agents' commissions, insurance brokering and agency services, insurance and pension consultancy services, evaluation and loss adjustment services, actuarial services, salvage administration services, and regulatory and monitoring services on indemnities and recovery services. These services are charged through explicit charges.

*g. Financial services*

**10.118** Financial services cover financial intermediary and auxiliary services, except insurance and pension fund services. These services include those usually provided by banks and other financial corporations. They include deposit taking and lending, letters of credit, credit card services, commissions and charges related to financial leasing, factoring, underwriting, and clearing of payments. Also included are financial advisory services, custody of financial assets or bullion, financial asset management, monitoring services, liquidity provision services, risk assumption services other than insurance, merger and acquisition services, credit rating services, stock exchange services, and trust services.

**10.119** Financial services may be charged for by:

- (a) explicit charges;
- (b) margins on buying and selling transactions;
- (c) asset management costs deducted from property income receivable in the case of asset-holding entities; or
- (d) margins between interest payable and the reference rate on loans and deposits (called financial intermediation service charges indirectly measured, abbreviated as FISIM).

For financial intermediaries, the balance between explicit and implicit charges may vary over time and from insti-

tution to institution, so data on both are needed to get a complete picture of their supply of services.

*Explicit charges*

**10.120** Services are charged for by explicit charges in the case of many financial services and require no special calculation. Some explicit charges associated with deposit and lending services include application and commitment fees, fees for one-off guarantees, early or late repayment fees or penalties, and account charges. (However, an increase in interest rates as a result of late payment would not be classified as an explicit fee, but would be included with other interest and, so, taken into account as FISIM.)

**10.121** Explicit charges also include commissions and other fees related to letters of credit, bankers' acceptances, lines of credit, financial leasing, money transfer, and foreign exchange transactions. Also included are commissions and other charges related to transactions in securities: brokerage, placements of issues, underwritings, and redemptions; commissions and fees paid for the arrangement of financial derivative contracts; commissions of commodity futures traders; and asset management services, financial market operational and regulatory services, security custody services, and so forth.<sup>12</sup> Service charges on purchases of IMF resources are included among an economy's financial service payments, as are charges (similar to commitment fees) associated with undrawn balances under stand-by or extended arrangements with the IMF. Charges payable to a financial institution for arranging the provision of financial resources, which are services, should be distinguished from amounts payable to the suppliers of financial resources for the use of these resources (which are income; see paragraph 11.3(b)).

*Margins on buying and selling transactions*

**10.122** Dealers or market-makers in financial instruments may charge, in full or part, for their services by having a spread between their buying and selling prices. Dealers, market-makers, foreign exchange bureaus, and other intermediaries producing this kind of service are distinguished from other traders by the existence of a buy-sell spread, which shows that they serve the market

<sup>12</sup>Financial derivative transactions may take place directly between two parties or through intermediaries. In the latter case, there may be implicit or explicit service charges. It is not usually possible to distinguish implicit service charges. Therefore, it is recommended that net settlement payments of derivative contracts be recorded as financial transactions. However, when possible, service charge components should be recorded separately.

in a somewhat similar way to a wholesaler, by providing liquidity and inventory. Foreign exchange, shares, bonds, notes, financial derivatives, and other financial instruments are often bought and sold in this way.

10.123 The dealers' service charges are included indistinguishably in the financial transactions to which they relate. In such cases, the difference between the reference price and the dealer's buying price at the time of purchase represents the service charge to the seller. Similarly, the difference between the reference price and the dealer's selling price at the time of sale represents the value of the service provided to the buyer. The reference price is usually a mid-price between the buying and selling prices; some dealers may have their own internal price for determining their buying and selling prices. In contrast to the reference price, the prices actually paid or received include the financial service component. By using the reference price at the time of purchase or sale, any holding gains or losses on the dealer's trading activity are excluded from services. The service can also be measured by applying the dealers' average margin as a percentage to the value of transactions through dealers.

*Asset management costs taken out of income*

10.124 Some institutional units have the sole or predominant function of holding financial assets on behalf of their owners. For example, some mutual funds, holding companies, trusts, and special purpose entities serve this purpose. In the process of managing those assets, these enterprises incur administrative expenses, such as payments to fund managers, custodians, banks, accountants, lawyers, or their own staff. The expenses can be charged for explicitly as a fee, or implicitly by being paid out of investment income received or out of the assets of the enterprise. The expenses implicitly paid for should be recognized as a service to the owners. For example, a hedge fund may distribute a proportion of the net income of the fund to the entity that manages the fund, which should be recorded as a charge for services. Similarly, a custodian may charge lower fees in exchange for the right to on-lend securities (the income from on-lending securities is discussed in paragraphs 11.67-11.68).

10.125 Implicit asset management service charges can be measured at cost. The corresponding entry is to increase the net value of investment income payable to the investor to the gross value before deduction of the expenses. Without the recognition of the output of such services, the costs incurred would lead to negative

operating surplus for the asset management enterprises. With this treatment, these enterprises have a net operating surplus of zero.

*FISIM*

10.126 Actual interest can be seen as including both an income element and a charge for a service. Lenders and deposit-takers operate by offering rates of interest to their depositors that are lower than the rates that they charge to their borrowers. The resulting interest margins are used by the financial corporations to defray their expenses and to provide an operating surplus. Interest margins are an alternative to charging customers explicitly for financial services. In addition to financial intermediation, where funds are taken in as deposits and loaned, lending of own funds can give rise to FISIM in the cases of money lenders and loans made from banks' own funds.

10.127 By convention, these indirect charges in respect of interest apply only to loans and deposits and only when those loans and deposits are provided by, or deposited with, financial corporations (as defined in paragraph 4.63). While loans by holding companies, special purpose entities, and other captive financial institutions to their affiliates are not normally expected to generate FISIM, they may do so if they charge a margin. Financial corporations may generate FISIM even if they have only loans or only deposits; for instance, a credit card issuer that raises all of its funds by debt securities can earn FISIM on its loans to credit card customers.

10.128 The rate of FISIM may vary owing to a range of factors, such as the accessibility of funds, services included such as arrangements for check-writing facilities (for deposits), perceptions of the credit risk of the borrower, and the collateral provided (for loans). Additionally, large-scale ("wholesale") loans and deposits tend to have lower rates of FISIM than small-scale ("retail") loans and deposits.

10.129 FISIM payable by each of the depositors and borrowers are calculated by using the concept of a "reference" rate of interest. The reference rate should contain no service element and reflect the risk and maturity structure of deposits and loans. The rate prevailing for interbank borrowing and lending may be a suitable choice as a reference rate. A single rate should be used for transactions in the domestic currency, whereas different rates should be applied for loans and deposits in other currencies. The reference rate will change over time with market conditions.



**Box 10.5. Numerical Example of Calculation of FISIM**

The data requirements for the calculation of FISIM are:

- (1) values of loans and deposits (available from the IIP);
- (2) the corresponding interest payable/receivable (available from the primary income account); and
- (3) the applicable reference rate (usually available from central bank bulletins and other publications).

In this example, all loans and deposits are denominated in domestic currency and are issued by financial corporations. The interbank interest rate is 5 percent per annum.

Average value of loans during the year = 1000

Actual interest receivable by financial corporations on loans = 70  
partitioned into:

50 pure interest receivable (derived as 1000 at 5 percent)

20 FISIM receivable (derived as 70 - 50)

Average value of deposits during the year = 500

Actual interest payable by financial corporations on deposits = 10  
partitioned into:

25 pure interest payable (derived as 500 at 5 percent)

15 FISIM receivable (derived as 25 - 10)

Total FISIM receivable by financial corporations = 35 (20+15)

Notes:

The difference between interest receivable and payable is not the same as FISIM. In this example, the difference is 25, which differs from the correct figure because the loan assets do not match the deposit liabilities. (For example, an economy which had external loan assets funded entirely from domestic sources, there would be zero interest payable, so the difference between international interest payable and receivable is an unsuitable estimate of FISIM.) Unlike the reference rate concept, the method fails to separate the services provided to depositors from those to borrowers, so it does not provide a basis to identify the partner economy.

The average value of loans or deposits should be used in the calculation, as it corresponds to the amount on which interest accrues. If values change significantly during the period, the use of an end-of-period value as a proxy for the average may give an unsatisfactory result.

A more detailed calculation may take into account different currencies and maturities.

**10.130** For cross-border deposits and loans, different currencies may be involved, so separate reference rates should be applied for each currency that is a significant proportion of loans or deposits. To be closest to the definition of the reference rate and for international symmetry of recording, the rate should be taken from the financial markets of the home market of the currency, and preferably be the same as used by statistical compilers in that economy. (The data compiled for the currency composition in Tables I-III of Appendix 9 can provide relevant information on calculation of FISIM for each major currency.)

**10.131** FISIM is calculated as follows:

- (a) for loans from financial corporations—the difference between the interest actually payable on loans and the amount that would be payable if the reference rate were used, and

- (b) for deposits with financial corporations—the difference between the interest that would be earned if a reference rate were used and the interest actually earned.

(See Box 10.5 for a numerical example.)

**10.132** Because a repo with supply of cash is treated as involving a loan or deposit, as stated in paragraphs 5.52-5.53, it may give rise to FISIM. Similarly, a financial lease is treated as giving rise to a loan (see paragraphs 5.56-5.58) so it may also give rise to FISIM if provided by a financial corporation. Interbank loans and deposits generally occur at or close to the reference rate, in which case there is no FISIM. However, where there are significant international interbank transactions at interest rates above the reference rate (e.g., if the debtor bank has a lower credit rating), it would be

suitable for FISIM to be identified. See also paragraphs 11.74-11.75 on the effects of FISIM on interest.

**10.133** Estimates of cross-border FISIM can be calculated from data on the international investment position or banking data on deposits and loans from financial corporations in conjunction with the amounts of actual interest payable and receivable and reference interest rates. For economies where cross-border FISIM is small, it can be measured with relatively simplified methods based on aggregated data.

**10.134** Negative FISIM may occur in reality (e.g., when loans are at fixed interest rates and market rates rise). Negative FISIM can also occur owing to measurement error. For example, some large international transactions between banks may be at or near the reference rate, so a small error in measuring the reference rate could cause negative FISIM.

**10.135** The identification of FISIM as the financial service implicitly included in interest requires corresponding adjustments to interest as recorded in the primary income account. Actual interest payable by borrowers is partitioned between a pure interest charge at the reference rate (in primary income) and FISIM (a service). Similarly, pure interest receivable by depositors is calculated by applying the reference rate to depositors, and depositors are shown as consuming a service equivalent to the difference between the actual interest and interest at the reference rate. The interest shown in the primary income accounts is shown after adjusting for FISIM—"pure interest"; also, there is a memorandum item for interest before adjusting for FISIM—"actual interest" (see paragraphs 11.74-11.75).

**10.136** Financial services exclude pure interest, dividends, life insurance and pension services, other insurance services, nonfinancial advisory services provided by banks (included under other business services), and holding gains and losses on purchases and sales of financial instruments.

*h. Charges for the use of intellectual property n.i.e.*

**10.137** Charges for the use of intellectual property n.i.e. include:

- (a) Charges for the use of proprietary rights (such as patents, trademarks, copyrights, industrial processes and designs including trade secrets, franchises). These rights can arise from research and development, as well as from marketing; and

- (b) Charges for licenses to reproduce or distribute (or both) intellectual property embodied in produced originals or prototypes (such as copyrights on books and manuscripts, computer software, cinematographic works, and sound recordings) and related rights (such as for live performances and television, cable, or satellite broadcast).

(As shown in Table 10.4, some other kinds of intellectual property are included in other categories.)

**10.138** The production of books, recordings, films, software, disks, and so forth is a two-stage process of which the first stage is the production of the original and the second stage the production and use of copies of the original. The output of the first stage is the original itself over which legal or de facto ownership can be established by copyright, patent, or secrecy. The owner of the asset may use it directly to produce copies that give the purchaser a license to use. Alternatively, the owner may issue a license to other producers to reproduce and distribute the content. The payments made by the licensee to the owner may be described in various ways, such as fees, commissions, or royalties. The treatment of flows relating to intellectual property is summarized in Table 10.4. In contrast to temporary rights to use, outright sales of patents, copyrights, and industrial processes and designs are included under research and development services (discussed in paragraph 10.147). Similarly, temporary rights for computer software and audiovisual originals are treated differently from outright sales (as shown in Table 10.4).

**10.139** The time of recording of charges for the use of intellectual property follows the substance of the license agreement. If the rights to use intellectual property are sold for a fixed fee, under a noncancelable contract, and where the licensor has no remaining obligations to perform, then the whole sum is a sale. Otherwise charges are allocated over the life of the agreement. In practice, it may be feasible to record the payments only when they are made.

**10.140** Franchise fees, trademark revenue, payments for use of brand names, and so forth include aspects of property income (i.e., putting a nonfinancial non-produced asset at the disposal of another unit) as well as aspects of services (such as the active processes of technical support, product research, marketing, and quality control). In principle, it would be desirable to separate the income and service elements. However, it may not generally be feasible to do so in practice; in which case, a convention is adopted that the entire

**Table 10.4. Treatment of Intellectual Property**

	Use of intellectual property		Sale/purchase of ownership rights <sup>3</sup>
	charges for the use of intellectual property n.i.e.		capital account entry
<b>Franchises and trademarks</b>			
<b>Outcomes of research and development</b>	charges for the use of intellectual property n.i.e.		research and development services
<b>Computer services; Audiovisual and related services:</b>	<b>License to use excluding reproduction and distribution<sup>1</sup></b>	<b>License to reproduce and/or distribute<sup>1</sup></b>	
(a) Customized all types	relevant service item <sup>4</sup>		
(b) Noncustomized—downloaded or otherwise electronically delivered	relevant service item <sup>4</sup>		
(c) Noncustomized—provided on physical media with periodic license fee	relevant service item <sup>4</sup>	charges for the use of intellectual property n.i.e.	relevant service item <sup>4</sup>
(d) Noncustomized—provided on physical media with right to perpetual use	goods		

<sup>1</sup>Covers the case where a specific product is supplied with the right to use the intellectual property embodied in it, but not to cop/ it for further distribution. The transactions should be classified under the appropriate goods and services items.

<sup>2</sup>Covers the case where authority to reproduce and/or distribute the intellectual property is delegated by its owner.

<sup>3</sup>Covers the case where there is a change of economic ownership of the whole of the intellectual property right in question. The seller no longer has any rights or obligations associated with the intellectual property. This case also includes second or subsequent outright sales of intellectual property rights.

<sup>4</sup>The relevant service item is either computer services (see paragraph 10.143), or audiovisual and related services (see paragraphs 10.162–10.166), depending on the nature of the content provided.

For example, the sale/purchase of a copy of a software package that is mass-produced, and is obtained by an individual to load onto a single computer is covered by a license to use that excludes reproduction and distribution; this situation would be recorded in goods or services depending on the examples (see examples (b), (c), and (d) under software in Table 10.4). If a manufacturer pays for the right to include the software on computers that it produces, then the payment would be a license to reproduce and/or distribute (charges for the use of intellectual property provided by the owner of the original).

values are to be classified as charges for the use of intellectual property. Such a convention would be taken as a starting point, but if additional information to make a split is available, the compiler should do so.

#### *i. Telecommunications, computer, and information services*

**10.141** Computer and telecommunication services are defined in terms of the nature of the service, not the method of delivery.<sup>13</sup> To illustrate, provision of business services, such as accounting services, is included under the appropriate heading under other business services, even if these services are entirely delivered by telephone, computer, or the Internet. Only amounts payable for transmission should be included under telecommunications services; downloaded content should be included in the appropriate item (computer, information, audiovisual, etc., services).

<sup>13</sup>However, the mode of delivery is taken into account in some cases in the distinguishing between goods and services, as shown in Table 10.4.

#### *Telecommunications services*

**10.142** Telecommunications services encompass the broadcast or transmission of sound, images, data, or other information by telephone, telex, telegram, radio and television cable transmission, radio and television satellite, electronic mail, facsimile, and so forth, including business network services, teleconferencing, and support services. They do not include the value of the information transported. Also included are mobile telecommunications services, Internet backbone services, and online access services, including provision of access to the Internet. Excluded are installation services for telephone network equipment (included in construction) and database services (included in information services).

#### *Computer services*

**10.143** Computer services consist of hardware- and software-related services and data-processing services. Table 10.4 shows the classification of various arrangements for software and other types of intellectual property products. Computer services include:

- (a) sales of customized software (however delivered) and related licenses to use;
- (b) the development, production, supply, and documentation of customized software, including operating systems, made to order for specific users;
- (c) noncustomized (mass-produced) software downloaded or otherwise electronically delivered, whether with a periodic license fee or a single payment;
- (d) licenses to use noncustomized (mass-produced) software provided on a storage device such as a disk or CD-ROM with a periodic license fee (noncustomized software on storage devices with licenses that convey perpetual use is included in goods; see paragraph 10.17(c) and Table 10.4);
- (e) sales and purchases of originals and ownership rights for software systems and applications;
- (f) hardware and software consultancy and implementation services, including the management of subcontracted computer services;
- (g) hardware and software installation, including installation of mainframes and central computing units;
- (h) maintenance and repairs of computers and peripheral equipment;
- (i) data recovery services; provision of advice and assistance on matters related to the management of computer resources;
- (j) analysis, design, and programming of systems ready to use (including web page development and design), and technical consultancy related to software;
- (k) systems maintenance and other support services, such as training provided as part of consultancy;
- (l) data-processing and hosting services, such as data entry, tabulation, and processing on a time-sharing basis;
- (m) web page hosting services (i.e., the provision of server space on the Internet to host clients' web pages); and
- (n) provision of applications, hosting clients' applications, and computer facilities management.

**10.144** Software includes general business productivity software, computer game software, and other applications. However, as shown in Table 10.4 and para-

graph 10.17(d), some forms of software are classified under goods. It may be analytically useful to be able to identify all software, whether in goods or services. The time of recording software services follows the same principles as for other intellectual property, identified in paragraph 10.139.

**10.145** Excluded from computer services are computer training courses not designed for a specific user (included in other personal, cultural, and recreational services). Charges for licenses to reproduce or distribute software (or both) which are included in charges for the use of intellectual property, are also excluded. Leasing of computers without an operator is included in operational leasing.

#### *Information services*

**10.146** Information services include news agency services, such as the provision of news, photographs, and feature articles to the media. Other information provision services include database services—database conception, data storage, and the dissemination of data and databases (including directories and mailing lists), both online and through magnetic, optical, or printed media; and web search portals (search engine services that find Internet addresses for clients who input keyword queries). Also included are direct nonbulk subscriptions to newspapers and periodicals, whether by mail, electronic transmission, or other means; other online content provision services; and library and archive services. (Bulk newspapers and periodicals are included under general merchandise.) Downloaded content that is not software (included in computer services) or audio and video (included in audiovisual and related services) is included in information services.

#### *j. Other business services*

##### *Research and development services*

**10.147** Research and development services consist of services that are associated with basic research, applied research, and experimental development of new products and processes. In principle, such activities in the physical sciences, social sciences, and humanities are covered, including the development of operating systems that represent technological advances. Also included is commercial research related to electronics, pharmaceuticals, and biotechnology.

**10.148** The definition of research and development services used here and in the CPC is wider than the Frascati definition (which is used to define the scope

of capital formation in the 2008 SNA); it includes other product development that may give rise to patents. Outright sales of the results of research and development (such as represented in patents, copyrights, and sale of information about industrial processes) are included in research and development. However, amounts payable for use of proprietary rights arising from research and development are included under charges for the use of intellectual property n.i.e.; see paragraphs 10.137-10.140.

#### ***Professional and management consulting services***

**10.149** Professional and management consulting services include:

- (a) legal services, accounting, management consulting, managerial services, and public relations services; and
- (b) advertising, market research, and public opinion polling services.

**10.150** Services for the general management of a branch, subsidiary, or associate provided by a parent enterprise or other affiliated enterprise are included in other business services, often under professional and management consulting services. However, reimbursements of ancillary services supplied by affiliated enterprises, such as transport, purchasing, sales and marketing, or computing, should be shown under the relevant specific heading. Management fees are included in other business services. However, disproportionately large values of services between affiliated enterprises should be examined for signs that they are disguised dividends, such as large fluctuations that do not reflect actual changes in the services provided.

#### ***Technical, trade-related, and other business services***

**10.151** Technical, trade-related, and other business services include:

- (a) architectural, engineering, and other technical services;
- (b) waste treatment and depollution, agricultural, and mining services (discussed further in paragraph 10.152);
- (c) operating leasing services (discussed further in paragraphs 10.153-10.157);
- (d) trade-related services (discussed further in paragraph 10.158); and
- (e) other business services (discussed further in paragraph 10.159).

#### ***Waste treatment and depollution, agricultural, and mining services***

**10.152** Waste treatment and depollution services include waste collection and disposal, remediation, sanitation, and other environmental protection services. They also include environmental services, such as production of carbon offsets or carbon sequestration, that are not classified under any more specific category. Other technical services include agricultural, mining, and veterinary services.

#### ***Operating leasing***

**10.153** *Operating leasing is the activity of renting out produced assets under arrangements that provide use of a tangible asset to the lessee, but do not involve the transfer of the bulk of risks and rewards of ownership to the lessee.* Operating leasing may also be called leasing or rental services of specified produced assets, such as buildings or equipment, as specified in the CPC. Rental is also used as a term for the amounts payable under operating leases for produced assets, and is a service.<sup>14</sup>

**10.154** Operating leasing can be identified by the following characteristics:

- (a) The lessor, or owner of the equipment, normally maintains a stock of assets in good working order that can be hired on demand, or at short notice, by users;
- (b) The assets may be rented out for varying periods of time. The lessee may renew the rental when the period expires; and
- (c) The lessor is frequently responsible for the maintenance and repair of the asset as part of the service that is provided to the lessee. The lessor must normally be a specialist in the operation of the asset and may also undertake to replace the equipment in the event of a serious or prolonged breakdown.

Thus, in addition to the provision of an asset, the service provided under operating leasing by the lessor includes other elements, such as convenience and security, servicing, and back-up facilities.

**10.155** An operating lease is distinguished from:

- (a) a financial lease, where the risks and rewards of ownership of the asset are transferred to the

<sup>14</sup>In contrast, rent is used to describe amounts payable under a resource lease covering natural resources, such as land, water, or mineral rights. Rent arising from such resource leases is included in the primary income account, as discussed in paragraphs 11.85–11.90.

lessee; with an operating lease, the lessor has the risks and benefits (see paragraphs 5.56-5.60 for definition and elaboration on financial leases);

- (b) a resource lease, where the asset provided is a natural resource, rather than a produced asset (see paragraphs 11.85-11.90 for a definition and elaboration on resource leases and rent); and
- (c) a lease included under contracts, leases, and licenses, where the lease itself—rather than the underlying asset—becomes an economic asset of the lessee. (See paragraph 13.12 for elaboration on these leases.)

**10.156** Operating leasing services cover leasing (rental) and charters, without crew, of ships, aircraft, and transport equipment, such as railway cars, containers, and rigs, without crew. Also included are operating lease payments relating to other types of equipment without an operator, including computers and telecommunications equipment. License payments for the right to use intangible assets, such as software, intellectual property, and so forth are included under specific headings (computer services, charges for the use of intellectual property n.i.e., etc.) rather than operating leasing. Excluded from operating leasing services are leasing of telecommunications lines or capacity (included in telecommunications services) and rental of ships and aircraft with crew (included in transport services).

**10.157** Operating leases of dwellings and other buildings are included in this item, if not included in travel. If there is no objective basis on which to split the payment between rent on land and rental on the buildings, it is recommended to treat the whole amount as rental when the building component is believed to exceed the land component, and as a rent otherwise. However, rent of land alone and rent of other natural resources are classified as primary income (such leases are called resource leases; see paragraph 11.85). Rental of buildings by international organizations, embassies, and so forth, is included under government goods and services n.i.e. Rental of accommodation and vehicles to nonresidents during visits to other economies is included in travel (see paragraphs 10.86-10.88).

#### *Trade-related services*

**10.158** Trade-related services cover commissions on goods and service transactions payable to merchants, commodity brokers, dealers, auctioneers, and commission agents. For example, these services include the auctioneer's fee or agent's commission on sales of ships, aircraft, and other goods. If the trader owns the goods

being sold, the trader's margin is generally included indistinguishably in general merchandise FOB (if the goods pass through the economy of the trader) or under goods under merchanting (otherwise). However, any margins not included in the FOB price of the goods are included in trade-related services. Brokerage on financial instruments is excluded from trade-related services (included in financial services) as are transport-related charges, such as agency commissions (included in transport services).

#### *Other business services*

**10.159** Other business services include distribution services related to water, steam, gas, and other petroleum products and air-conditioning supply, where these are identified separately from transmission services; placement of personnel, security, and investigative services; translation and interpretation; photographic services; publishing; building cleaning; and real estate services. Also included are forfeited down payments not able to be specified to any other service.

**10.160** Business and other services, such as transport, construction, and computing, may be subcontracted. This arrangement may also be called "outsourcing." For example, a specialist service arranger may be paid to provide back-office functions for a customer, which the service arranger subcontracts to another contractor. Thus, subcontracting is similar in some ways to merchanting of goods, because the services are purchased and resold. However, for services, the degree of transformation involved may be harder to assess than for goods, such as in the case of bundling and managing the services of different contractors. "Service merchanting" of this kind is an important activity in some economies. The value of services exported and imported in the economy of the service arranger is recorded on a gross basis. (This treatment is applicable because the arranger buys and sells the services; if the arranger acted as an agent on a commission basis, then only the commission would be recorded as the service provided by the arranger.) These services are classified to the appropriate specific service classification, such as transport, construction, computing, or other business services. (See also paragraph 10.75 for transport.) However, if the activity is significant for an economy, net data could be provided on a supplementary basis.

#### *k. Personal, cultural, and recreational services*

**10.161** Personal, cultural, and recreational services consist of (a) audiovisual and related services and (b) other personal, cultural, and recreational services.

*Audiovisual and related services*

**10.162** Audiovisual and related services consist of services and fees related to the production of motion pictures (on film, videotape, disk, or transmitted electronically, etc.), radio and television programs (live or on tape), and musical recordings. Table 10.4 summarizes the treatment of intellectual property associated with audiovisual and related services, as well as other types of intellectual property.

**10.163** Included are amounts receivable or payable for rentals of audiovisual and related products, and charges for access to encrypted television channels (such as cable and satellite services). Fees to actors, directors, and producers involved with theatrical and musical productions, sporting events, circuses, and other similar events are included in this item (unless they are employees of the entity making payments, in which case the transactions are classified as compensation of employees).

**10.164** Mass-produced recordings and manuscripts that are purchased or sold outright or for perpetual use are included under audiovisual and related services if downloaded (i.e., delivered electronically). However, those on CD-ROM, disk, paper, and so forth, are included in general merchandise. Similar products obtained through a license to use (other than when conveying perpetual use) are included in audiovisual and related services, as is the use of other online content related to audio and visual media. (See paragraph 10.166 for the treatment of originals.) The principles for the timing for related audiovisual and related services, such as for music and film copyrights and for master recordings, are the same as those for other types of intellectual property, as discussed in paragraph 10.139.

**10.165** Charges or licenses to reproduce or distribute (or both) radio, television, film, music, and so forth are excluded from audiovisual and related services and included in charges for the use of intellectual property n.i.e.

**10.166** Purchases and sales of original manuscripts, sound recordings, films, and so forth are included in audiovisual and related services.

*Other personal, cultural, and recreational services*

**10.167** Other personal, cultural, and recreational services include health services, education services, and others, as discussed in the following paragraphs.

**10.168** Health services consist of services provided by hospitals, doctors, nurses, and paramedical and similar personnel, as well as laboratory and similar services,

whether rendered remotely or on-site. However, health services provided to nonresidents who are present in the territory of the service provider are included in travel (see also paragraph 10.94). Veterinary services are included in other technical services (see paragraph 10.152).

**10.169** Education services consist of services relating to education, such as correspondence courses and education via television or the Internet, as well as by teachers and so forth who supply services directly in host economies. However, education services provided to nonresidents who are present in the territory of the service provider are included in travel (see also paragraph 10.94).

**10.170** Other personal, cultural, and recreational services include those associated with museums and other cultural, sporting, gambling, and recreational activities, except those included in travel. The fees and prizes of athletes are included.

**10.171** The amounts paid for lottery tickets or placed in bets consist of two elements:

- (a) a service charge receivable by the unit organizing the lottery or gambling (this charge may also have to cover taxes on gambling); and
- (b) transfers to cover the amounts payable to the winners and, in some cases, amounts payable to charities.

The value of the lottery and other gambling services supplied by or to nonresidents is estimated as the amount wagered by nonresidents multiplied by the overall ratio of services to the total amount wagered for that gambling operator or type of gambling. This method for separately identifying the service component is similar to the method used for insurance services. For current transfers associated with gambling, see paragraphs 12.25-12.26.

**10.172** Acquisition of other personal, cultural, and recreational services (such as education, health, museums, and gambling) by persons while outside their territory of residence is included in travel (see paragraph 10.88) and excluded from this item.

*/. Government goods and services n.i.e.*

**10.173** Government goods and services n.i.e. cover:

- (a) goods and services supplied by and to enclaves, such as embassies, military bases, and international organizations;
- (b) goods and services acquired from the host economy by diplomats, consular staff, and military personnel located abroad and their dependents; and

- (c) services supplied by and to governments and not included in other categories of services.

Transactions of public corporations (defined in paragraph 4.108) are not included, unless the other party is one of the specified types of institutions.

***Goods and services supplied by and to government and international organization enclaves***

**10.174** As government and international organization enclaves are not residents of the territory in which they are physically located (as discussed further in paragraph 4.5(e)), their transactions with residents of the territory of location are international transactions. For the same reason, transactions of embassies, military bases, and so forth with their home economies are resident-to-resident and outside the scope of international accounts.

**10.175** Government goods and services n.i.e. credits include the supply of goods and services to embassies, consulates, military units or bases, defense agencies, and other official entities (such as aid missions; government tourism, information, and trade promotion offices) of foreign governments located in the compiling economy.

**10.176** Government goods and services n.i.e. debits include acquisition of goods and services by embassies, and so forth of the government of the compiling economy in other territories. Charges for visas and other services provided by embassies and consulates are also included in government goods and services n.i.e. The supply and purchase of goods and services by international organizations are also included in government goods and services n.i.e. The acquisition of goods and services for joint military arrangements, peacekeeping forces, and other services, such as those provided by the United Nations, are also included in government goods and services n.i.e.

**10.177** All types of goods and services, such as office supplies, vehicles, repairs, electricity, and rental of premises, for embassies, military bases, international organizations, and so forth purchased from the host economy or economies other than the home economy are included under government goods and services n.i.e. However, construction of new and existing structures is included under construction (see paragraph 10.108).

***Goods and services acquired by staff employed in enclaves and their dependents***

**10.178** All expenditure on goods and services by diplomats, consular staff, and military personnel located

abroad in the economies in which they are located is also included in government goods and services n.i.e. (These staff are classed as nonresidents of the territory of their location, as discussed in paragraph 4.123.) The expenditure of dependent members of the same household is also included. However, the expenditure of locally engaged staff of embassies, military bases, and so forth and international organization staff is not included in government goods and services n.i.e. (and is usually a resident-to-resident transaction). (These staff are classed as residents of the territory of their location, as discussed in paragraphs 4.123-4.124.) The supply of goods and services to foreign diplomats and so forth located in the compiling economy is shown as credits, while the expenditure of the compiling economy's diplomats and so forth in the economy of their posting is shown as debits. (Goods disposed of by diplomats, and so forth are similarly recorded with the signs reversed; for example, a car sold at the end of a posting is shown as a debit to the local economy.)

***Other services supplied by and to governments***

**10.179** Services supplied by and to governments should be classified to specific services (business services, health, etc.), if possible. For instance, acquisition of new and existing buildings for an embassy, consulate, and so forth is classified as construction, rather than government goods and services n.i.e. (see paragraph 10.108). However, some services are related to government functions that are not able to be classified to another specific service category, so are classified as government services n.i.e. For example, technical assistance on public administration is included in government services. Also, payments for police-type services (such as keeping order), such as those supplied with mutual agreement by a foreign government or international organization, are included in government services n.i.e. Additionally, government supply of licenses and permits that are classified as services (as discussed in paragraphs 10.180-10.181) are also government services n.i.e. Box 10.6 covers issues associated with technical assistance.

***Government licenses, permits, and so forth***

**10.180** 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 license or other certificate for a fee. If the issue of such licenses involves little or no work on the part of government, the licenses being granted automatically on payment, it is likely that they are simply a device to raise taxes, even though the



### Box 10.6. Technical Assistance

#### *Who provides technical assistance?*

Technical assistance is provided by the entity that employs the personnel delivering the services (technical assistance personnel), which could include a non-government entity. The provider is not necessarily the same as the party that provides the funding.

#### *What is the residence of the technical assistance provider?*

Technical assistance provided by an entity resident in the donor economy should be recorded as an export of a service by the donor economy to the recipient economy.

#### *How is technical assistance classified?*

Technical assistance covers a wide variety of different services, including computing and business services, and should be classified by the nature of the service provided to specific services, if possible. Technical assistance provided by government, or an international organization, is classified as government services only when not classified to a specific service, and where the technical assistance personnel are employed by the donor government or an international organization.

#### *How is technical assistance funded?*

Technical assistance may be subject to payment by the recipient, or funded by a current or capital transfer from the donor.

When cross-border technical assistance is provided without a fee being charged to the recipient, a current or capital transfer for the value of the services provided is recorded. If a third party funds the costs of technical assistance, then the funds provided are routed through the recipient economy to the service (or technical assistance) providing economy.

In principle the value of the services provided is estimated by the costs incurred by the donor government (including any costs in the donor economy, recipient economy, or a third

economy) in providing technical assistance. In the absence of detailed information the value could be estimated by the salary paid to the technical assistance personnel plus any other identifiable costs (such as travel costs).

#### *How are payments to technical assistance personnel classified?*

If the technical assistance personnel are resident in the donor economy and employed by the donor government, payments to these technical assistance personnel are only recorded in the domestic accounts of the donor economy.

If the technical assistance personnel are resident in the recipient economy (or any economy other than the donor economy) but employed by the donor government, compensation of employees payable by the donor economy is recorded in the international accounts (paragraph 11.15).

If the technical assistance personnel are resident in the recipient economy, considered employed by the recipient government, but their salaries are paid by the donor government, a current transfer from the donor to the recipient economy (paragraph 12.47) is recorded in the international accounts, with the recipient government imputed as paying compensation to the resident technical assistance personnel in the domestic accounts of the recipient economy. In this case, the output of the technical assistance is attributed to the recipient economy.

If the technical assistance personnel are resident in the recipient economy but are not considered to be in an employer-employee relationship with the donor or the recipient entity (see paragraphs 11.11-11.12) then payments to them are classified as payments for services, not the compensation of employees.

If the technical assistance activities in the recipient economy are such that a branch is recognized (paragraphs 4.26-4.28) and the technical assistance personnel are employed by the branch, payment of compensation by the donor economy is rerouted through the branch as equity.

government may provide some kind of certificate, or authorization, in return. However, if the government uses the issue of licenses to exercise some proper regulatory function, such as checking the competence or qualifications of the person concerned, checking the efficient and safe functioning of equipment, or carrying out some other form of control that it would otherwise not be obliged to do, the payments made should be treated as purchases of services from government rather than payments of taxes, unless the payments are clearly out of all proportion to the costs of providing the services.

**10.181** The borderline between taxes and payments of charges for services rendered is not always clear-

cut in practice.<sup>15</sup> By convention, amounts payable by households for licenses to own or use vehicles, boats, or aircraft and also licenses for recreational hunting, shooting, or fishing are treated as taxes, whereas amounts payable by households for all other kinds of licenses, permits, certificates, passports, and so forth, are treated as purchases of services. (For more details on taxes, see paragraph 12.30.)

<sup>15</sup>In the case of permits issued by the private sector, treatment as a tax is not an option, so the fee can only be a service or contract, lease, or license asset. In the case of licenses (government or private) that may be resold by the holder, the resale is recorded in the capital account under contracts, leases, and licenses (see paragraphs 13.11-13.16).

# I I Primary Income Account

## A. Overview of the Primary Income Account

Reference:

2008 SNA, Chapter 7, The Distribution of Income Accounts.

**11.1** *The primary income account shows primary income flows between resident and nonresident institutional units.* In the SNA, primary distribution of income is recorded in two accounts, namely, the generation of income account (which records primary income generated in the production process) and the allocation of primary income account (which records primary income allocated to institutional units for the provision of labor, financial assets, and natural resources). In the international accounts, all primary income flows relate to the allocation of primary income account.

**11.2** The main components and structure of the account are shown in Table 11.1. Credit entries reflect primary income receivable by the compiling economy and debit entries reflect primary income payable by the compiling economy. The balance on primary income shows net primary income receivable by the compiling economy, which is defined as the total value of primary income receivable by the compiling economy less the total value of primary income payable.

**11.3** *Primary income represents the return that accrues to institutional units for their contribution to the production process or for the provision of financial assets and renting natural resources to other institutional units.* Two types of primary income are distinguished:

(a) Income associated with the production process. Compensation of employees is income for the contribution of labor inputs to the production process. Taxes and subsidies on products and production are also income related to production; and

(b) Income associated with the ownership of financial and other nonproduced assets. *Property income is the return for providing financial assets and renting natural resources. Investment income is the return for providing financial assets; it consists of dividends and withdrawals from income of quasi-corporations, reinvested earnings, and interest.* However, ownership of financial derivatives and employee stock options does not give rise to investment income. The relationship between financial assets and the type of investment income they generate is shown in Table 5.2.

**11.4** Cross-border primary income flows provide a link between the concept of gross domestic product (GDP) and gross national income (GNI). GDP is linked to the concept of production, in which value added is generated. Contributors to the value added (such as labor, finance, and entrepreneurship) receive returns for their contributions. The economic process of income generation from production together with primary income distributions result in the GNI for an economy. The difference between the GNI and GDP is equal to the difference of primary income receivable from nonresidents and primary income payable to nonresidents, often described as "net income from abroad." When labor, financial resources, and natural resources owned by residents are put at the use of nonresidents, primary income is earned. When labor, financial resources, and natural resources are owned by nonresidents and are put at the use of residents, primary income is payable. GNI is larger (smaller) than GDP if more (less) income is generated from the provision of labor, financial resources, and natural resources owned by residents to nonresidents than the similar income payable to nonresidents.

**11.5** Primary income should be distinguished from secondary income. Primary income captures returns for the provision of labor and financial assets and renting of natural resources. Secondary income

**Table 11.1. Overview of the Primary Income Account**

	Credits	Debits
<i>Balance of goods and services</i>		
<b>Compensation of employees</b>		
<b>Investment income</b>		
Direct investment		
Income on equity and investment fund shares		
Dividends and withdrawals from income of quasi-corporations		
Reinvested earnings		
Interest		
Portfolio investment		
Income on equity and investment fund shares		
Dividends on equity other than investment fund shares		
Investment income attributable to investment fund shareholders		
Dividends on investment fund shares		
Reinvested earnings on investment fund shares		
Interest		
Other investment		
Income on equity and investment fund shares		
Interest		
Investment income attributable to policyholders in insurance, standardized guarantees, and pension funds		
Reserve assets		
Income on equity and investment fund shares		
Interest		
<b>Other primary income</b>		
Rent		
Taxes on production and imports		
Subsidies		
<i>Total primary income credits and debits</i>		
<i>Balance on primary income</i>		
<i>Balance on goods, services, and primary income</i>		

**Note:** This table is expository; for Standard Components, see Appendix 9.

captures further redistribution of income through current transfers, such as by governments or charitable organizations. Secondary income is described in Chapter 12.

11.6 The structure of the primary income account is consistent with that of the corresponding financial flows and positions, thus facilitating the analysis of rates of return. (See Table 5.2 for classification of financial assets and liabilities and the corresponding type of income they generate.) For example, rent is shown separately so that it is not mixed with returns on financial assets. Investment income attributable to policyholders in insurance, standardized guarantees, and pension funds is also to be shown as a separate item, if relevant. Specific further groupings of primary income are discussed in the subsequent sections.

11.7 Section B of this chapter discusses the coverage, timing, and valuation issues for each type of primary income (compensation of employees, divi-

dends, reinvested earnings, interest, investment income attributable to policyholders in insurance, standardized guarantees, and pension funds, rent, and taxes and subsidies on products and production). Section C explains specific issues and possible classification of investment income by functional category of financial assets and liabilities (direct investment, portfolio investment, other investment, and reserve assets).

## B. Types of Primary Income

11.8 The international accounts distinguish the following types of primary income:

- (a) compensation of employees;
- (b) dividends;
- (c) reinvested earnings;
- (d) interest;

- (e) investment income attributable to policyholders in insurance, standardized guarantees, and pension funds;
- (f) rent; and
- (g) taxes and subsidies on products and production.

These income categories are described in paragraphs 11.10-11.94.

11.9 Table 11.1 presents investment income using both functional and instrument classifications of financial assets. Investment income is generally linked to a particular type of financial instrument. For example, dividends are returns on equity and investment fund shares. Sometimes, a group of financial instruments has the same type of investment income. For example, deposits, loans, and debt securities all give rise to interest. This section describes various types of investment income and other types of primary income. The next section includes a description of specific issues on investment income related to the functional categories of financial assets and liabilities.

### I. Compensation of employees

11.10 *Compensation of employees presents remuneration in return for the labor input to the production process contributed by an individual in an employer-employee relationship with the enterprise.* In the international accounts, compensation of employees is recorded when the employer (the producing unit) and the employee are resident in different economies. For the economy where the producing units are resident, compensation of employees is the total remuneration, in cash or in kind, payable by resident enterprises to non-resident employees in return for work done by the latter during the accounting period. For the economy where the individuals are resident, it is the total remuneration, in cash or in kind, receivable by them from nonresident enterprises in return for work done during the accounting period. Residence of enterprises and individuals is described in Section E of Chapter 4, Economic Territory, Units, Institutional Sectors, and Residence.

11.11 Cross-border compensation of employees arises only when a resident individual is employed by a nonresident or when a resident employs a nonresident individual. Therefore, it is important to establish whether an employer-employee relationship exists between a resident individual and a nonresident employer or between a nonresident individual and a resident employer. An employer-employee relationship exists when there is an agreement, which may be formal or informal, between

an entity and an individual, normally entered into voluntarily by both parties, whereby the individual works for the entity in return for remuneration in cash or in kind. The remuneration is normally based on either the time spent at work or some other objective indicator of the amount of work undertaken. If an individual is contracted to produce a given result, it suggests a service contract relationship between the entity and a self-employed. Self-employed individuals are deemed to operate their own unincorporated enterprises, and thus sell output they produce. Self-employed individuals may also employ others. Self-employed individuals are generally responsible for decisions on markets, scale of operations, and finance, and are also likely to own or rent machinery or equipment on which they work.

11.12 When an individual performs work for an entity, it may not always be clear whether an employer-employee relationship exists between the individual and the entity. Provision of several types of services may pose such problems because entities may choose either to purchase a service from a self-employed worker or to hire an employee to perform the job. The status of the worker has important implications for the international accounts. If an employer-employee relationship exists between the worker and the producing entity, the payment constitutes compensation of employees. If an employer-employee relationship does not exist, the payment constitutes a purchase of services. (See Chapter 10, Goods and Services Account for specific categories of services.)

11.13 Several factors may have to be considered in determining whether an employer-employee relationship exists. An important test of whether an employer-employee relationship exists is that of control. The right to control or to direct, both as to what shall be done and how it shall be done, is a strong indication of an employer-employee relationship. The method of measuring or arranging for the payment is not important as long as the employer has the effective control on both the method and the result of the work undertaken by the individual. However, certain control on the work being undertaken may also exist for the purchase of a service. Therefore, other criteria should also be used to define more clearly the employer-employee relationship. If the individual is solely responsible for social contributions, that would suggest that the individual is a self-employed service provider. Payment of social contributions by the employer is an indication of employer-employee relationship. If the individual is entitled to the same kind of benefits (e.g., allowances, holidays, sick leave) that the enterprise generally provides to its employees, this indicates an employer-employee relationship. Payment

of taxes on the provision of services (such as sales tax or value-added tax) by the individual is an indication that the individual is a self-employed service provider.

11.14 Cross-border employees include seasonal or other short-term workers (less than one year) and border workers who are residents of one economy and work in another economy. Nonresidents who are employed as domestic helpers or housekeepers (for less than one year) by resident households are also treated as nonresident employees. Because embassies, consulates, military bases, and so forth are considered extraterritorial to the economies in which they are located (see Chapter 4, Economic Territory, Units, Institutional Sectors, and Residence; Section E, Residence, for the definition of residence), the compensation receivable by local (host country) staff of these institutional entities is classified as payable to resident entities by nonresident entities. Compensation receivable by employees from international organizations, which are extraterritorial entities, represents receipts from nonresident entities.

11.15 According to the residence principles for households as explained in paragraphs 4.116-4.130, technical assistance personnel employed by international organizations or governments on long-term assignments (for one year or more) are residents of the economy in which they reside (unless they are government employees with diplomatic status). Similarly, employees of parent enterprises working in an affiliated enterprise in another economy for one year or more are residents of the economy in which they reside. Although such employees continue to be legally employed and paid by the parent enterprise (which may be international organizations, foreign governments, or commercial enterprises), their employer-employee relationship may not always be clear. They should be considered employees of the institutional unit for which they work if this unit effectively manages and controls their work. The contractual arrangement for hiring or paying salaries may simply be a matter of convenience. In some cases it may be difficult to determine who is managing and controlling the work. In such cases, the workers should be considered to be employed by the entity that pays them.

11.16 Compensation of employees is recorded on an accrual basis. It is measured by the value of the remuneration in cash or in kind that an employee becomes entitled to receive from an employer with respect to work undertaken during the relevant period, whether paid in advance, simultaneously, or in arrears of the work itself. To the extent that payment has not been made for work performed, the economy of the employer must record an entry in the accounts payable and the

economy of the employee must record an entry in the accounts receivable.

11.17 Compensation of employees has three main components:

- (a) wages and salaries in cash,
- (b) wages and salaries in kind, and
- (c) employers' social contributions.

*a. Wages and salaries in cash*

11.18 Wages and salaries in cash consist of amounts payable in cash (or any other financial instruments used as means of payments) to employees in return for labor input rendered, before deducting withholding taxes and employees' contributions to social insurance schemes (which are shown in the secondary income account; see paragraph 12.35). Included are basic wages and salaries; extra pay for overtime, night work, and week-end work; cost of living allowances, local allowances, and expatriation allowances; bonuses; annual supplementary pay, such as "thirteenth month" pay; allowances for transportation to and from work; holiday pay for official holidays or annual holidays; and housing allowances. Wages and salaries in cash do not include the reimbursement by employers of expenditures made by employees in order to enable them to take up new or relocated jobs (e.g., reimbursement for travel and related expenses) or expenditures on items needed to carry out their work (e.g., tools or special clothing). These are shown as acquisition by the employer of goods and services.

*b. Wages and salaries in kind*

11.19 Wages and salaries in kind consist of amounts payable in the form of goods, services, interest forgone, and shares to employees in return for labor input rendered. Examples are meals; accommodation; sports, recreation, or holiday facilities for employees and their families; transportation to and from work; goods and services from the employer's own processes of production; bonus shares distributed to employees; and so forth. Benefits in kind should be valued at the market-equivalent price. The goods or services may be provided free or at a reduced cost. For example, when employees receive loans at reduced or zero rates of interest, the interest forgone is the difference between the interest charged and a market-equivalent interest charge. To provide a consistent and economically meaningful way of recording benefits in kind, some "rerouting" may be involved (see paragraph 3.16 for an example of rerout-

ing). That is, although the benefits are purchased by the employer, the benefits are treated as if the employer paid the amount of the benefit to the employee who, in turn, acquired the item. The rerouting may affect the resident-to-nonresident nature of the transaction.

11.20 Employee stock options (ESOs) are a way of paying wages and salaries in kind. ESOs are valued by reference to the fair value of the equity underlying the ESO awarded. The value of ESOs at the time of granting provides the measure of compensation of employees that should be recorded as accruing over the period to which the option relates, generally the period between the granting and vesting dates. Sometimes, the options may cover the period before the granting date, which should also be taken into account in allocating the compensation of employees. The value of the ESO accumulates as compensation of employees is recorded, so that at vesting date, it has accumulated to the value of the ESO at granting. Changes in the value of ESOs at or after the vesting date are not compensation of employees, but are holding gains and losses (see paragraph 9.30). Transactions and positions in ESOs are recorded within financial derivatives and ESOs, with a supplementary item for economies in which cross-border transactions in ESOs are significant.

11.21 In cross-border situations, a multinational parent company may directly provide ESOs to employees of its foreign subsidiaries. The value of ESOs should be recorded as compensation of employees payable by the subsidiary, the actual employer, and hence this transaction is domestic. The liabilities of the parent companies and acquisition of assets by the employees of the subsidiary in the form of ESOs are recorded in the respective economies' international accounts. If the ESO is supplied free or below cost to the subsidiary, a transaction between the parent and actual employer should be imputed for the value of the ESO similar to the treatment of transfer pricing (see paragraphs 11.101-11.102).

c. *Employers' social contributions*

11.22 *Employers' social contributions are social contributions payable by employers to social security funds or other employment-related social insurance schemes to secure social benefits for their employees.* Social security schemes are operated by general government; other employer-related social insurance schemes may be operated by the employers themselves or by an insurance corporation or may be an autonomous pension scheme. Examples of social benefits

include employers' contributions or subsidies for pensions, life insurance, and health insurance; allowances for children, spouse, family, education, or other payments with respect to dependents; payments made to workers absent from work because of illness, accidental injury, maternity leave, and so forth; and severance payments. Both actual and imputed social contributions are included. For defined contribution employer pension schemes, the actual amounts payable by employers are included in the compensation of employees. For defined benefit pension schemes, including unfunded pension schemes, the amount of employers' social contributions should be determined on the basis of actuarial calculations that yield contributions required to secure the de facto entitlements to the social benefits. (See paragraph 5.66 for the definition of pension entitlements.)

11.23 Employees who are employed outside their economy of residence may incur travel expenses (see paragraphs 10.91-10.93) and may be subject to the payment of income taxes (see paragraph 12.28). These flows should be recorded on a gross basis respectively as travel expenses and taxes on income; that is, they should not be deducted from compensation of employees.

## 2. Dividends and withdrawals from income of quasi-corporations

11.24 *Dividends are the distributed earnings allocated to the owners of equity for placing funds at the disposal of corporations.* Raising equity through the issue of shares is an alternative way of raising funds compared to borrowing. In contrast to debt financing, however, equity finance does not give rise to a liability that is fixed in monetary terms and does not entitle the holders of shares of a corporation to a fixed or predetermined income. Owners of equity receive their share of distributed earnings, the timing and amounts of which are decided by corporations.

11.25 The concept of dividends is linked to the instrument classification; namely, they are the return payable by corporations to their shareholders or owners.<sup>1</sup> Dividends are most often quoted in terms of the amount of money declared payable per share. They may also be quoted in terms of a percentage of the market value of shares, referred to as dividend yield. Income on nonparticipating preference shares is treated as interest income, rather than dividend income, because such shares are classified as debt instruments.

<sup>1</sup>Manufactured dividends are discussed in paragraph 11.69.

11.26 In addition to dividends from corporations, distributed income from quasi-corporations (such as distributed branch profits) should be included under this heading. In legal terms, quasi-corporations cannot distribute income in the form of dividends. Nevertheless, the owner, or owners, of a quasi-corporation may choose to withdraw some or all of the income of the enterprise, and some quasi-corporations formally organized as trusts, partnerships, or other institutions may formally distribute some or only a portion of their earnings. From an economic point of view, the withdrawal of such income is equivalent to the distribution of corporate income through dividends and is treated the same way. Withdrawals from income of quasi-corporations do not include withdrawals of funds realized by the sale or disposal of the quasi-corporation's assets (e.g., the sale of inventories, fixed assets, or land or other natural resources). Transmittal of funds resulting from such disposals of assets is recorded as a withdrawal from the equity of quasi-corporations in the financial account. Income from rent earned on land and buildings directly held by nonresidents is also classified under dividends and distributed incomes from a notional direct investment enterprise.

11.27 Exceptional payments by corporations (including quasi-corporations such as branches) to their shareholders that are made out of accumulated reserves or sales of assets should not be treated as dividends. Such exceptional payments, sometimes called super-dividends, are treated as withdrawals of equity, and therefore recorded in the financial account (as noted in paragraph 8.23). The exceptional nature of the payments is normally determined as being disproportionately large relative to the recent level of dividends and earnings. Although dividends are notionally paid out of the current period's operating surplus, corporations often smooth the payments of dividends, sometimes paying out rather less than operating surplus but other times paying out a little more, especially when the operating surplus itself is very low. For practical reasons, no attempt is made to align dividend payments with earnings except when the dividends are disproportionately large. If the level of dividends declared is greatly in excess of previous dividends and trends in earnings, the excess should be excluded from dividends and shown as a withdrawal of equity (see paragraph 8.23).

11.28 Stock dividends arise where stockholders elect to receive payments of dividends in the form of issue of new shares. The stock dividends are essentially a capitalization of earnings and an alternative to distributing cash dividends. Therefore, stock dividends are treated

as income (in the primary income account), which is then immediately reinvested (in the financial account).

11.29 Bonus shares refer to issues of new shares to all stockholders in proportion to existing ownership. These arrangements are not treated as transactions because no new resources have been provided. The claim of the shareholders on the entity is the same before and after the issuance of bonus shares. (See also paragraph 8.33.)

11.30 Liquidating dividends, whether partial or total, arise mainly at the time of the termination of a company. These are treated as a withdrawal of equity, shown in the financial account, as a convention based on the assumption that liquidating dividends are more likely to involve previously existing equity finance rather than current income.

11.31 Dividends are recorded at the time the shares go ex-dividend (see paragraph 3.48 for recording of dividends). Withdrawals of income from quasi-corporations, that is, distributed profits, are recorded when they are withdrawn by their owners. Dividends and withdrawals from income of quasi-corporations are recorded gross of any withholding taxes. These taxes are deemed to be payable by recipients of such income.

11.32 Dividends and withdrawals by owners of quasi-corporations are also identified for equity in investment funds. Investment funds are usually portfolio investment, but they may also occur in other functional categories. For equity in investment funds and direct investment, the owners' earnings include both the distributed income and reinvested earnings.

### 3. Reinvested earnings

11.33 This section describes the treatment in the international accounts of reinvested earnings from equity participation. Reinvested earnings is associated with the concept of attributing retained earnings to their owners.

**11.34** *Retained earnings of an enterprise shows the net earnings from production and primary and secondary income transactions before attributing reinvested earnings. It is equal to net operating surplus plus primary income, current transfers receivable, and change in pension entitlements, and minus primary income (excluding reinvested earnings payable to the enterprise's direct investors and owners of investment funds) and current transfers payable. Retained earnings of investment funds and the part of the retained earnings*

of direct investment enterprises that belongs to direct investors are treated as being distributed to the owners who then are deemed to reinvest back. The imputation of income to the owners of investment funds and direct investors is shown in the primary income account as "reinvested earnings" and the corresponding flow is recorded in the financial account as "reinvestment of earnings" (see paragraphs 8.15-8.16 for the recording of financial account entries). Reinvestment of earnings is an imputed financial transaction. In the position data, reinvestment of earnings is not shown separately but included implicitly in the total value of equity.

11.35 In macroeconomic statistics, corporations are defined as entities separate from their owners and able to take economic decisions (see paragraphs 4.13-4.15 for the definition of corporations as institutional units). Owners receive dividends and face other financial gains and losses arising from the activity of the corporations they own.<sup>2</sup> For corporations, the notion that the institutional units are decision-making entities implies that retained earnings are treated as the income and saving of that entity rather than those of its owners. So the undistributed income arising from the net operating surplus, net property income, and net current transfers is recorded as retained earnings or net saving of corporations. Losses are negative net saving. Quasi-corporations, such as branches and notional units, are treated in the same way as incorporated entities.

11.36 However, when retaining earnings is a deliberate decision of owners to reinvest, treating them as if they were retained by corporations would not reflect economic reality. Although most economic relationships between a corporation and its owners may be considered to take place in an arm's length situation, the distribution of its net earnings to its owners, in some cases, may be subject to the control and influence the owners have on corporate decisions. Attribution of cross-border income is particularly important for deriving consistent and comparable measures of national disposable income and national saving. Retained earnings of investment funds and the part of the retained earnings of direct investment enterprises belonging to direct investors are treated as being distributed to the owners and reinvested back by the owners in their enterprises.

<sup>2</sup>The amount of dividends payable in any given accounting period depends on a range of factors, including the corporation's judgment of its own investment opportunities relative to those available in the market, differences in the tax treatment of distributed and undistributed income, and the degree of influence and control of the owners in management decisions.

*a. Investment income attributable to investment fund shareholders*

11.37 Investment income attributable to the owners of investment fund shares (or units) includes dividends payable to them as well as retained earnings. Investment funds provide a convenient, accessible, and affordable vehicle for financial investment. Typically, investment funds sell shares or units to the public and invest in a diversified portfolio of securities, although they may also invest in other assets, including real estate, or they may be limited to a small number of investors (see paragraphs 4.73-4.75 on investment funds as an institutional subsector). Each share represents a proportional equity in the investment portfolio managed by investment funds.

11.38 Earnings from investment funds can be viewed as being passed on to their shareholders (or unit-holders) as they are earned in the form of investment income on their equity. Investment funds earn income by investing the money received from shareholders. Shareholders' income from investment funds is defined as the investment income earned on the fund's investment portfolio after deducting operating expenses. The net earnings of investment funds after deducting the operating expenses belong to shareholders. When only a part of the net earnings is distributed to shareholders as dividends, the retained earnings should be treated as if they were distributed to the shareholders and then deemed reinvested. The consequence of the treatment of the retained earnings of investment funds is that the saving of investment funds is always zero.

11.39 Investment income attributable to owners of investment funds excludes holding gains and losses arising from investment by the funds. Holding gains and losses are recorded in the other changes in financial assets and liabilities account. (If dividends from an investment fund include distribution of amounts derived from holding gains, reinvested earnings may be negative.)

*b. Reinvested earnings on direct investment*

11.40 Investment income attributable to direct investors on their equity includes dividends, withdrawals from income of quasi-corporations, and reinvested earnings. The reinvested earnings are the direct investors' share of the retained earnings of the direct investment enterprise. Reinvested earnings are attributed to direct investors who are in an immediate direct investment relationship with the direct investment enterprises (i.e., when equity participation by direct investors meets



the 10 percent threshold). However, reinvested earnings are not attributed to direct investors when the equity participation provides less than 10 percent of the voting power. (For example, a direct investor may directly hold a stake of 1 percent of an indirectly held subsidiary; although it is a direct investor by virtue of the chain of ownership, it is not shown as a direct recipient of reinvested earnings on its 1 percent holding.) Paragraphs 6.8-6.24 define direct investment relationships. In the case of a government-owned nonresident entity used solely for fiscal purposes, transactions are imputed between the government and the government-owned nonresident entity to reflect the fiscal activities of the government (see paragraphs 8.24-8.26). Therefore, such government-owned entities do not give rise to reinvested earnings.

11.41 The rationale behind the treatment of reinvested earnings on direct investment is that, because a direct investment enterprise is, by definition, subject to control, or influence, by a direct investor or investors, the decision to retain and reinvest some of its earnings within the enterprise represents an investment decision on the part of the direct investor(s). Many factors may influence the decisions of direct investors on the proportions of net earnings of direct investment enterprises to be distributed or retained, including taxation systems, transfer costs, investment opportunities in the ongoing business and elsewhere, relative costs of moving financial resources, and need to expand the ongoing business. Therefore, attributing the retained earnings of direct investment enterprises to their direct investors is needed for consistent and comparable measures of national income and national saving. However, because reinvested earnings are recorded only for equity in direct investment and investment funds, but not for other types of equity, it may be useful for some analysis to have measures of income and the current account with and without reinvested earnings.

11.42 Reinvested earnings represent the direct investors' proportion, in terms of equity held, of the earnings that foreign subsidiaries and associates do not distribute as dividends. The undistributed earnings of branches are also considered to be reinvested earnings.

11.43 Reinvested earnings of a direct investment enterprise are, therefore, the direct investor's share of the direct investment enterprise's retained earnings or net saving (before reinvested earnings payable are deemed distributed). Retained earnings or net saving (before reinvested earnings payable are deemed distributed) of an enterprise may be formally stated as:

Net operating surplus (operating revenue minus operating expenses)

- + Dividends receivable;
- + Interest receivable;
- + Rent receivable;
- + Enterprise's share of reinvested earnings of any direct investment enterprises;
- + Current transfers receivable;
- Dividends payable;
- Interest payable;
- Rent payable;
- Taxes and other current transfers payable.

(These items correspond exactly to *SMA* items; additional information on the treatment of particular items of revenue and expense can be found in the *2008 SNA*.) Reinvested earnings are recorded in the period in which the retained earnings accrue. See also Box 11.5 for an example of the calculation of reinvested earnings.

11.44 Reinvested earnings are measured on the basis of net saving before reinvested earnings are deemed distributed, and thus linked to the concept of operational earnings generated from production, lending and borrowing financial assets, and renting natural resources, and current transfers. Reinvested earnings do not include any realized or unrealized holding gains or losses. Holding gains and losses may arise from valuation changes, including exchange-rate-related gains and losses, revaluation of fixed assets, and changes in market prices of financial assets and liabilities. Reinvested earnings also do not include gains or losses due to other changes in volume of assets, such as write-offs of nonproduced, nonfinancial assets, write-offs of bad debts, and uncompensated seizures of assets. Because business accounting measures of profits often include holding gains or losses, adjustments to business accounting records may be necessary. Holding gains and losses and other changes in volume of financial assets and liabilities are described in Chapter 9, Other Changes in Financial Assets and Liabilities Account. Provisions for various types of losses, such as for bad debts, are internal bookkeeping entries that should not be taken into account in determining the net saving and reinvested earnings.

11.45 Retained earnings of a direct investment enterprise are measured after deducting corporate taxes charged on the income of the enterprise. Such taxes are payable by the enterprise and not by its

**Box 11.I. Reinvested Earnings with Chain of Ownership**

Enterprise A has a 100 percent subsidiary Enterprise B, which in turn has a 100 percent subsidiary Enterprise C.

Enterprise A is owned 95 percent by portfolio investors, while Enterprise C owns 5 percent (reverse investment).

In the following example, earnings are as stated and none of the enterprises pays dividends during the period—all earnings are retained; so the following results are obtained for reinvested earnings:

	Earnings from Own Operations	Reinvested Earnings:	
		Payable	Receivable
Enterprise A	100	0	120
Enterprise B	40	120	80
Enterprise C	80	80	0

## Notes:

- The reinvested earnings receivable for Enterprise A consist of the reinvested earnings receivable from its immediate direct investment enterprise, Enterprise B. However, the reinvested earnings of Enterprise C are indirectly taken into account through reinvested earnings of Enterprise B. (See paragraph 11.47.)
- No reinvested earnings are payable on the reverse investment equity of Enterprise C in Enterprise A. (See paragraph 11.99.)

owners. Furthermore, retained earnings should be calculated after any provision for consumption of fixed capital. Consumption of fixed capital is measured by the value, at current replacement cost, of the fixed assets used up (as a result of physical deterioration, normal obsolescence, or normal accidental damage) during an accounting period. In the calculation of consumption of fixed capital, the expected economic life of an individual asset should be taken into account. (Expected life and normal obsolescence or damage do not include losses due to wars or major natural disasters.) Depreciation used in the business accounts is not necessarily the same as consumption of fixed capital as the depreciation is usually based on historic cost or book values. If data based on historic cost or book values are used, they should be adjusted to current replacement cost basis for the purpose of calculating consumption of fixed capital.

11.46 Reinvested earnings can be negative when a direct investment enterprise has a loss on its operations or the dividends declared in a period are larger than net income in that period. If direct investment abroad generates negative earnings, the entry should be shown as a negative income receivable by the direct investor. Simi-

larly, the economy of the direct investment enterprise should record the losses as negative income payable.

11.47 In a chain of direct investment relationships, reinvested earnings need only be recorded between the direct investor and directly owned direct investment enterprises. The passing of retained earnings from indirect holdings should be taken into account through the chain of direct investment relationships. Retained earnings of an enterprise in the chain would include reinvested earnings derived from its immediate direct investment enterprise (see paragraphs 6.8-6.24 for a definition of direct investment relationships), which as a direct investor would receive reinvested earnings from its immediate direct investment enterprise, and so on. Therefore, reinvested earnings are passed on to the indirect direct investors through the chain indirectly, as illustrated in Box 11.1.

**4. Interest**

Reference:

IMF and others, *External Debt Statistics: Guide for Compilers and Users*, Chapter 2, Appendix, Accrual of Interest Costs—How Should This Be Implemented? and paragraphs 6.15-6.17.

**11.48** *Interest is a form of investment income that is receivable by the owners of certain kinds of financial assets, namely deposits, debt securities, loans, and other accounts receivable, for putting the financial assets at the disposal of another institutional unit. Income on SDR holdings and SDR allocations is also included in interest.* Not all current account flows associated with debt instruments are interest; some may be commissions or fees, which are charges for financial services (see paragraphs 10.118-10.136 for a discussion of financial services).

**11.49** Interest is recorded on an accrual basis; that is, interest is recorded as accruing continuously over time to the creditor on the amount outstanding. Depending on the contractual arrangements, the rate at which interest accrues can be a percentage of the amount outstanding, a predetermined sum of money, a variable sum of money dependent on a defined indicator, or some combination of these methods. Under the accrual basis, as interest accrues, the amount outstanding increases; that is, accrued interest not yet paid is a part of the amount outstanding. What are commonly referred to as interest payments, therefore, are financial account transactions that reduce the debtor's existing liability. The amount initially advanced or borrowed is also known as initial principal. Periodic coupon payments may cover part or whole of the interest accrual during that period as well as payments that reduce the initial principal.

*a. Currency of denomination and fixed-rate vs. index-linked instruments*

**11.50** For the purpose of defining and measuring interest, it is useful to distinguish between the following three types of arrangements:

**(a) Domestic-currency-denominated fixed-rate instruments.** At inception, the contracting parties determine all future cash flows that the debtor must make in domestic currency. Interest for these instruments is the difference between the sum of all debtor's payments and the funds the creditor makes available to the debtor. The information on the amount outstanding and interest rates needed to calculate interest accruals is known at inception.

**(b) Foreign-currency-denominated fixed-rate instruments.** At inception, future cash flows are determined in the relevant foreign currency. The recording of interest on foreign currency fixed-rate instruments is also straightforward. Interest is defined according to the formula described

in (a) above, with the only difference being that, in the first instance, a foreign currency is used as the currency of denomination. Interest expressed in foreign currency is to be converted into the domestic currency at the mid-point market exchange rate for the periods in which the interest accrues. The information on amount outstanding and interest rates needed to calculate interest accruals in the currency of denomination is known at inception. Debt instruments with both the amount to be paid at maturity and all periodic payments (such as coupons) linked to a foreign currency are treated as though they are denominated in that foreign currency.

**(c) Index-linked instruments.** The indexation mechanism links the amount to be paid at maturity or periodic payments (such as coupons) (or both) to indicators agreed by the parties, and the values of the indicators are not known in advance. As a result, the amount of interest cannot be known at the time of issue. For some instruments, it can be determined only at the time of redemption. Indexed instruments include those indexed to the consumer price index, a stock exchange index, a commodity price, and so forth. Index-linked debt instruments are those on which payments are linked to a reference item that normally changes over time in response to market pressures. All other debt instruments should be classified as fixed-rate. As noted in paragraph 11.50(b), debt instruments with both the amount to be paid at maturity and periodic payments linked to a foreign currency are classified and treated as though they are denominated in that foreign currency. All other types of index-linked instruments, including those that are partially linked to exchange rates (e.g., those for which either only the amount to be paid at maturity or only periodic payments are linked to an exchange rate), are treated as being denominated in domestic currency for the recording of interest and other economic flows. The calculation of interest accrual for index-linked instruments is described in paragraphs 11.59-11.65.

*b. Interest on loans, deposits, and accounts receivable/payable*

**11.51** The nature of financial assets and liabilities in the form of deposits, loans, and accounts receivable/payable is explained in Chapter 5, Classification of Financial Assets and Liabilities. In general, the interest accrual on these financial assets and liabilities is determined by

applying the relevant interest rate as specified in the contractual arrangements between parties to the amount outstanding at each point of time throughout the accounting period. Some instruments have a fixed interest rate for the entire life of the instrument. Some instruments may have terms for changes in interest rates, once or several times, during the life of the instrument. For each period, the relevant interest rate should be used to calculate interest accrued in that period. Some loans and deposits may also have indexation of the amount to be paid at maturity or periodic payments (or both). Interest accruals arising from indexation as described in paragraphs 11.59-11.65 also apply to indexed loans and deposits.

*c. Interest on debt securities—traded debt instruments and concept of interest*

11.52 Defining and measuring interest for traded debt securities is not straightforward. While debtors have obligations to settle according to the terms and conditions set at the inception of the debt instruments, holders of securities acquired in the secondary markets may not know or even care about the interest rate at the time of issue. There are three approaches for defining and measuring interest for traded debt instruments:

- (a) Interest is equal to the amounts the debtors will have to pay to their creditors over and above the repayment of the amounts advanced by the creditors. Interest accrual on a debt instrument is determined for the entire life by the conditions set at inception of the instrument. Interest accrual is determined using the original yield-to-maturity. A single effective yield, established at the time of security issuance, is used to calculate the amount of accrued interest in each period to maturity. This approach is also known as the debtor approach.
- (b) Interest is the income that follows from applying, at any point in time, the discount rate of future receivables implicit in the instrument's market value. The accrual of interest under this approach reflects current market conditions and expectations. Interest accrual at any given time is determined using the current yield-to-maturity. The effective interest rate for calculating the accrued interest varies with period-to-period changes in the market price of the securities. This approach is also known as the creditor approach.
- (c) Interest is the income that follows from applying the discount rate implicit in the cost at which the instrument was acquired. The accrual of inter-

est under this approach reflects market conditions and expectations at the time of acquisition. Interest is determined using the remaining yield-to-maturity at the time the debt instrument is acquired. The effective interest rate will change only if the security is resold in the secondary market. This approach is also known as the acquisition approach.

11.53 In the international accounts, interest is recorded following the first approach described above in paragraph 11.52(a). The same approach is followed in other macroeconomic statistical systems. Interest calculated according to the market rates as described in paragraph 11.52(b) may be reported as a supplementary item, which is important particularly for analyzing rates of return. It should be noted that for debt securities the valuation and recording of transactions in the financial account and positions in the balance sheets do not depend on the method used for the calculation and recording of interest accrual. Acquisitions and disposals of debt securities are recorded at transaction prices and the positions are recorded at market prices or fair values.

*Debt securities with known cash flows*

11.54 For debt securities for which the issue and redemption prices are the same (i.e., issued at par), total interest accruals over the whole life of the securities are given by the periodic coupon payments. If coupon payments are fixed, accrued interest can be calculated by allocating the coupon payment to the relevant period using a daily compound formula.

11.55 Certain debt securities, such as short-term bills of exchange and zero-coupon bonds, are such that the debtor is under no obligation to make any payments to the creditor until the liability matures. In effect, the debtor's liability is discharged by a single payment covering both the amount of the funds originally borrowed and the interest accrued and accumulated over the entire life of the liability. Instruments of this type are said to be discounted because the amount initially borrowed is less than the amount to be repaid. The difference between the amount to be repaid at the end of the contract and the amount originally borrowed is interest that must be allocated over the accounting periods between the beginning and end of the contract. The interest accruing in each period is recorded in the primary income account with the same amount increasing the debtor's liability for the same instrument in the financial account. An example is shown as Box 11.2.

### Box 11.2. Numerical Example of Calculation of Interest Accrual on a Zero-Coupon Bond

A bond is issued on January 1, Year 1, with 100 repayable in five years, with no coupons.

If the market rate of interest at the time of issue is 10 percent for that maturity and credit rating, then the bond will be issued at a price of 62.09 (that is,  $100/1.1$ ).

The annual interest calculations and associated values of the principal are as follows:

	IIP		IIP
	Value of Debt Securities January 1	Income Interest Accrued	Value of Debt Securities December 31
Year 1	62.09	6.21	68.30
Year 2	68.30	6.83	75.13
Year 3	75.13	7.51	82.64
Year 4	82.64	8.26	90.91
Year 5	90.91	9.09	100.00

Notes:

- According to the debtor approach (see paragraph 11.52(a)), the interest in each period is fixed at inception.
- The sum of interest over the five years is 37.91, equal to the difference between 62.09 (price at issue) and 100 (price at redemption).
- Interest accrued each year increases in line with the growing accumulated value of accrued interest.
- The corresponding entry to the interest accrued is an increase in debt securities in the financial account. The values of the bond during the period are unknown, because of holding gains and losses. While fluctuations in market interest rates will cause changes in the value, the calculation of interest is unaffected.

(For further details, see *External Debt Statistics: Guide for Compilers and Users*, paragraph 2.66 and Table 2.3.)

11.56 A slightly more complicated case is a deep-discount bond, which is a discounted instrument that also requires periodic coupon payments. In such cases, the interest accrual is the amount of the coupon payable periodically plus the amount of interest accruing in each period attributable to the difference between the redemption price and the issue price. Interest accrual from the periodic coupon payments is derived as explained in paragraph 11.54. Interest accrual from the amortization of the discount (the difference between the issue and redemption prices) can be calculated by summing daily amortizations for the reporting period. Although amortization rates could be calculated on monthly or quarterly bases, amortization at a daily rate facilitates the allocation of the amortized discount to the individual reporting periods.

11.57 In some cases, debt securities are issued at a premium rather than at a discount. The method of determining the interest accrual is identical to the case of a discounted instrument except that when issued at a premium, the difference between the redemption and issue price is amortized over the life of the instrument and reduces (rather than increases as in the case of the discounted instrument) the amount of interest accruing in each period.

11.58 Stripped securities raise special issues for accrual of interest. Unofficial strips are issued by a third party without the authorization of the original issuer and, hence, the stripped securities are new instruments—a liability of the strip issuer. The original debt securities continue to accrue interest according to the term specified in the contract. Interest on stripped securities

accrues at the rate determined at the time of issuance of strips. Official strips (issued with the authorization of the original issuer through a strip dealer it appoints) simply change the arrangements for holding the original instrument, and thus the strips remain the direct obligation of the original issuer. Interest on official strips therefore accrues at the rate on the underlying security, but not at the rate prevailing at the time of stripping.

### *Index-linked debt securities*

11.59 As explained in paragraph 11.50, an indexation mechanism links the amount to be paid at maturity or coupon payments (or both) to indicators agreed by the parties. The values of the indicators are not known in advance. For debt securities with indexation of the amount to be paid at maturity, they may be known only at the time of redemption. As a result, interest flows before redemption are uncertain and cannot be determined with certainty. For estimating interest accruals before the values of the reference indicators are known, some proxy measures will have to be used. In this regard, it is useful to distinguish the following three arrangements:

- (a) indexation of coupon payments only with no indexation of amount to be paid at maturity,
- (b) indexation of the amount to be paid at maturity with no indexation of coupon payments, and
- (c) indexation of both the amount to be paid at maturity and coupon payments.

The principles described in paragraphs 11.60-11.66 for index-linked debt securities apply to all index-linked debt instruments.

11.60 When only coupon payments are index-linked, the full amount resulting from indexation is treated as interest accruing during the period covered by the coupon. It is most likely that by the time data are compiled for a reporting period, the date for the coupon payment would have been passed and hence the value of index is known. When the date for the coupon payment has not been passed, the movement in the index during that part of the reporting period covered by the coupon can be used to calculate the interest accrual.

11.61 When the amount to be paid at maturity is index-linked, the calculation of interest accruals becomes uncertain because the redemption value is unknown; in some cases the maturity time may be several years in the future. Two approaches can be followed to determine the interest accrual in each accounting period:

- (a) Interest accruing in an accounting period due to the indexation of the amount to be paid at maturity may be calculated as the change in the value of this amount outstanding between the end and beginning of the accounting period due to the movement in the relevant index. (See Box 11.3 for an example.)
- (b) Interest accruals may be determined by fixing the rate of accrual at the time of issue. Accordingly, interest is the difference between the issue price and the market expectation, at inception, of all payments that the debtor will have to make, which is recorded as accruing over the life of the instrument. This approach records as income the yield-to-maturity at issuance, which incorporates the results of the indexation that are foreseen at the moment the instrument was created. Any deviation of the underlying index from the originally expected path leads to holding gains or losses that will not normally cancel out over the life of the instrument. (See Box 11.4 for an example.)

11.62 Although the first approach (using the movement in the index) has the advantage of simplicity, interest includes all changes and fluctuations in the value of the amount to be paid at maturity in each accounting period due to the movement in the relevant index. If there is a large fluctuation in the index, this approach may yield negative interest in some periods even though market interest rates at the time of issue and current period may be positive. Also, fluctuations behave like holding gains and losses. The second approach (fixing the rate at the time of issue) avoids such problems, but the actual future cash flows may differ from the initially expected cash flows unless ex ante market expectations are exactly met. This means that interest for the life of the instrument may not be equal to the difference between the issue price and redemption value.

11.63 The first approach works well when a broad-based indexation of the amount to be paid at maturity is used (e.g., a consumer price index or nominal GDP) because such indexation is expected to change relatively smoothly over time. However, the first approach may give counter-intuitive results when the indexation of the amount to be paid at maturity combines motives for both interest income and holding gains (e.g., a narrow price index such as a commodity price, stock price, or gold price). Therefore, when indexation includes a holding gain motive, typically indexation based on a single, narrowly defined item, the second approach is preferred; otherwise the first approach should be used for the measurement of interest accrual.

### Box 11.3. Numerical Example of Calculation of Interest Accrual on an Index-Linked Bond—Broad-Based Index

A bond is issued on Jan 1, Year 1 at a price 1000 for five years, with no coupons, indexed to a broad price index. The index value at the beginning of the period is 100.

The index and bond values, with the derived interest and revaluations are as follows:

	Broad Price Index		Revaluation	Bond
	End of Period	Interest		Dec. 31
Year 1	107.0	70	-12	1,058
Year 2	113.0	60	-17	1,101
Year 3	129.0	160	58	1,319
Year 4	148.0	190	10	1,519
Year 5	140.3	-77	-39	1,403
Years 1-5		403	0	

#### Notes:

- Total interest over the five years (i.e., 403) is determined by the movement of the index (i.e., 40.3 percent increase).
- Since this is a bond, revaluations also arise because of changes in market conditions, such as changes in market interest rates, credit ratings, and expectations about the future path of the index. However, they are zero over the life of the bond when it is repaid at its indexed value.
- Negative values of interest can arise in the periods when the index declines.
- The corresponding entry to the interest accrued is an increase in debt securities in the financial account.
- Fluctuations in market interest rates cause changes in the value of the bond, but the calculation of interest is unaffected.

11.64 Because debt instruments with both the amount to be paid at maturity and coupon payments indexed to foreign currency are treated as though they are denominated in that foreign currency, interest, other economic flows, and positions for these instruments should be calculated using the same principles that apply to foreign-currency-denominated instruments. Interest should accrue throughout the period using the foreign currency as the currency of denomination and converted into the domestic currency using mid-point market exchange rates. Similarly, the amount outstanding should be valued using the foreign currency as the unit of account with the end of period exchange rate used to determine the domestic currency value of the entire debt instrument (including any accrued interest) in the international investment position. Changes in market values of debt securities due to exchange rate movements and interest rate changes are treated as revaluations.

11.65 When both the amount to be paid at maturity and coupon payments are indexed to a broad-based reference item, interest accruals during an accounting

period can be calculated by summing two elements: the amount resulting from the indexation of the coupon payment (as described in paragraph 11.60) that is attributable to the accounting period, and the change in the value of the amount outstanding between the end and beginning of the accounting period arising from the movement in the relevant index (as described in paragraph 11.61(a)). When both the amount to be paid at maturity and coupon payments are indexed to a narrow index that includes a holding gain motive, interest accruals for any accounting period can be determined by fixing the yield-to-maturity at issuance as explained in paragraph 11.61(b).

#### *Debt securities with embedded derivatives*

11.66 For debt securities with embedded derivatives, such as call, put, or equity conversion options, the accounting for accrued interest is the same as for securities that do not have such features. For all periods leading up to the exercise of the option, the interest accrual is unaffected by the presence of the option.

**Box 11.4. Numerical Example of Calculation of Interest Accrual on an Index-Linked Bond—Narrowly Based Index**

A bond is issued on Jan 1, Year 1 at a price 1000 for five years, with no coupons, indexed to a narrow price index. The index value at the beginning of the period is 100. (The numbers are the same as the example in Box 11.3, but the treatment differs because the narrow index treatment is applied in Box 11.4.) Market interest rates are 8 percent per annum at the time of issue.

The index and bond values, with the derived interest and revaluations are as follows:

	Narrow Price Index			Bond
	End of Period	Interest	Revaluation	Dec. 31
Year 1	107.0	80	-22	1,058
Year 2	113.0	86	-43	1,101
Year 3	129.0	93	124	1,318
Year 4	148.0	101	100	1,519
Year 5	140.3	109	-225	1,403
Years 1-5		469	-66	

**Notes:**

- The total increase in value over the five years (i.e.,  $469 - 66 = 403$ ) is determined by the movement of the index (i.e., 40.3 percent increase).
- According to the debtor approach (see paragraph 11.52(a)), the interest in each period is fixed according to the interest rate at inception. The interest for Year 1 is 80 (8 percent of 1000), for Year 2 it is 86 (8 percent of  $1000 + 80$ ), for Year 3 it is 93 (8 percent of  $1000 + 80 + 86$ ), and so on.
- The revaluation for the whole life of the bond is due to the difference between the increase in the index and the compound increase that would have occurred at the market rate of interest. (Revaluations also arise for individual periods during the life of the bond because of changes in market conditions, such as changes in market interest rates, credit ratings, and expectations about the future path of the index.)
- Fluctuations in market interest rates cause changes in the value of the bond, but the calculation of interest is unaffected.

When the embedded option is exercised, the securities are redeemed and accrual of interest ceases.

**d. Fees on securities lending and gold loans**

11.67 Securities lending without cash collateral consists of the delivery of securities for a given time period. (This is discussed further in paragraphs 7.58-7.61.) Usually the borrowers (e.g., brokers) subsequently on-sell the securities outright to other clients. The ability of the borrower to on-sell the securities reflects that legal ownership is transferred to the borrower, while the economic risks and rewards of ownership remain with the original owner. In return, the "lender" receives a fee from the "borrower" for the use of the security. Gold loans consist of the delivery of gold for a given time period. They may be associated with physical gold

or (less frequently) unallocated gold accounts. As with securities lending, legal ownership of the gold is transferred (the temporary borrower may on-sell the gold to a third party), but the risks and benefits of changes in the gold price remain with the lender. Gold borrowers (usually market dealers or brokers, but also gold producers and industrial gold users) often use these transactions to cover their sales to third parties in periods of (temporary) gold shortage. A comparable fee is paid to the original owner for the use of the gold. The amount of the fee is determined by the value of the underlying asset and the duration of the reverse transaction. Warrants may also sometimes be lent.

11.68 Securities and monetary gold are financial instruments and thus the fees for securities lending without cash collateral and gold loans are payments



for putting a financial instrument at the disposal of another institutional unit. Accordingly, fees on securities lending (equity securities as well as debt securities) and gold loans accrue to the security owner and are treated as interest (with the corresponding entry in other accounts receivable/payable; see paragraph 5.73). As a simplifying convention, fees paid on loans of non-monetary gold are also treated as interest. For securities lending, although, in some circumstances, the fee is payable to the custodian in the first instance (and used to defray custodial charges, in whole or in part), in principle, all of the fee is payable to the owner of the security who, in turn, is deemed to pay part or all of it to the custodian in a separate transaction. (Amounts accruing to custodians are included under custodial services, discussed under financial services in paragraphs 10.121 and 10.124.)

*e. Investment income accrued while securities are under reverse transactions*

11.69 The economic owner of securities continues to record dividends and the accrual of interest on the securities even when the legal ownership changes under a reverse transaction (see paragraph 7.58) or a custodian has on-sold the securities to a third party (see paragraph 10.124). If the reverse transaction covers the period when dividends or coupons are payable, the security taker is typically obliged to compensate the security lender. (The payments to the security lender to compensate for the dividends are called "manufactured dividends.") The treatment of the reverse positions is on the research agenda.

*f. Accrual of interest on nonperforming debt*

11.70 Amount outstanding of nonperforming debt remains a legal liability of the debtor, so interest should continue to accrue unless the liability has been extinguished (e.g., by repayment or as a result of a bilateral arrangement between debtor and creditor). However, for some analysis, it may be more useful to exclude, from primary income measures, interest that is not realistically expected to be paid. It would, therefore, be useful for the creditor to provide supplementary information on accrued interest on nonperforming debt when it is significant and quantifiable. It is important that metadata should provide information on the method adopted for defining nonperforming debt. Nonperforming loans are described in paragraphs 7.50-7.53.

11.71 Following the accrual principle, arrears on debt repayments (both periodic payments and amount to be

paid at maturity) that are not paid on due dates should continue to be shown in the same instrument until the liability is extinguished (see also paragraph 3.56). For arrears arising from a debt contract, interest should accrue at the same interest rate as on the original debt, unless a different interest rate for arrears was stipulated in the original debt contract, in which case this stipulated interest rate should be used. The stipulated rate may include a penalty rate in addition to the interest rate on the original debt. If the terms and characteristics of the financial instrument automatically change when it goes into arrears, and if the classification of the loan is changed, the change should be recorded as a reclassification in the other changes in financial assets and liabilities account (see paragraph 3.56 for treatment of arrears). If the contract is renegotiated, transactions are recorded as a new instrument is created. If an item is purchased on credit and the debtor fails to pay within the period stated at the time the purchase was made, any extra charges incurred should be regarded as interest and accrue until the debt is extinguished.

11.72 When a one-off guarantee covering a debt that becomes nonperforming is activated, the guarantor assumes the liability for that debt. From the time of activation of the debt guarantee, the interest accrual becomes the liability of the guarantor. A guarantor may make payments for interest that are due on loans or other interest-bearing liabilities of other units for which it acts as the guarantor. Any interest accruing before the guarantor assumes the debt is a liability of the original debtor and payments by the guarantor should be classified on the basis of contractual arrangements between the guarantor and the original debtor. In most cases, such payments establish a claim by the guarantor on the original debtor, who is obliged to service the debt. In other cases, the claim on the debtor may be an increase in the existing equity participation (e.g., the activation of a guarantee made by a parent company for debt of its subsidiary will improve the balance sheet of the subsidiary and hence the parent company's equity in it). If the guarantor does not obtain a claim on the original debtor, a capital transfer from the guarantor to the debtor is recorded, particularly when the guarantor is a government unit. The treatment of one-off guarantees is described in paragraphs 8.42-8.45.

*g. Interest on financial leases*

11.73 Financial leases are defined and distinguished from operating leases in paragraphs 5.56-5.58. The implication of treating financial leases as a loan is that interest accrues on the loan. The lessor is treated as

making a loan to the lessee equal to the market value of the asset, this loan being gradually paid off over the period of the lease. The rate of interest on the imputed loan is implicitly determined by the total amount payable in rentals over the life of the lease in relationship to the market value of the asset at the time of lease initiation. The initial loan to the lessee, together with the lessee's subsequent repayments of the loan, are recorded in the financial account of the lessor and lessee. The interest payable on the loan is recorded in the primary income account. (A numerical example of calculation of items for financial leases is shown in Box A6b.1.)

#### *h. Pure interest (excluding FISIM)*

11.74 Typically, financial intermediaries offer lower rates of interest to their depositors than the rates that they charge to their borrowers. The resulting interest margins are used by the financial intermediaries to defray their expenses and to provide an operating surplus. This method of operation is an alternative to charging customers directly for services. The treatment of this margin (FISIM—financial intermediation services indirectly measured) and its measurement are described in paragraphs 10.126-10.136.

11.75 The primary income account records "pure interest" by eliminating the FISIM component from "actual interest." "Actual interest" payable to a financial intermediary includes the service charge, which should be subtracted to give the interest recorded as investment income in the international accounts. Similarly, "actual interest" receivable from a financial intermediary is seen as having had a service charge already deducted, so the actual interest receivable from the financial intermediary will be increased by the value of the service received to provide interest recorded as investment income in the international accounts. The "pure interest" is calculated using the reference interest rate. The concept of "reference" interest rate and its application are described in paragraphs 10.129-10.130. Actual interest charged or received by banks is needed for certain analytical purposes (for instance, for debt sustainability analysis and analysis of rates of return) and should be disseminated as a memorandum item.

#### *i. Interest under high inflation*

11.76 High inflation gives rise to specific issues in measuring and interpreting interest. An obvious example is that interest rates for domestic-currency-denominated instruments could be significantly higher than those for foreign-currency-denominated instruments. Thus, nomi-

nal interest for domestic-currency-denominated instruments includes compensation for the loss of purchasing power on the monetary value of the funds advanced. The topic of accounting under high inflation is important and more pervasive in the accounts than simply the question of how to measure interest in these circumstances. Indeed, the whole issue of the measurement of transactions on a current price basis is called into question when prices at the end of the period are several times those at the start of the period. Chapter 29, Satellite Accounts and Other Extensions, of the 2008 SNA provides guidance on compiling and presenting data in conditions of inflation, covering the whole range of issues from the goods and services account, through income and financial accounts, to balance sheets.

### **5. Investment income attributable to policyholders in insurance, standardized guarantees, and pension funds**

11.77 *Investment income attributable to policyholders in insurance, standardized guarantees, and pension funds represents returns to policyholders on their claims in insurance and standardized guarantee schemes in the form of technical reserves and income payable on pension entitlements.*

11.78 The operations of insurance corporations, standardized guarantee schemes, and pension funds include charging premiums, paying claims, and managing and investing funds. However, the observed transactions do not always reflect the underlying economic relationships between the insurance corporations or pension funds and policyholders, and it is necessary to rearrange these operations so that the underlying economic behavior is reflected in the economic accounts. One such rearrangement is the imputation of investment income attributable to policyholders in insurance corporations, standardized guarantee schemes, and pension funds. The measurement of these services is described in paragraphs 10.109-10.117.

11.79 Insurance corporations, standardized guarantees schemes, and pension funds hold technical reserves to meet obligations arising from claims and entitlements. The definition and classification of these technical reserves are described in paragraphs 5.62-5.63 and 7.63-7.68. The technical reserves and entitlements represent a liability of the insurer, issuer of standardized guarantees, and defined benefit pension fund, and a corresponding asset of the policyholders and beneficiaries. To meet their technical reserve liabilities, the insurers, guarantors, and pension funds make investments in

various assets, such as financial assets, land, or buildings. However, the investments by insurers, guarantors, and pension funds are not necessarily equal to the technical reserves and entitlements.

11.80 For nonlife insurance policies, the technical reserves represent prepayment of premiums and reserves against outstanding claims. Guarantors have technical provisions for calls under standardized guarantees. The investment income on these technical reserves is treated as income attributable to the policyholders.

11.81 For life insurance, the insurers' liability equals the present value of expected claims from existing policyholders. Set against these liabilities, the insurance corporations hold assets, and the income earned by insurance corporations from these assets is attributed to the policyholders as investment income on their claims on life insurance corporations. (See paragraph A6c.33 for further information.)

11.82 For defined contribution pension schemes, the investment income payable on pension entitlements is measured in the same way as for the investment income attributable to insurance policyholders (i.e., equal to the investment income on funds plus any income earned by renting land and buildings owned by the fund). For the defined benefit pension schemes, because the value of entitlements is the present value of future payments, the investment income payable on pension entitlements is measured as the increase in benefits payable because the date when the entitlements become payable is closer. The amount of the increase is not affected by whether the pension scheme actually has sufficient funds to meet all the obligations nor by how it is funded (whether from investment income or holding gains, for example). (In contrast, changes in model assumptions are recorded under other changes in volume—see paragraph 9.24.)

11.83 Investment income attributable to policyholders is retained by the insurance corporations, guarantors, and pension funds in practice. It is therefore treated as being paid back by the policyholders to the insurance corporations, guarantors, and pension funds in the form of premium supplements that are additional to actual premiums payable under the terms of the insurance and pension policies. The corresponding entries to the investment income attributable to insurance policyholders for casualty insurance, including standardized guarantees, are called premium supplements and taken into account in deriving service charges and net premiums. (See paragraphs 12.41-12.42 and Appendix 6c, Topical Summary—Insurance, Pension Schemes, and Standardized Guarantees.)

11.84 The total amount of investment income attributable to policyholders is allocated among policyholders. The allocation to policyholders could be made in proportion to actual premiums payable by them. Investment income payable by resident insurers, guarantors, and pension funds to nonresident policyholders can be estimated by multiplying the gross premiums earned from nonresidents by the ratio of investment income attributable to policyholders to gross premiums earned for all operations. To the extent that these ratios vary for different lines of business (reinsurance, marine, life, pension funds, standardized guarantees, etc.), the calculations should be made separately. Such investment income receivable by resident policyholders from nonresident insurers, guarantors, and pension funds is not readily observable. Ratios of investment income attributable to policyholders to premiums that are observed in other similar cases could be used to calculate investment income receivable.

## 6. Rent

Reference:

2008 SNA, Chapter 7, The Distribution of Income Accounts.

11.85 *Rent covers income receivable for putting natural resources at the disposal of another institutional unit.* The party providing the natural resource is called the lessor or landlord, while the user is called the lessee or tenant. The terms under which rent is payable are expressed in a resource lease. A *resource lease is an agreement whereby the legal owner of a natural resource that has an infinite life makes it available to a lessee in return for a regular payment recorded as rent.*

11.86 Examples of rent include amounts payable for the use of land extracting mineral deposits and other subsoil assets, and for fishing, forestry, and grazing rights. The regular payments made by the lessees of natural resources such as subsoil assets are often described as royalties, but they are classified as rents. Payments or receipts by government of rent on land without buildings (e.g., for military bases) should be shown as rent, not as government goods and services n.i.e. If a single payment covers both the return on land and structures on it and there is no objective basis on which to split the payment for the use of land and structures, the whole amount should be treated as rent when the value of land is believed to exceed the value of structures, and as purchase of services (rental) otherwise.

11.87 Usually, the entity using land or natural resources is a resident institutional unit. However, if the

user is a nonresident then a cross-border transaction on rent arises. For example, a forestry or fishing operation that pays for temporary access to naturally growing fish or timber in another economic territory gives rise to rent in the international accounts. It is also possible that other natural resources adjoining a border could be extracted from a base on the other side of the border, thus giving rise to rent. Payments for overflight rights are also rent, unless they relate primarily to air traffic control, in which case they would be other transport services. Rent arrangements can be contrasted with:

- (a) outright ownership of the resources concerned, which would be recorded as an international transaction in a natural resource (see paragraph 13.9) or, more likely, give rise to a notional direct investment enterprise that owns the resource (paragraphs 4.34-4.40); or
- (b) when the right to use an asset amounts to an economic asset but not outright ownership of the underlying asset, the purchase and sale are classified under contracts, leases, and licenses (e.g., a right to use a natural resource for 10 years, such as a spectrum license; see paragraph 13.11); or
- (c) rentals, which represent charges for the use of fixed assets, such as houses and machinery (see paragraphs 10.153-10.157 on rentals arising from operating leases).

11.88 Notional direct investment enterprises created for holding land and leases on land for long periods will normally generate rent (or travel or operational leasing services if there is a building on the land). Notional units are described in paragraphs 4.34-4.40. When the land or buildings are used by the owners (who are nonresidents) of the notional unit, an imputation for rent (in the case of use of land) or travel services (e.g., in territories that had a large number of vacation homes owned by nonresidents) or operational leasing (if nonresident enterprises own premises for their own use) would be necessary. These imputations are recorded under relevant categories of the current account. The income arising from the notional direct investment enterprise is recorded under direct investment income. For example, if the vacation home is rented, the notional unit receives the payment for accommodation and generates net earnings that are considered withdrawals from income of quasi-corporations, generated by the provision of accommodation services.

11.89 Rent is recorded on an accrual basis; that is, rent is treated as accruing continuously to the owner throughout the period of the contract agreed between

the owner and the user. The rent recorded for a particular accounting period is, therefore, equal to the value of the accumulated rent payable over that period of time, as distinct from the amount of rent due to be paid during that period or the rent actually paid. An up-front rent payment covering several periods gives rise to a financial asset of the lessee and liability of the lessor, classified under accounts receivable/payable. Similarly, a payment after the rent period(s) gives rise to other accounts receivable/payable.

11.90 If a lessee subleases a natural resource, the income from the subleasing should be classified as rent, as should the income payable to the owner of the natural resource by the owner of the lease.

## 7. Taxes and subsidies on products and production<sup>3</sup>

11.91 Taxes and subsidies on products and production are included in the primary income account. (See paragraphs 10.180-10.181 for distinction between taxes and services.) Taxes on income and wealth are included in the secondary income account (see paragraphs 12.28-12.31 for taxes on income and wealth). Cross-border taxes and subsidies on products and production are normally not significant except perhaps in economic unions. They arise if an international or regional organization levies its own taxes or pays subsidies (which may also be done through national governments). They may also arise when economic activity by nonresidents (such as short-term construction or installation projects) is insufficient to constitute a branch. Although taxes on products may be levied at various stages (production, distribution, or use), they are included in the prices of goods and services. Therefore, for purchasers, the prices paid include relevant taxes on products, while for governments such taxes are considered primary income.

11.92 Taxes and subsidies on products and production should be recorded in the primary income account to maintain the conceptual consistency with *SNA*. The 2008 *SNA* distinguishes between

- (a) Taxes on products, which are payable per unit of a good or service. Examples include value-added tax, import duties, export taxes, and excise; and
- (b) Other taxes on production. Examples include payroll taxes, recurrent taxes on buildings and land, and business licenses.

<sup>3</sup>This item corresponds to the 2008 *SNA*'s "Taxes on production and on imports" and "Subsidies."

The same distinction is made for subsidies. As mentioned in paragraph 11.4, the balance on the primary income account makes up the difference between GDP and GNI. Subsidies are shown separately from taxes, rather than being deducted from taxes.

11.93 In some cases, an exporter of a good contractually agrees to pay import duties. In such cases, the duties are outside the scope of the primary distribution of income in the international accounts. This treatment is adopted because the duties arise from the process of importation, and so they are an obligation of the importer. They are, therefore, treated as payable by the importer, and so are resident-to-resident transactions. The amount of import duties paid by the exporter, therefore, is not included in the FOB value of the goods. (Because the tax is imputed as being paid by the importer, it is a resident-to-resident transaction.) Similarly, if an importer agrees to pay export taxes, the tax is still an obligation of the exporter. The amount of the export tax paid by the importer, therefore, is included in the FOB value of the goods and rerouted through the exporter. (See also paragraph 10.34.) (This treatment is the same as applies to arrangements to pay freight and insurance services.)

11.94 In some circumstances, a duty or other tax may be imposed by the customs authorities without ownership being acquired by a resident of that territory. Examples may include goods to be processed, repaired, or stored, or for use by visitors. In such cases, when customs duties are payable by nonresidents, the duties are recorded as taxes on products payable by nonresidents.

## C. Investment Income and Functional Categories

11.95 This section deals with investment income that is included under each functional category of financial assets and liabilities. It also discusses specific issues related to investment income for a functional asset category. A functional asset category includes different types of financial instruments that serve the same function, and hence a functional category can include different types of investment income. Financial derivatives and employee stock options do not give rise to investment income.

### I. Direct investment income

11.96 Direct investment income includes all investment income arising from direct investment

positions between resident and nonresident institutional units. As noted in paragraph 6.28, debt between selected affiliated financial intermediaries is not included in direct investment, so the corresponding income on those instruments is also classified as portfolio or other investment income. Rare cases of other primary income, such as compensation of employees and rent between direct investors and direct investment enterprises, are not included under direct investment income.

11.97 Direct investment relationships are defined in paragraphs 6.8-6.24. Three types of direct investment relationships and associated investment income flows can be distinguished:

- (a) Direct investors' investment in direct investment enterprises. This category includes investment income flows (distributed earnings, reinvested earnings, and interest) between the direct investor and its direct investment enterprises (whether in an immediate relationship or not).
- (b) Reverse investment (defined in paragraph 6.40). This type of relationship covers investment income flows on liabilities of direct investors to their direct investment enterprises and on claims of direct investment enterprises on their direct investors.
- (c) Between fellow enterprises. This covers investment income flows between all fellow enterprises that belong to the same direct investment group.

Dividends, withdrawals from income of quasi-corporations, and interest can apply for any of these types of direct investment relationships. Reinvested earnings are attributed to direct investors only when equity participation by the direct investor meets the 10 percent threshold. A numerical example of the calculation of reinvested earnings is given in Box 11.5.

11.98 Investment income associated with various types of financial instruments is discussed in Section B above. Table 11.2 shows various types of investment income by three types of direct investment relationship.<sup>4</sup> Interest can be broken down further by type of financial instruments. The possibility of a detailed presentation of direct investment income as shown in Table 11.2 not only allows explicit links to financial instruments but also expands the analytical value of the

<sup>4</sup>Note that the titles in Table 11.2 refer to the position to which the income flows relate, so the heading "direct investors in direct investment enterprises" refers to investment income payable to direct investors by their direct investment enterprises.

### Box 11.5. Numerical Example of Calculation of Reinvested Earnings of a Direct Investment Enterprise

#### Profit and Loss Statement of Enterprise A

Nonresident direct investors own 50 percent of the equity of Enterprise A.

#### Revenue:

1. Sales of finished goods	20,000
+ increase in inventories of finished goods	500
2. Transport services provided	3,000
3. Repair services	6,000
4. Dividends	3,000
5. Interest on bonds	1,000
6. Profit on sale of property	1,000
7. Total revenue (1 through 6)	34,500

#### Expenses:

8. Raw materials purchased	12,000
- increase in inventories of materials	2,000
9. Salaries and wages	5,000
10. Office rental	500
11. Travel of employees	2,000
12. Fuel, electricity, other costs	500
13. Depreciation	1,000
14. Interest on loans	1,000
15. Bad debt provisions	2,000
16. Total expenses (8 through 15)	22,000
17. Net income (before taxes)	12,500
18. Taxes on income	4,000
19. Net income (after taxes)	8,500
20. Dividends payable	5,000

Reinvested earnings can be derived by:

#### (a) Adjusting net income after taxes:

Net income after taxes (line 19 = 8,500)
- dividends (line 20 = 5,000)

- revenue not part of output, primary income or secondary income (namely, holding gains, line 6 = 1,000)  
 + expenses not being a transaction (namely, bad debt provisions, line 15 = 2,000)  
 = 4,500, multiplied by 0.5  
 = 2,250.

#### (b) From the national accounting relationships

output of goods and services (line 1 + line 2 + line 3; which gives 29,500);

-intermediate consumption of goods and services; (line 8 + line 10 + line 11 + line 12; which gives 13,000)

- consumption of fixed capital (line 13, which gives 1,000) (Assumes depreciation is an acceptable approximation to consumption of fixed capital. Aggregate adjustments may be possible if it is not.)

+ primary and secondary income receivable (line 4 + line 5, which gives 4,000);

- primary and secondary income payable (line 9 + line 14 + line 18 + line 20; which gives 15,000)

\* all multiplied by the direct investor's share in the equity of the enterprise

= 4,500 multiplied by 0.5  
 = 2,250

In practice, data for these calculations may not always be available monthly or quarterly, or may not be available for the most recent period(s). As a result, it may be necessary to derive some items from partial data or by methods, such as extrapolation, ratios, and models.

data for detailed analysis of direct investment relationships. However, the second and third categories may be insignificant or confidential in some cases, allowing for dissemination of only aggregate data for all three types combined.

#### Income on reverse investment

11.99 Reverse investment is defined in paragraph 6.40. Investment income on reverse investment is shown on a gross basis. That is, both the income receivable from claims on direct investors and income payable on liabilities to direct investment enterprises are shown separately. However, income data may also be presented according to the directional principle on a supplementary basis. There are no reinvested earnings on reverse equity because the 10 percent threshold has not been met.

#### Income on investment between fellow enterprises

11.100 There are no reinvested earnings on equity between fellow enterprises because the 10 percent threshold has not been met. The treatment of fellow enterprises in income data presented according to the directional principle is discussed in paragraph 6.43 and Box 6.4.

#### Transfer pricing

11.101 Transfer pricing at values that differ significantly from arm's length prices is usually associated with shifting resources between related enterprises, so it relates to direct investment income measures. Transfer pricing may be motivated by income distribution or equity buildups or withdrawals. Examples may be the provision of goods and services without

**Table 11.2. Detailed Breakdown of Direct Investment Income**

	Credits	Debits
<b>Direct investment income</b>		
<b>Income on equity and investment fund shares</b>		
<b>Dividends and withdrawals from income of quasi-corporations</b>		
<b>Reinvested earnings</b>		
<b>Interest</b>		
1. Direct investors in direct investment enterprises		
Income on equity and investment fund shares		
Income on equity other than investment fund shares		
Dividends and withdrawals from income of quasi-corporations		
Reinvested earnings		
Income on investment fund shares		
Dividends		
Reinvested earnings		
Interest		
By type of financial instruments		
2. Direct investment enterprises in direct investors (reverse investment)		
Income on equity and investment fund shares		
Income on equity other than investment fund shares		
Dividends and withdrawals from income of quasi-corporations		
Income on investment fund shares		
Dividends		
Reinvested earnings		
Interest		
By type of financial instruments		
3. Between fellow enterprises		
Income on equity and investment fund shares		
Income on equity other than investment fund shares		
Dividends and withdrawals from income of quasi-corporations		
Income on investment fund shares		
Dividends		
Reinvested earnings		
Interest		
By type of financial instruments		

**Note:** This table is expository; for Standard Components, see Appendix 9.

explicitly charging, or at understated or overstated values. Where transfer pricing is identified and quantified with a high degree of certainty, the relevant entry should be adjusted to an arm's length value (see also paragraphs 3.77-3.78). Compilers in each of the economies involved are encouraged to cooperate and exchange information in order to avoid asymmetrical recordings of bilateral data. In addition to the adjustment to the flow itself, there should be a corresponding entry, as stated below:

- (a) if a direct investment enterprise is overinvoiced on a good or service provided by the direct investor or
- (b) if a direct investor is underinvoiced on a good or service provided by the direct investment enterprise,

then the transfer pricing acts as a hidden dividend from the direct investment enterprise, so dividends should be increased by the difference between the market value of the goods and services and the prices actually charged:

- (a) if a direct investment enterprise is underinvoiced on a good or service provided by the direct investor or
- (b) if a direct investor is overinvoiced on a good or service provided by the direct investment enterprise,

then the transfer pricing acts as a hidden investment in the direct investment enterprise, so direct investment equity flows should be increased by the difference between the market value of the goods and services and the prices actually charged.

Table 11.3. Detailed Breakdown of Other Investment Income

	Credits	Debits
<b>Other investment income</b>		
Income on equity and investment fund shares		
Income on equity other than investment fund shares		
Dividends and withdrawals from income of quasi-corporations		
Income on investment fund shares		
Dividends		
Reinvested earnings		
Interest		
Deposits		
Loans		
Trade credit and advances		
Other accounts receivable and payable		
SDR allocations	n.a.	
Nonmonetary gold loans		
Investment income attributable to policyholders in insurance, pension funds, and standardized guarantee schemes		

Note: This table is expository; for Standard Components, see Appendix 9.

**11.102** The adjustments for transfer pricing have implications for reinvested earnings and for data of the counterpart economy. It is, therefore, useful to exchange information to the extent possible with counterpart economies in order to avoid asymmetrical recordings.

## 2. Portfolio investment income

**11.103** Portfolio investment income includes income flows between residents and nonresidents arising from positions in equity and debt securities other than those classified under direct investment or reserve assets. Financial instruments covered in portfolio investment are described in paragraphs 6.54-6.57.

**11.104** Two types of portfolio investment income are distinguished at the first level, namely, income on equity securities and investment fund shares, and income on debt securities. The income on investment fund shares includes both dividends and reinvested earnings. Income on equity securities other than investment fund shares includes only distributed earnings (dividends). Interest is further classified by types of debt security and by maturity. Such a detailed classification of portfolio investment income ensures consistency with both instrument and functional classifications of financial assets and liabilities.

**11.105** Portfolio investment income can be further classified by domestic institutional sectors (see Chapter 4, Economic Territory, Units, Institutional Sectors, and

Residence; Section D, Institutional Sectors) for owners of securities as well as issuers of securities. A variety of other supplementary disaggregations by foreign sector, currency of denomination, and so forth may be desirable for specific analytical purposes.

## 3. Other investment income

**11.106** Other investment income covers flows between resident and nonresident institutional units in regard to interest on deposits, loans, trade credit and advances, and other accounts receivable/payable; income on equity and investment fund shares that are not classified in any other functional categories; and investment income attributable to policyholders in insurance, standardized guarantees, and pension funds. Interest payable on SDR allocations is also recorded under other investment income. Fees for nonmonetary gold loans should also be included in interest under other investment income (see paragraph 11.68). Table 11.3 shows various types of other investment income and associated financial instruments.

**11.107** Other investment income on equity excludes income on direct investment equity and portfolio investment in equity securities. Equity participation in some incorporated or unincorporated enterprises (such as partnership or joint ventures) does not qualify either as direct investment (because the equity participation is below the 10 percent threshold) or as portfolio investment (because they are not equity securities). Such



equity participation is classified under other investment (see also paragraphs 5.26 and 6.62) and any income distributed to the owners should be classified in other investment income. Similarly, some investment funds may be organized by and limited to a small number of members, but may not meet the definition of direct investment or portfolio investment. Both distributed and reinvested earnings on such investment fund shares are classified under other investment income.

**11.108** Other investment income should be further classified by type of financial instruments. It can also be classified by the domestic institutional sectors (for both income receivable on holdings of external assets and income payable on external liability positions).

#### **4. Income on reserve assets**

**11.109** Data on income on reserve assets is useful for studying rates of return on reserves, and for ensuring that rates of return on other categories exclude reserves.

Investment income on reserve assets includes income on equity and investment fund shares, and interest. Fees on security lending and monetary gold loans (as discussed in paragraph 11.67) and interest on unallocated gold accounts (as discussed in paragraph 6.80) are also included under interest on reserve assets. Income on equity and investment fund shares can be further classified into dividends on equity securities and income attributable to investment fund shareholders. The latter includes both distributed and reinvested earnings. Interest receivable can also be further classified by type of financial instruments. If not available for publication, income from reserve assets should be included in other investment-interest.

**11.110** Interest on SDR holdings is shown on a gross basis under income on reserve assets. That is, the value of interest payable on SDR allocations is not deducted. (Interest payable on SDR allocations is shown as income under other investment liabilities, as stated in paragraph 11.106.)

## Secondary Income Account

### A. Overview of the Secondary Income Account

Reference:

2008 SNA, Chapter 8, The Redistribution of Income Accounts.

**12.1** *The secondary income account shows current transfers between residents and nonresidents. Various types of current transfers are recorded in this account to show their role in the process of income distribution between the economies. Transfers may be made in cash or in kind. Capital transfers are shown in the capital account (see paragraphs 13.19-13.34).*

**12.2** Whereas primary income affects national income (see paragraph 11.4 for the definition of gross national income), secondary income, together with primary income, affects gross national disposable income. Capital transfers do not affect disposable income and, hence, are recorded in the capital account.

**12.3** The balance on the secondary income account presents total credits less total debits, and is called balance on secondary income. In addition, the balance of the sum of all current account transactions can also be shown at the end of this account because it is the last account in the sequence of current accounts. The balance on all current accounts is called the current account balance, an important economic aggregate in analyzing external imbalance. The current account balance also links to the national accounts as it is equal to the saving-investment balance for the economy (see paragraphs 14.4-14.5).

**12.4** The components and structure of the secondary income account are shown in Table 12.1. Current transfers can be further classified by institutional sectors receiving or providing the transfers. In some cases, compilers may be interested in compiling data classified by sector of provider for credits and sec-

tor of recipient for debits. For economies that are major recipients of assistance, it would be desirable to show current and capital transfers with consistent classifications to allow them to be compared and aggregated.

### B. Concepts and Coverage

**12.5** In describing the content of the secondary income account, two important distinctions are made: (a) transfers are distinguished from other types of transactions (see paragraphs 12.6-12.11) and (b) current transfers are distinguished from capital transfers (see paragraphs 12.12-12.15).

#### I. Transactions: exchanges and transfers

**12.6** As explained in paragraph 3.13, every transaction is either an exchange or a transfer. An exchange involves a provision of something of economic value in return for a corresponding item of economic value.

**12.7** *A transfer is an entry that corresponds to the provision of a good, service, financial asset, or other nonproduced asset by an institutional unit to another institutional unit when there is no corresponding return of an item of economic value.* Transfers can also arise where the value provided in return for an item is not economically significant or is much below its value. The accounting system in the international accounts requires that each party to a transaction record two entries (see paragraphs 3.26-3.31 for the description of the accounting system). When something of economic value (e.g., goods, services, or a financial asset) is provided without a corresponding return of an item of economic value, the corresponding entry is made as a transfer. A cash transfer consists of the payment of currency or transferable deposit by one institutional unit to another without anything supplied in return. A transfer in kind consists of either the transfer of ownership of a

**Table 12.1. Overview of the Secondary Income Account**

	Credits	Debits
<i>Balance on goods, services, and primary income</i>		
Personal transfers		
Current taxes on income, wealth, etc.		
Social contributions		
Social benefits		
Net premiums on nonlife insurance and standardized guarantees		
Nonlife insurance claims and calls under standardized guarantees		
Current international cooperation		
Miscellaneous current transfers		
<i>Total current transfers credits and debits</i>		
<b>Balance on secondary income</b>		
Adjustment for change in pension entitlements		
<b>Current account balance</b>		
<i>Current account balance (excluding reinvested earnings)</i>		

**Note:** This table is expository; for Standard Components, see Appendix 9.

good or asset, other than cash, or the provision of a service, again without any corresponding return of an item of economic value. A transfer is classified as a current or capital transfer (see paragraphs 12.12-12.15).

12.8 A unit making a transfer receives no specific quantifiable benefit in return that can be recorded as part of the same transaction. Nevertheless, certain transfers (e.g., net nonlife insurance premiums) may entitle the unit making the payment to some contingent future benefits. Taxes are usually used to provide certain collective services that the taxpayers may be able to consume. Even in the context of taxes payable by residents, such benefits are generally uncertain or not quantifiable, and hence items such as net nonlife insurance premiums and taxes other than those on products and production are treated as transfers. Taxes on products and production are, however, treated as primary income. (See paragraphs 11.91-11.94.)

12.9 The borderline between transfers and exchanges may, in some cases, be unclear. The distinction between taxes and charges for government services is one such case. Paragraphs 12.30 and 10.180-10.181 provide the guidelines for distinguishing taxes from services. Another case is the distinction between personal transfers and compensation of employees when individuals go abroad for employment. The distinction between the recording of one or the other of these transactions is based on the nature of the transaction and how long the individuals stay in the economic territories where they are working, that is, whether they are considered residents of the

economies where they are working. Similarly, a case of distinction between financial transactions and personal transfers is described in paragraph 12.24.

12.10 A nonprofit institution serving households (NPISH, as defined in paragraph 4.100) may be a direct investor in a corporation. However, flows between two NPISHs are generally transfers, rather than investment, because it is considered that flows in these cases are seldom driven by commercial considerations.

12.11 Transfers do not generally arise between commercial entities. For example, provision of goods and services without an explicit charge or at understated value between institutional units in a direct investment relationship does not represent a transfer. In this instance, the corresponding entry is in direct investment equity (see paragraphs 11.101-11.102). However, net nonlife insurance premiums and nonlife insurance claims are transfers that may occur between commercial entities. Likewise, a commercial entity may be involved in the provision of current or capital transfer to another commercial entity as a compensation for damages to properties or other losses.

## 2. Distinction between current and capital transfers

12.12 Transfers may be either current or capital. To avoid duplication, the distinction between current and capital transfers is discussed primarily in this chapter rather than in Chapter 13, Capital Account. To

distinguish current transfers from capital transfers, it is preferable to focus on the special characteristics of capital transfers.

**12.13** *Capital transfers are transfers in which the ownership of an asset (other than cash or inventories) changes from one party to another; or that oblige one or both parties to acquire or dispose of an asset (other than cash or inventories); or where a liability is forgiven by the creditor. Cash transfers involving disposals of noncash assets (other than inventories) or acquisition of noncash assets (other than inventories) are also capital transfers. A capital transfer results in a commensurate change in the stocks of assets of one or both parties to the transaction without affecting the saving of either party. Capital transfers are typically large and infrequent, but capital transfers cannot be defined in terms of size or frequency. A transfer in kind without a charge is a capital transfer when it consists of (a) the transfer of ownership of a nonfinancial asset (other than inventories, i.e., fixed assets, valuables, or nonproduced assets) or (b) the forgiveness of a liability by a creditor when no corresponding value is received in return. However, capital equipment provided by a direct investor to its direct investment enterprise is not a capital transfer, but involves a transaction in direct investment equity. A transfer of cash is a capital transfer when it is linked to, or conditional on, the acquisition or disposal of a fixed asset by one or both parties to the transaction (e.g., an investment grant).*

**12.14** *Current transfers consist of all transfers that are not capital transfers. Current transfers directly affect the level of disposable income and influence the consumption of goods or services. That is, current transfers reduce the income and consumption possibilities of the donor and increase the income and consumption possibilities of the recipient. For example, social benefits and food aid are current transfers.*

**12.15** It is possible that some cash transfers may be regarded as capital by one party to the transaction and as current by the other party. A large economy that regularly makes investment grants in cash to a number of smaller economies may regard the outlays as current, even though they may be specifically intended to finance the acquisition of assets. So that a donor and a recipient do not treat the same transaction differently, a transfer should be classified as capital for both parties even if it involves the acquisition or disposal of an asset, or assets, by only one of the parties. When there is doubt about whether a transfer should be treated as current or capital, it should be treated as a current transfer.

The treatment of nonlife insurance claims as current or capital is discussed in paragraphs 12.44-12.45.

### 3. Recording and valuation of transfers

**12.16** Although no good, service, or asset is received in return from the counterpart, the recording of a transfer nevertheless must give rise to two entries for each party to the transaction. For a transfer in cash, the donor records a decrease in currency or deposits and a transfer payable; the recipient records an increase in currency or deposits and a transfer receivable. For a provision of goods or services in kind without a charge, the donor records an export of goods or services and a transfer payable; the recipient records an import of goods or services and a transfer receivable. When a liability is forgiven, the creditor and debtor extinguish the financial asset and liability, respectively, with the corresponding entries recorded as transfers.

**12.17** In general, the time of recording of transfers is determined by the time of the change of economic ownership of the resources (such as goods, services, financial assets) that are corresponding entries to transfers. Determining the time of recording for grants and other voluntary transfers can be complex because there is a wide variety of eligibility conditions that have various legal powers. In some cases, a potential transfer recipient has a legal claim when certain conditions have been satisfied, such as the prior incurrence of expenses for a specific purpose or the passage of legislation. These transfers are recorded when all requirements and conditions are satisfied. In cases where the transfer recipient never has a claim on the donor, the transfer should be attributed to the time at which the cash payment is made, the asset conveyed, or liability forgiven.

**12.18** Taxes and other compulsory transfers should be recorded when the activities, transactions, or other events occur that create the government's claim to the taxes or other payments. The time of recording of taxes is the time at which tax liability arises. Accordingly, the amount of taxes is determined by the amount due for payment as evidenced by tax assessments, declarations, or other instruments, such as sales invoices or customs declarations, that create liabilities in the form of obligations to pay on the part of taxpayers. Some compulsory transfers, such as fines, penalties, and property forfeitures, are determined at a specific time. These transfers are recorded when a legal claim to the funds is established, which may be when a court renders judgment or an administrative ruling is published. If data on taxes are on a cash basis, adjustments

should be made for large differences to approximate the accrual basis of recording.

12.19 Because a transfer is the corresponding entry to an actual resource flow or a forgiven liability, the value of the transfer equals the value of the corresponding flow. Generally, transfers in kind give rise to valuation difficulties for the actual resource flow and, accordingly, also the corresponding transfer entries. The principles for the valuation of in-kind transactions are described in paragraph 3.72.

### C. Types of Current Transfers

12.20 The international accounts classify the following types of current transfers:

#### Personal transfers

#### Other current transfers

- (a) current taxes on income, wealth, etc.,
- (b) social contributions,
- (c) social benefits,
- (d) net nonlife insurance premiums,
- (e) nonlife insurance claims,
- (f) current international cooperation, and
- (g) miscellaneous current transfers.

These categories of current transfers are described in paragraphs 12.21-12.58 in the context of international accounts.

#### I. Personal transfers

Reference:

IMF, 2009, *International Transactions in Remittances: Guide for Compilers and Users*.

12.21 *Personal transfers consist of all current transfers in cash or in kind made or received by resident households to or from nonresident households.* Personal transfers thus include all current transfers between resident and nonresident individuals, independent of:

- (a) the source of income of the sender (irrespective of whether the sender receives income from labor, entrepreneurial or property income, social benefits, and any other types of transfers; or disposes assets); and

- (b) the relationship between the households (irrespective of whether they are related or unrelated individuals).

By convention, current transfers between households with regard to lotteries and other gambling are included under personal transfers (discussed in paragraph 12.26).

12.22 *Workers' remittances are current transfers made by employees to residents of another economy.* They are included as a supplementary item.

12.23 The connection to the residence status of the person concerned is important in determining whether a personal transfer is involved. For example, in the case of workers, personal transfers include only those transfers abroad made by workers who are residents of the economy in which they are employed. Resources may be sent abroad by residents of an economy for the purpose of financing other residents of the same economy who are staying abroad (such as those sent by parents to children who are studying in other territories). These transactions should not be recorded as current transfers in the balance of payments because the parties are residents of the same economy. The expenses abroad constitute a purchase of education services in the case of students. Expenditures incurred abroad by residents staying for less than one year in foreign economic territories are generally recorded as travel (see paragraphs 10.86-10.100).

12.24 Funds sent abroad by individuals who are resident in the economy in which they are employed, self-employed, or operating a business, for the purpose of making a deposit in his or her own account with a bank located abroad, represent a financial investment, which is recorded in the financial account, rather than as a personal transfer. But any withdrawals to provide resources to a relative or another person (without a quid pro quo) should be recorded as a personal transfer. The situation of joint accounts can arise with workers resident abroad who have joint bank accounts with relatives in their home countries. The treatment of such joint accounts is discussed in paragraph 4.145. If the joint account emigrant workers hold in their home country is freely usable by its holders in the home country, the account may be considered to be held by residents in the home economy (liability to residents). In such a case, the deposits made to the account by the nonresident should be shown as funded by a transfer from abroad and withdrawals by residents from the account would be domestic transactions.

*Lotteries and other gambling*

12.25 The amounts paid for lottery tickets or placed in bets consist of:

- (a) a service charge to the unit organizing the lottery or gambling (discussed in paragraph 10.171); and
- (b) current transfers that are payable from the gamblers to the winners and, in some cases, to charities.

The transfers are regarded as taking place directly from those participating in the lottery or gambling to the winners and charities. That is, they are not recorded as transfers to or by the unit operating the gambling. Some of the service charge at purchasers' prices may include gambling taxes, which are shown as payable by the operator, not the customers.

12.26 When nonresident households take part in gambling there may be net transfers between residents and nonresidents. In some cases the winner of a lottery does not receive a lump sum immediately but a stream of payments over future periods. This arrangement should be recorded as the receipt of the lump sum as a current transfer equal to the present value of the payment stream and the immediate purchase of an annuity. The recording of annuities is described in paragraphs A6c.29-A6c.35.

*Remittances*

12.27 Appendix 5 describes the concept of remittances for measuring and analyzing international remittances and resource flows to households and NPISHs. Three categories of remittances are defined, which may be included as supplementary items, as follows:

- (a) **Personal remittances.** From the perspective of the recipient economy, personal remittances are defined as:

- Personal transfers receivable;
  - + Compensation of employees receivable;
  - Taxes and social contributions payable (related to compensation of employees);
  - Transport and travel expenditures payable by residents employed by nonresidents (as defined under business travel in paragraphs 10.91-10.93);
  - + Capital transfers receivable from households.
- (b) **Total remittances.** From the perspective of the recipient economy, total remittances are defined as

Personal remittances receivable;

+ Social benefits receivable.

Although conceptually, total remittances include nonlife insurance transactions (net nonlife insurance premiums and nonlife insurance claims), these transactions are excluded on practical grounds.

- (c) Total remittances and transfers to NPISHs. From the perspective of the recipient economy, this category is defined as:

- Total remittances receivable;
- + Current transfers receivable by NPISHs;
- + Capital transfers receivable by NPISHs.

Current and capital transfers to NPISHs are generally recorded under miscellaneous current transfers or other capital transfers (discussed in paragraphs 12.53 and 13.31).

**2. Other current transfers**

- a. *Current taxes on income, wealth, etc.*

Reference:

2008 SNA, Chapter 8, The Redistribution of Income Accounts; Section C, Current Taxes on Income, Wealth, etc.

12.28 Current taxes on income, wealth, etc., in the international accounts consist mainly of taxes levied on the income earned by nonresidents from the provision of their labor or financial assets. Taxes on capital gains arising from assets of nonresidents are also included. Taxes on wages and salaries earned by nonresident employees are recorded as payable by the nonresident employees. Taxes on income and capital gains from financial assets can be payable by individuals, corporations, nonprofit institutions, governments, and international organizations. Taxes on interest and dividends are recorded as payable by the recipients of the interest or dividends. Taxes on financial transactions (such as taxes on issue, purchase, and sale of securities) payable by nonresidents are also current transfers. (However, if such taxes have been classified as other taxes on products and production in the national accounts, by convention, they may be treated in the same way in the international accounts for consistency.) Taxes on income and wealth may be imposed by and payable directly to international organizations, such as the agencies of an economic union. Taxes on rent and ownership of land are treated as payable by the resident producers or resident notional

institutional units; hence, they generally should not be recorded in the balance of payments. Inheritance taxes are treated as capital transfers (see paragraph 13.28 for the treatment of inheritance taxes). Refunds of taxes to taxpayers are treated as negative taxes; that is, the amount of taxes is reduced by tax refunds.

12.29 Any other current taxes (other than taxes on income and wealth, as explained in the preceding paragraph, and taxes on products and production that are recorded in the primary income account as explained in paragraph 11.91) are also included in the secondary income account.

12.30 Specific permission is granted by governments through issuing a license or other certificate for which a fee is demanded. A "fee" that is a tax should be distinguished from a "fee" that is a payment in return for services provided by governments (see also paragraphs 10.180-10.181 for distinction between taxes and services). If the issue of such licenses involves little or no work on the part of government or the fee charged is clearly out of all proportion to the costs associated with the issuance of licenses, it is likely that the licenses being granted automatically on payment of the amounts due are simply a device to raise taxes, even though the government may provide some kind of certificate, or authorization, in return. However, if the government uses the issue of licenses 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—the payments made should be treated as purchases of services from government rather than payments of taxes, unless the payments are not broadly proportional to the costs of providing the services.

12.31 Any fines or penalties on the late payment of taxes are included in the amount of associated taxes.

#### b. *Social contributions*

Reference:

2008 SNA, Chapter 8, The Redistribution of Income Accounts; Section D, Social Insurance Schemes and Section E, Net Social Contributions.

**12.32** *Social contributions are the actual or imputed contributions made by households to social insurance schemes to make provision for social benefits to be paid.* Social insurance schemes include social security schemes (which cover the entire community or large sections of

it and are imposed, controlled, and financed by government) and employment-related schemes (including funded and unfunded pension schemes). Social contributions in the international accounts are recorded when a resident makes contributions to social security and pension schemes in another economy for his or her employment in that economy, or an employer makes actual or imputed contributions on behalf of the employee. (Social contributions by an employer on behalf of its employees are included in compensation of employees; see paragraphs 11.22-11.23.) Similarly, social contributions are recorded when a nonresident makes social contributions to the resident social security and pension schemes.

12.33 The calculation of the amount of social contributions varies for social security and pension schemes. For social contributions to social security schemes, the amount of social contributions recorded in the secondary income account includes the actual contributions payable by the employers and employees. Because the amount payable by employers is included in the compensation of employees, the total of social contributions payable to social security schemes is recorded as a transfer payable by the employees.

12.34 The calculation of social contributions to pension schemes involves contribution supplements and service charges. Contribution supplements, which represent investment income payable on pension entitlements, are described in paragraph A6c.41 and charges for pension fund services are explained in paragraph 10.118. Furthermore, the treatment of social contributions is designed to treat social insurance transactions simultaneously as income distribution and financial transactions.

12.35 Social contributions to pension schemes are determined as follows:

- Employers' actual contributions;
- + Employers' imputed contributions;
- + Employees' actual contributions;
- + Contribution supplements corresponding to investment income payable by pension schemes on pension entitlements;
- Service charges payable to pension schemes.

12.36 Employers' actual and imputed contributions are rerouted through employees (for explanation of rerouting, see paragraph 3.16). Contribution supplements represent investment income payable by pension schemes on pension entitlements. All the service charges are treated as charges payable by the employees, because the beneficiaries are the ultimate users.

For determining the contribution supplements and service charges for a group or groups of policyholders, ratios of these items to actual contributions payable from various similar sources may have to be used.

12.37 Pension entitlements represent claims of beneficiaries on the funds. The payments of social contributions into the pension schemes and the receipts of pensions by beneficiaries therefore constitute the acquisition and disposal of financial assets. In addition, they are recorded as current transfers in the secondary income account as social contributions and social benefits, respectively, so that disposable incomes of households reflect these flows. Negotiated changes in pension entitlements are current transfers (if they relate to current periods) or capital transfers (otherwise). In contrast, changes arising from revision to model assumptions are other changes in volume (see paragraph 9.24).

12.38 In order to reconcile the treatment of pensions as current transfers with the treatment of pension entitlements as financial assets, it is necessary to introduce an adjustment item. This adjustment item adds back social contributions to, and subtracts pension receipts from, the balance on secondary income. After the adjustment, the current account balance is the same as what it would have been if social contributions and pension receipts were not recorded as current transfers. This item is called "adjustment for change in pension entitlements" and is equal to:

- the total value of the actual social contributions payable into pension schemes;
- + the total value of contribution supplements payable out of the property income attributed to pension fund beneficiaries;
- the value of the associated service charges;
- the total value of the pensions paid out as social benefits by pension schemes (see paragraph 12.40).

(Changes in pension entitlements arising from capital transfers are not included in this item.)

12.39 When cross-border flows of pension contributions and pension receipts are significant, the adjustment item must be recorded in order to reconcile the current and financial accounts. For the economy of the employees, the adjustment item is added to the balance on secondary income (a credit entry) and for the economy of the pension schemes, opposite adjustment is needed; that is, the adjustment item is deducted from the balance on secondary distribution of income (a

debit entry). When cross-border flows are minor, the adjustment item may be omitted.

#### c. *Social benefits*

Reference:

2008 SNA, Chapter 8, The Redistribution of Income Accounts; Section F, Social Benefits Other Than Social Transfers in Kind.

12.40 Social benefits include benefits payable under social security and pension schemes. They include pensions and nonpension benefits regarding events or circumstances such as sickness, unemployment, housing, and education, and may be in cash or in kind. Also included are social benefits payable to households by government units or NPISHs to meet the same needs as those under social insurance schemes but that are not made under a social insurance scheme. Cross-border social benefits may be insignificant but can be important in economies where a significant number of residents have or had employment in other economies.

#### d. *Net premiums on nonlife insurance and standardized guarantees*

12.41 Net nonlife insurance premiums and net premiums on standardized guarantees are described in paragraphs 12.42 and 12.43, respectively. Net nonlife insurance premiums are derived from total nonlife insurance premiums and premium supplements after deducting the service charges. Only the net nonlife insurance premiums constitute current transfers and are recorded in the secondary income account. The service charges constitute purchases of services by the policyholders and are recorded as insurance services. Net nonlife reinsurance premiums are calculated and recorded in the same way as for the direct nonlife insurance.

12.42 Nonlife insurance premiums consist of both the gross premiums payable by policyholders to obtain insurance during the accounting period (premiums earned) and the premium supplements payable out of the investment income attributable to insurance policyholders. The total of the nonlife insurance premiums payable in this way has to cover payments of service charges to the insurance enterprises for arranging the insurance and payments for the insurance itself. The way in which the service charges are calculated is explained in paragraph 10.111. After the service charges are deducted from total nonlife insurance premiums and premium supplements, the remainder is described as net nonlife insurance



premiums. These are the amounts available to provide cover against various events or accidents resulting in damage to goods or property or harm to persons as a result of natural or human causes—fires, floods, crashes, collisions, sinkings, theft, violence, accidents, sickness, and so forth—or against financial losses resulting from events such as sickness, unemployment, and accidents.

12.43 Some units, especially government units, may provide guarantees against creditors defaulting in conditions that have the same characteristics as nonlife insurance. This happens when many guarantees of the same sort are issued and it is possible to make a realistic estimate of the overall level of claims under current guarantees. In this case, the fees payable (and the investment income earned on the technical provisions for calls) are treated in the same way as nonlife insurance premiums and the calls under the guarantees are treated in the same way as nonlife insurance claims. Therefore, net premiums on standardized guarantees are derived from total premiums and premium supplements after deducting the service charges.

*e. Nonlife insurance claims and calls under standardized guarantees*

12.44 Nonlife insurance claims are the amounts payable in settlement of claims that become due during the current accounting period. Claims become due at the moment when the eventuality occurs that gives rise to a valid claim. They are equal to claims paid within the accounting period plus changes in the technical reserves against outstanding claims. Nonlife reinsurance claims are calculated and recorded in the same way as for the direct nonlife insurance.

12.45 The nonlife insurance claim is treated as a transfer to the claimant that accrues at the time that the insured event occurs. Insurance claims have a mix of current and capital elements. As a convention, cross-border nonlife insurance claims are treated as current transfers, except in the cases covered in paragraph 13.24.

12.46 Claims payable under standardized guarantees are recorded under this item in the secondary income account (see also paragraph 12.43).

*f. Current international cooperation*

12.47 Current international cooperation consists of current transfers in cash or in kind between the govern-

ments of different countries or between governments and international organizations. This includes:

- (a) transfers between governments that are used by the recipients to finance current expenditures, including emergency aid after natural disasters; they include transfers in kind in the form of food, clothing, blankets, medicines, and so forth;
- (b) annual or other regular contributions paid by member governments to international organizations (excluding taxes payable to supranational organizations) and regular transfers made as matter of policy by the international organizations to governments (for the treatment of capital contributions, see paragraph 13.32); and
- (c) payments by governments or international organizations to cover the salaries of those technical assistance staff who are deemed to be resident in the economy in which they are working and who are in an employer-employee relationship with the host government. Also included is technical assistance supplied in kind.

Current international cooperation does not cover transfers intended for purposes of capital formation; such transfers are recorded as capital transfers. Contributions that give rise to equity are acquisitions of shares or other equity (as in paragraph 5.26).

12.48 External aid provided by governments through a nonresident entity created to undertake fiscal functions is also considered to be current international cooperation. These transfers are described in paragraphs 8.24-8.26.

12.49 When goods and services acquired from market producers are provided to governments or other entities by international organizations, other governments, or NPISHs, without charge to the recipient, they should be valued at market prices, that is, the prices paid by the purchasers. When a transfer in kind involves goods and services produced by international organizations, other governments, or NPISHs, the valuation should be based on cost of production, consistent with the general principles for the valuation of services produced by general government and NPISHs.

12.50 Generally, funding of technical assistance has characteristics of current transfers. However, technical assistance that is tied to or part of capital projects is classified as capital transfers because investment grants are capital transfers. (See also paragraphs 13.25-13.26 concerning investment grants, which are capital transfers.)

12.51 Loans with concessional interest rates could be seen as providing a current transfer equal to the difference between the actual interest and the market-equivalent interest. If such a transfer were recognized, it would usually be recorded as current international cooperation, and the interest recorded would be adjusted by the same amount. However, the means of incorporating the impact within the SNA and international accounts have not fully evolved, although various alternatives have been advanced. Accordingly, until the appropriate treatment of concessional debt is agreed, information on concessional debt could be provided through supplementary information. The supplementary information should show the benefits arising from concessional debt as one-off transfers 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. (See paragraphs A2.67-A2.69 for a more detailed description of the calculation.) This option has the advantage of considering all the possible sources of transfers in debt concessionality—maturity period, grace period, and frequency of payments, as well as the interest rate—and is consistent with nominal valuation of loans. Such an approach should be used for official lending involving an intention to convey a benefit and occurrence in a noncommercial setting (usually government-to-government). Commercial situations are different in that concessional interest rates may be used to encourage the purchase of the goods and services, and so should not be treated in the same way.

g. *Miscellaneous current transfers*

**1252** *Miscellaneous current transfers, in cash or in kind, include all current transfers other than those described in the previous sections of this chapter. The* categories of miscellaneous current transfers between residents and nonresidents are described in paragraphs 12.53-12.58.

***Current transfers to NPISHs***

12.53 Current transfers to NPISHs are transfers received by resident NPISHs from nonresident institutional units in the form of membership dues, subscriptions, donations, and so forth whether made on a regular or occasional basis. Grants and donations

between NPISHs are generally classified as current transfers (e.g., donations for relief works).

***Other miscellaneous current transfers***

*Fines and penalties*

12.54 Fines and penalties imposed on institutional units by courts of law or other government bodies are treated as miscellaneous current transfers. However, early or late repayment penalties agreed as part of the original contract are not included in current transfers; they should be treated along with the associated good, or service, or income, as appropriate.

*Payments of compensation*

12.55 Payments of compensation consist of current transfers paid by institutional units to other institutional units in compensation for injury to persons or damage to property caused by the former that are not settled as payments of nonlife insurance claims. Payments of compensation could be either compulsory payments awarded by courts of law or settlements agreed out of court. Compensation may cover nonfulfillment of contracts, injuries to persons, damages to property, or other losses that are not covered by insurance policies. This heading covers compensation for injuries or damage caused by other institutional units. It also includes *ex gratia* payments made by government units or NPISHs in compensation for injuries or damages caused by natural disasters.

12.56 Major compensation payments for extensive damages (e.g., oil spillages or side effects of pharmaceutical products) are treated as capital rather than current transfers (see also paragraph 13.29).

*Other*

12.57 Gifts and donations of a current nature not included elsewhere are regarded as current transfers. However, payments of membership dues or subscriptions to market nonprofit organizations serving businesses, such as chambers of commerce or trade associations, are treated as payments for services rendered and are therefore not transfers. (See also paragraphs 13.29-13.34 on other capital transfers.)

12.58 Payments to international or supranational authorities that are regarded as being compulsory, and for which nothing is provided in return, but which are not taxes, are classified as miscellaneous transfers.

# Capital Account

## A. Concepts and Coverage

Reference:

2008 SNA, Chapter 10, The Capital Account.

**13.1** *The capital account in the international accounts shows (a) capital transfers receivable and payable between residents and nonresidents and (b) the acquisition and disposal of nonproduced, nonfinancial assets between residents and nonresidents.*

13.2 An overview of the capital account is shown in Table 13.1. The balance on the capital account shows the total credits less debits for capital transfers and nonproduced, nonfinancial assets. In addition, the sum of the current and capital account balances can also be shown as a balancing item. The balancing item is labeled as net lending (+)/net borrowing (-) from the capital and current accounts. That sum is also conceptually equal to net lending (+)/net borrowing (-) from the financial account, as discussed in paragraph 8.4. Although conceptually equal, they may differ in practice. The current and capital accounts show nonfinancial transactions, with the balance requiring net lending or net borrowing, while the financial account shows how net lending or borrowing is allocated or financed.

13.3 In economic literature, "capital account" is often used to refer to what is called the financial account in this *Manual* and in the *SNA*. The term "capital account" was also used in the *Balance of Payments Manual* prior to the fifth edition. The use of the term "capital account" in this *Manual* is designed to be consistent with the *SNA*, which distinguishes between capital transactions and financial transactions.

13.4 The *SNA* capital account shows capital formation for the full range of produced and nonproduced assets (shown in Table 5.1). The corresponding parts of the international accounts show only transactions in nonproduced, nonfinancial assets. Transactions in produced assets are included in the goods and services account,

which does not distinguish whether those goods or services are destined for capital or current purposes.

13.5 The value of net lending/net borrowing in the international accounts is conceptually the same as the aggregate of net lending/net borrowing of the domestic sectors in the *SNA*. This is because all the resident-to-resident flows cancel out. It is also equal to the opposite of net lending/net borrowing of the rest of the world sector in the *SNA*. The relationship between saving and net lending/net borrowing is shown in the capital account of the *SNA* as:

$$\begin{aligned}
 & \text{Net lending (+)/net borrowing (-)} \\
 = & \text{ Saving;} \\
 - & \text{ Acquisition of nonproduced, nonfinancial assets;} \\
 + & \text{ Disposal of nonproduced, nonfinancial assets;} \\
 + & \text{ Capital transfers receivable;} \\
 - & \text{ Capital transfers payable.}
 \end{aligned}$$

13.6 Acquisition and disposal of nonproduced, nonfinancial assets are recorded at the time of change of ownership, in line with the general principles in paragraphs 3.41-3.59. Capital transfers are recorded when all requirements and conditions for receiving them are satisfied and the receiving unit has an unconditional claim. Determining this time can be complex if there is a wide variety of eligibility conditions that have various legal powers. In some cases, a potential transfer recipient has a legal claim when certain conditions are satisfied, such as the prior incurrence of expenses for a specific purpose, or the passage of legislation. In other cases, the transfer recipient never has a claim on the donor and it should be attributed to the time at which the cash payment is made, the asset is conveyed, or liability is canceled.

13.7 Acquisition and disposals of nonproduced, nonfinancial assets and capital transfers receivable and payable are recorded separately on a gross basis, rather

**Table 13.1. Overview of the Capital Account**

	Credits	Debits
<i>Current account balance</i>		
Acquisitions (DR.)/disposals (CR.) of nonproduced, nonfinancial assets		
Natural resources		
Contracts, leases, and licenses		
Marketing assets		
Capital transfers		
Debt forgiveness		
Other		
<i>Capital account balance</i>		
<i>Net lending (+)/net borrowing (-) (from current and capital accounts)</i>		

**Note:** This table is expository; for Standard Components, see Appendix 9.

than netted. Gross data are important in the context of cross-border analysis and allow the derivation of net flows, if needed. Principles for the recording and valuation of current and capital transfers are stated in paragraphs 12.16-12.19.

## B. Acquisitions and Disposals of Nonproduced, Nonfinancial Assets

Reference:

2008 SNA, Chapter 10, The Capital Account, and Chapter 13, The Balance Sheet.

13.8 Nonproduced, nonfinancial assets consist of:

- (a) natural resources;
- (b) contracts, leases, and licenses; and
- (c) marketing assets (and goodwill).

### I. Natural resources

**13.9** *Natural resources include land, mineral rights, forestry rights, water, fishing rights, air space, and electromagnetic spectrum.* International transactions in land and other natural resources do not usually arise because notional resident units are generally identified as the owners of these immovable assets. (The identification of notional units is discussed in paragraphs 4.34-4.40.) As a result, purchases and sales of these assets are generally resident-to-resident transactions. In contrast to a change of ownership of the resource, the right to use a natural resource on a temporary basis is classified as rent (as discussed in paragraphs 11.85-11.90) or a contract, lease, or license, if

it amounts to an economic asset in its own right (as discussed in paragraph 13.11).

**13.10** International transactions in land arise when there are acquisitions and disposals of land for enclaves of international organizations and foreign governments. (International organizations are defined in paragraphs 4.103-4.107.) International transactions also occur when there are voluntary changes of sovereignty over a particular area, whether for payment or as a transfer. The value of any associated buildings and equipment would be shown separately in the goods and services account, if practical.

### 2. Contracts, leases, and licenses

**13.11** *Contracts, leases, and licenses covers those contracts, leases, and licenses that are recognized as economic assets.* These assets are creations of society and its legal system, and are sometimes called intangible assets. Examples include marketable operating leases, permissions to use natural resources that are not recorded as outright ownership of those resources, permissions to undertake certain activities (including some government permits), and entitlements to purchase a good or service on an exclusive basis. Transactions in these assets are recorded in the capital account, but holdings of these assets are not recorded in the IIP because there is no counterpart liability. (These assets are recorded in the national balance sheet.)

**13.12** A marketable operating lease can be transferred or subleased. It may be treated as an asset only when the lease specifies a predetermined price for the use of an asset that differs from the price the asset could be leased for at the current time. They could

cover property, time-share accommodation, equipment, and other produced assets. Marketable operating lease asset flows are recorded in the capital account when the lessee sells the right and thus realizes the price difference.

13.13 Some leases and licenses are not nonproduced, nonfinancial assets and, therefore, are not covered in the capital account. Examples include the following:

- If the right to use land or another natural resource is provided on a short-term, nontransferable basis, then amounts payable are classified as rent (discussed in paragraphs 11.85-11.90).
- If a government provides permission to undertake an activity, unrelated to its ownership of an underlying asset or a service, and the permit does not meet the definition of an economic asset, then a tax is recorded (discussed in paragraphs 10.180-10.181 and 12.30). An example could arise when a government issues a restricted number of gambling licenses.
- If ownership of intellectual property products, such as research and development, computer software and databases, and entertainment, literary, and artistic originals, is provided, then a service is recorded. Similarly, the provision of temporary right to use or reproduce intellectual property products is shown as a service. In contrast, the sale of franchises or trademarks is included under marketing assets. (The treatment of these items is elaborated in Table 10.4.)
- A financial lease gives rise to a loan and a change of economic ownership of the leased asset to the lessee (discussed in paragraphs 5.56-5.60). An operating lease for use of a produced asset gives rise to a service (discussed in paragraphs 10.153-10.157).

13.14 According to general principles, various arrangements involving emissions permits can be classified in the balance of payments in different ways, including the following:

- If a nonresident enterprise purchases an emission permit from a resident government, the payment is classified as a cross-border tax on production in most circumstances. However, if the payment is part of the cost of establishing a direct investment enterprise in the resident economy, it is rerouted as a resident-to-resident transaction, with the payment by the nonresident enterprise recorded as an equity investment in its direct investment enterprise (see

paragraph 4.47). Also, if the issuing government provides extensive services for the purchaser, the payment is instead classified in services (see paragraphs 10.180-10.181).

- If the permit is tradable (as most are), then it is an economic asset. A resale of this asset by a resident to a nonresident enterprise is recorded under contracts, leases, and licenses in the capital account (if it does not involve direct investment, as described in the previous bullet).

International expenditures associated with cleaning up or improving the environment are recorded consistent with general balance of payments classification principles, usually as services (see paragraph 10.152). (See *2008 SNA*, Chapter 17, for further information.)

13.15 Entitlements to future goods and services on an exclusive basis may be an asset under contracts, leases, and licenses. Examples include the transfer fees paid by one sporting club to another for the transfer of a player, and a transferable contract to acquire a good or service at a fixed price, which may be called an option. Very rarely, such an asset may have a negative value (e.g., where the contract has an obligation to purchase at one price, and the market price has fallen below that, so the purchaser under the contract may have to pay another party to take up the obligation).

13.16 Another example of contracts, leases, and licenses can arise with time-share arrangements (see paragraph 10.100(c)).

### 3. Marketing assets (and goodwill)

13.17 *Marketing assets consist of items such as brand names, mastheads, trademarks, logos, and domain names.* When sold separately from the entity that owns them, they are recorded as acquisitions and disposals of nonproduced, nonfinancial assets. (Marketing assets is included with goodwill in the *2008 SNA* asset categories. However, goodwill arises separately only in domestic accounts.)

13.18 Internet domain names are recognized as a marketing asset in some cases. However, normal registration fees payable to a domain authority represent a service, because the fees are in return for work done. In contrast, where the domain name has a premium value (i.e., in excess of the basic registration fee) because of its scarcity, it is a kind of license included under marketing assets. Similarly, the fee for designing a new logo is a business service, whereas an amount to acquire an existing logo would be included under marketing assets.

## C. Capital Transfers

Reference:

2008 SNA, Chapter 10, The Capital Account.

**13.19** *Capital transfers are transfers in which the ownership of an asset (other than cash or inventories) changes from one party to another; or which obliges one or both parties to acquire or dispose of an asset (other than cash or inventories); or where a liability is forgiven by the creditor.* The definition of transfers and the distinction between current and capital transfers are given in paragraphs 12.12-12.15. Governments, households, and nonprofit institutions undertake transfers to convey a benefit to another party.

**13.20** Transfers from enterprises consist of compulsory transfers to governments or other units under court orders, or voluntary transfers to nonprofit institutions and other entities. Unlike governments, households, or nonprofit institutions, commercial entities do not generally have the motivation to transfer resources to other entities for no return, so there are only limited cases where a commercial entity provides a capital transfer to another commercial entity, and some cases of debt assumption and activation of one-off guarantees (as discussed further in paragraphs 8.42-8.45).

**13.21** There may be imputed capital transfers as a result of government use for fiscal purposes of entities resident in other economies, as discussed in paragraphs 8.24-8.26.

### I. Debt forgiveness

Reference:

IMF and others, *External Debt Statistics: Guide for Compilers and Users*, Chapter 8, Debt Reorganization.

**13.22** *Debt forgiveness is the voluntary cancellation of all or part of a debt obligation within a contractual agreement between a creditor and a debtor.*<sup>1</sup> With debt forgiveness, the contractual arrangement cancels or forgives all or part of the principal amount outstanding, including interest arrears (interest payments that fell due in the past) and any other interest costs that have accrued. Debt forgiveness does not arise from the

<sup>1</sup>This includes forgiveness of some or all of the principal amount of a credit-linked note arising from an event affecting the entity on which the embedded credit derivative was written, and forgiveness of principal that arises when a type of event contractually specified in the debt contract occurs—for example, forgiveness in the event of a type of catastrophe.

cancellation of future interest payments that have not yet fallen due and have not yet accrued.

**13.23** Debt forgiveness is distinguished from debt write-off and is treated as a capital transfer transaction. In contrast to debt write-offs, debt forgiveness arises from an agreement between the parties to the debt and it has the intention to convey a benefit, rather than unilateral recognition by the creditor that the amount can no longer be collected. Debt forgiveness is unlikely to arise between commercial entities; more commonly there are debt write-offs (as discussed in paragraphs 9.8-9.11). (Appendix 1 on exceptional financing and Appendix 2 on debt reorganization provide additional information.)

### 2. Nonlife insurance claims

**13.24** Nonlife insurance claims are normally classified as current transfers. For exceptionally large claims, such as those following a catastrophe, some part of the claims may be recorded as capital transfers rather than as normal current transfers. It may be difficult for the parties to identify these events consistently, so, as a simplifying convention, all cross-border nonlife insurance claims are classified as current transfers, unless it is necessary to record a capital transfer to be consistent with the national accounts. To allow comparability with partner data, a supplementary item should be provided for insurance claims included in capital transfers. For current transfers relating to insurance premiums and claims, see paragraphs 12.41-12.46.

### 3. Investment grants

**13.25** Investment grants consist of capital transfers in cash or in kind made by governments or international organizations to other institutional units to finance all or part of the costs of their acquiring fixed assets. The recipients may be other governments or other entities. The recipients are obliged to use investment grants received in cash for purposes of gross fixed capital formation, and the grants are often tied to specific investment projects, such as large construction projects. Grants for investment made by organizations other than general government and international organizations are other capital transfers (see paragraph 13.29). In contrast to investment grants, a foreign government may also fund an investment project as a direct investor (see paragraph 6.22), in which case the amount invested is classified as equity in a direct investment enterprise. A direct investment stake is distinguished from a project funded by a capital transfer in that the direct investor owns voting

power in the enterprise and has a right to future benefits, such as dividends or the right to sell the asset.

13.26 If the investment project continues over a long period of time, an investment grant in cash may be paid in installments. Payments of installments continue to be classified as capital transfers even though they may be recorded in a succession of different accounting periods. Investment grants in kind consist of transfers of transport equipment, machinery, and other equipment by governments to nonresident units and also the direct provision of buildings or other structures for nonresident units. Investment grants include transfers of military equipment in the form of weapons or equipment that are classified as fixed assets.

#### 4. One-off guarantees and other debt assumption

13.27 Capital transfers occur when a one-off guarantee is activated and the guarantor acquires no claim on the debtor or a claim worth less than the value of the guarantee. The treatment is the same for other cases of debt assumption where the assumer is not a guarantor.

- If the original debtor still exists, the capital transfer is from the debt assumer to the debtor.
- If the original debtor no longer exists, the capital transfer is from the debt assumer to the creditor.

The value of any claim the debt assumer receives from the debtor (e.g., a promise of reimbursement) is regarded as a financial account transaction between the guarantor and the debtor. The treatment of one-off guarantees and other cases of debt assumption is described in more detail in paragraphs 8.42-8.45, including the circumstance when the guarantor is in a direct investment relationship with the debtor. Different types of guarantees are distinguished in paragraph 5.68.

#### 5. Taxes

Reference:

IMF, *Government Finance Statistics Manual 2001*, Chapter 5, Revenue.

13.28 Capital taxes consist of taxes levied at irregular and infrequent intervals on the values of the assets or net worth owned by institutional units or on the values of assets transferred between institutional units as a result of legacies, gifts inter vivos, or other transfers. They include:

- (a) Capital levies. Capital levies consist of taxes on the values of the assets or net worth owned by

institutional units levied at irregular, and very infrequent, intervals of time; and

- (b) Taxes on capital transfers. These consist of taxes on the values of assets transferred between institutional units. They consist mainly of inheritance taxes (death duties) and gift taxes, including those on gifts made between living members of the same family to avoid, or minimize, the payment of inheritance taxes. They do not include taxes on sales of assets.

Recurrent taxes on income and wealth as well as taxes on financial and capital transactions are classified as current transfers (see paragraphs 12.28-12.31). Detail on the classification of taxes can be found in *Government Finance Statistics Manual 2001*.

#### 6. Other capital transfers

13.29 Major nonrecurrent payments in compensation for extensive damages or serious injuries not covered by insurance policies are included in capital transfers. The payments may be awarded by courts of law or by arbitration, or settled out of court. They include payments of compensation for damages caused by major explosions, oil spillages, the side effects of pharmaceutical products, and so forth. However, if an amount payable under a court order or settlement is identifiable to a specific unpaid debt, it should be recorded under the relevant financial account item. See also paragraphs 12.55-12.56 for payments of compensation included in current transfers.

13.30 Assets of persons changing their economic territory of residence are other changes in volumes, and not imputed as being a transfer, as discussed in paragraphs 9.21-9.22.

13.31 Capital transfers include large gifts and inheritances (legacies), including those to nonprofit institutions. These capital transfers could be made under wills or when the donor is still living. Capital transfers include exceptionally large donations by households or enterprises to nonprofit institutions to finance gross fixed capital formation, such as gifts to universities to cover the costs of building new residential colleges, libraries, and laboratories. Capital transfers also include cash grants from donor governments or multilateral financial institutions to the debtor economy to be used to repay debt (see paragraph A 1.7).

13.32 A capital contribution to an international organization or nonprofit institution is a capital transfer

if it does not give rise to equity for the provider of the contribution.

13.33 As discussed in paragraphs 3.79, 12.51, and A2.67-A2.68, there is a transfer element with respect to concessional lending. The transfer element of concessional loans can be shown as supplementary data.

13.34 A bailout is a loosely defined term meaning a rescue from financial distress. One action that may occur as part of a bailout is that a government may

buy assets for more than their market value. The sale and purchase of the asset should be recorded at the market value and a capital transfer from the government to the seller of the claim should be recorded for the difference between the market price and the total amount paid.

13.35 Household-to-household capital transfers may be identified separately when they are significant. They are included in the supplementary item personal remittances, as discussed in Appendix 5.



CHAPTER  
**14**

# Selected Issues in Balance of Payments and International Investment Position Analysis

## A. Introduction

14.1 This chapter provides an introduction to the use of balance of payments and international investment position data in economic analysis. Preceding chapters of this *Manual* present the concepts underlying the components used in the international accounts. The importance of this accounting and statistical reporting framework describing an economy's international transactions and positions derives primarily from their impact on the domestic economy. Although the international accounts are sometimes called the "external sector" or "rest of the world sector," they do not constitute a sector, in the sense of a group of institutional units with similar motivations. Rather, international accounts show the relationship between domestic sectors and the rest of the world. This chapter discusses some of these major links.

14.2 This discussion directs particular emphasis to the factors influencing international transactions and positions and the extent to which such factors are sustainable. Finally, some of the implications of balance of payments adjustments for economic policy are considered. In this chapter, it is assumed, by and large, that international and domestic transactions are not constrained by formal or informal administrative controls and that market participants are free to respond to price signals and macroeconomic policies. It also assumed that the economy does not affect global interest rates.

14.3 Owing to the introductory nature of this chapter, the discussion of balance of payments financing and adjustment in Sections D and E is not exhaustive, and focuses on an illustrative case that demonstrates fundamental mechanisms and macroeconomic interactions. More complex cases with volatile and highly mobile financial and balance sheet effects bring additional concerns and limitations. These issues are briefly discussed in Section G, but more complete analysis

goes beyond the scope of the *Manual*, and the reader is encouraged to refer to additional literature, for which some references are provided in Section H. The chapter does not discuss the special issues associated with a currency union.

## B. General Framework

14.4 The relationships among the economic accounts in the *SNA* are described in Chapter 2, Overview of the Framework. The major accounts can be expressed as accounting identities. Because these are identities, no causation should be inferred. The *SNA* goods and services account shows the balance between supply and use:

$$\begin{aligned} \text{Supply} &= \text{Output} + M \\ &= \text{Use} = C + G + I + X + IC, \end{aligned} \quad (1)$$

where

$M$  = imports of goods and services

$C$  = household consumption

$G$  = government consumption

$I$  = gross capital formation<sup>1</sup>

$X$  = exports of goods and services

$IC$  = intermediate consumption

Because GDP is equal to gross output less intermediate consumption, identity (1) can be rearranged as:

$$GDP = C + G + I + X - M, \quad (2)$$

<sup>1</sup>Often called investment in economic analysis. The *SNA* uses the term "capital formation" to mean investment in nonfinancial assets so as to make a clear distinction from investment in financial assets. Investment is used subsequently in this chapter to mean capital formation in the *SNA* sense. Capital formation includes fixed capital, inventories, and valuables.

that is, the expenditure approach to GDP, where

$GDP$  = gross domestic product.

The definition of gross national disposable income (GNDY) is GDP plus net primary and secondary income from abroad, so

$$GNDY = C + G + I + X - M + BPI + BSI, \quad (3)$$

where

$BPI$  = balance on primary income

$BSI$  = balance on secondary income (net current transfers)

The current account balance is:

$$CAB = X - M + BPI + BSI \quad (4)$$

where

$CAB$  = current account balance

From equations (3) and (4), the current account balance can also be seen equivalently as the gap between disposable income and expenditure:

$$CAB = GNDY - C - G - I. \quad (5)$$

Or equivalently:

$$GNDY = C + G + I + CAB. \quad (6)$$

As defined in the *SNA* use of income account:

$$S = GNDY - C - G, \quad (7)$$

where

$S$  = gross saving.

Substituting identity (3) in (7),

$$S = I + CAB, \quad (8)$$

which can be rearranged as:

$$S - I = CAB. \quad (9)$$

That is, the current account balance is the gap between saving and investment.<sup>2</sup>

14.5 Thus, the current account balance mirrors the saving and investment behavior of the economy. In

<sup>2</sup>These relationships have been shown for the gross values of production, income, capital formation, and saving, before deduction of consumption of fixed capital. The relationships also hold if production, income, capital formation, and saving are expressed net of consumption of fixed capital.

analyzing changes in the current account balance of an economy, it is therefore important to understand the manner in which these changes reflect movements in saving and investment. For example, an increase in investment relative to saving will have the same impact on the current account—at least in the short run—as a decline in saving relative to investment. However, the longer-run implications for the external position of the economy may be quite different. More generally, identity (9) shows that any change in an economy's current account balance (e.g., a larger surplus or smaller deficit) is necessarily equivalent to an increase in saving relative to investment. This relationship highlights the importance of ascertaining the extent to which any policy measures designed to alter the current account balance directly (e.g., changes in tariffs, quotas, and exchange rates) will affect saving and investment behavior.

14.6 This link between domestic transactions and transactions with the rest of the world is shown in identity (5). The implication of this relationship for balance of payments analysis is that improvement in an economy's current account requires a reduction in expenditure relative to income. Alternatively, it may be possible to achieve an improvement in the current account balance by means of an increase in national income that is not matched by a commensurate rise in consumption or domestic investment. Implementation of structural measures that increase the efficiency of the economy would be one way to achieve this objective.

14.7 This last point highlights an important aspect of the identities shown previously; these are identities that define relationships among variables rather than describe the behavior of economic agents. By themselves, the identities cannot provide a full analysis of the factors determining developments in the current account. For example, total expenditure on goods and services by domestic residents ( $C + G + I$ ) is likely to be influenced in part by their income ( $GNDY$ ). Thus it would be inappropriate to use identity (5) to analyze the impact of a change in  $GNDY$  on the current account balance without taking full account of the induced response in consumption and capital formation of such a change. This example illustrates the necessity for understanding the spending propensities of residents of the economy when analyzing the balance of payments.

14.8 The interrelationship of the current account balance with saving and investment can be seen in greater detail by distinguishing between the private and government sectors. Private saving and investment

( $S_p$  and  $I_p$ ) and government saving and investment ( $S_g$  and  $I_g$ ) are identified as:

$$S-I = S_p + S_g - I_p - I_g \quad (10)$$

Use of the saving-investment gap identity for the current account in identity (9) then gives:

$$CAB = (S_p - I_p) + (S_g - I_g) \quad (11)$$

This identity shows that, if government sector dissaving is not offset by net saving on the part of the private sector, the current account will be in deficit. More specifically, the identity shows that the budgetary balance of the government ( $S_g - I_g$ ) may be an important factor influencing the current account balance. In particular, a sustained current account deficit may reflect persistent government spending in excess of receipts, and such excess spending suggests that fiscal tightening is the appropriate policy action.

14.9 To reiterate an important point, however, identity (11) cannot be used by itself to analyze developments in the balance of payments in terms of investment and saving on the part of the private and government sectors because there are links between the variables on the right-hand side of identity (11). For example, an increase in taxes could be considered the appropriate policy measure both to raise government saving (or reduce dissaving) and to contribute to an improvement in an economy's current account balance. In analyzing the impact of higher taxes, it is necessary to take account of the behavioral response of private saving and private investment. Private investment could be positively or negatively affected by higher taxes. The effect would depend, in part, on whether the taxes were levied on consumption, an action that would release domestic resources and thereby tend to "crowd in" domestic investment, or on returns to investment. In addition, private saving would tend to fall because of the decline in disposable income caused by taxes on consumption. Similarly, an increase in interest rates could tend to reduce private consumption and investment, but also tend to put upward pressure on the exchange rate with consequent effects on exports, imports, and differing effects on debt service for domestic currency and foreign currency liabilities.

14.10 Thus, identity (11) provides only a starting point for an analysis of the interaction between saving

and investment decisions and the balance of payments; the identity must be supplemented by specific information about the factors that determine the behavior of both the private sector and the government before the effect of policy measures on an economy's current account can be ascertained.

14.11 As noted in Box 2.1, the basic principle of double-entry bookkeeping used in constructing the balance of payments implies that the sum of all international transactions—current, capital, and financial—is in principle equal to zero.<sup>4</sup> Accordingly, the financial account shows how the sum of the current account and capital account balances is financed. For example, imports of goods may be financed by nonresident suppliers so that an increase in imports can be matched by a financial inflow. At the expiration of the financing period, the payment to the nonresident supplier will involve either a drawdown of foreign assets (e.g., foreign deposits held by domestic banks) or the replacement of the liability to the nonresident supplier by another liability to nonresidents. There are also close connections between many financial account transactions. For example, the proceeds from the sale of bonds in foreign financial markets (a financial inflow) may be invested temporarily in short-term assets abroad (a financial outflow).

14.12 This balance between financial and other entries can be expressed as:

$$NLB = CAB + KAB = NFA, \quad (12)$$

where

$NLB$  = net lending/net borrowing

$KAB$  = the capital account balance

$NFA$  = net financial account entries

In words, this identity shows that net lending/net borrowing (from the sum of the current account balance and capital account balance) is conceptually equal to net lending/net borrowing from the financial account. Alternatively, it could be said that the current account balance is equal to the sum of balances on the capital and financial accounts (with signs reversed, if necessary, depending on the presentation used)<sup>5</sup> including reserve assets.

<sup>4</sup>The scope of the "government sector" could be defined as general government or the public sector (definitions of both are given in Chapter 4), according to analytical needs; the private sector would be defined in a complementary way.

<sup>5</sup>In practice, they may not balance owing to errors or omissions.

<sup>6</sup>Net financial account transactions could be presented as in net lending (+)/net borrowing (-) in Tables 2.1 and 8.1 and following from the heading-based presentation in paragraph 3.31. Alternatively, they could be presented with a sign-based presentation (nega-

$$CAB = NKF + RT, \quad (13)$$

where

$NKF$  = net capital and financial account transactions excluding reserve assets

$RT$  = net reserve asset transactions

14.13 Thus the net provision of resources to or from the rest of the world, as measured by the current and capital account balances, must—by definition—be matched by a change in net claims on the rest of the world. For example, a surplus on the current and capital accounts is reflected in an increase in net claims, which may be in the form of acquisition of reserve assets on the part of the monetary authorities or other official or private claims on nonresidents. Alternatively, a deficit on the current and capital accounts implies that the net acquisition of resources from the rest of the world must be paid for by either liquidating foreign assets or increasing liabilities to nonresidents.

### C. Alternative Presentations of Balance of Payments Data

14.14 The different presentations discussed below can be used to highlight different aspects of balance of payments financing and its effect on the economy. These presentations involve reorganization of the items to emphasize particular aspects.

#### I. Standard presentation

14.15 The tables presented in Chapters 2 and 7-13 use a standard presentation that groups economic processes and phenomena, consistent with the *SMA* and other macroeconomic statistics. It features two major lines for balances:

- (a) between current account entries and accumulation entries—the balancing item is the current account balance, and
- (b) between financial and nonfinancial entries—the balancing item is net lending/net borrowing.

In addition, there are a range of other balancing items shown in Table 2.1 and Chapters 7-13 that highlight different components.

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tive signs for increases in assets, etc.), in which case the signs would need to be reversed.

#### 2. "Analytic" presentation

14.16 The analytic presentation is a reorganization of the standard presentation of balance of payments statistics to facilitate a basic distinction between (a) reserves and closely related items and (b) other transactions. The analytic presentation is an example of a satellite account and is designed to focus on management of reserves and closely related items, but the term "analytic" should not be taken to suggest that this presentation is suitable for all analytical purposes or that other presentations are not useful for other kinds of analysis. Table 14.1 illustrates this presentation. It draws the line between the ways monetary authorities finance transactions (below the line) and other items (above the line).

14.17 This presentation shows how reserves, along with the related items of IMF credit and loans, and exceptional financing (such as accumulation of arrears, debt forgiveness, intergovernmental grants, and debt restructuring) are used to finance other "autonomous" international transactions. Exceptional financing is discussed in detail in Appendix 1. The presentation is useful for monetary authorities that use intervention, including managed exchange rate regimes, with various degrees of flexibility. Arrears related to exceptional financing are recorded below the line as transactions in the analytical presentation with the corresponding entry in the relevant instrument. (This treatment is because, although the accumulation of arrears is not a transaction, it results from the actions of the monetary authorities.) Categories of the balance of the payments above-the-line from which transactions could be taken to below-the-line are marked as "(n.i.e.)."

#### 3. Sectoral analysis

14.18 Another analytical presentation groups items in the financial account by the type of resident recipient of external financing—for example, central bank, deposit-taking corporations except the central bank, general government. To support this approach, sectoral splits are required for most financial account items.

14.19 Sectoral presentations provide a convenient way to analyze the net foreign lending or borrowing of each domestic sector. These data help identify issues of sustainability and vulnerability. Sectoral analysis is developed in conjunction with the balance sheets (see paragraphs 14.57-14.66) and in the presentation of external debt statistics (see *External Debt Statistics: Guide for Compilers and Users*).

**Table 14.1. "Analytic" Presentation of the Balance of Payments'**

	Credits	Debits
<b>Current account n.i.e.</b>		
Goods		
Services		
Primary income		
Secondary income n.i.e.		
Balance on current account n.i.e.		
<b>Capital account n.i.e.</b>		
Balance on capital account n.i.e.		
<b>Financial account n.i.e.</b>		
Direct investment n.i.e.		
Portfolio investment n.i.e.		
Financial derivatives and ESOs n.i.e.		
Other investment n.i.e.		
Balance on financial account n.i.e.		
Balance on current capital, and financial accounts n.i.e.		
<b>Reserves and related items</b>		
Reserve assets		
IMF credit and loans		
Exceptional financing		
Total reserves and related items		

\*Exceptional financing items are moved from the current, capital, and financial accounts to the reserves and related items heading. For this reason, other items are stated as being n.i.e. (Exceptional financing is discussed in Appendix I.)

#### 4. Monetary presentation

Reference:

Louis Bê Duc, Frank Mayerlen, and Pierre Sola, *The Monetary Presentation of the Euro Area Balance of Payments*, European Central Bank Occasional Paper No. 96 (September 2008).<sup>6</sup>

14.20 The monetary presentation explicitly shows the link between the balance of payments and monetary and financial statistics (as mentioned in paragraph 2.8). It identifies the transactions of the deposit-taking corporations (plus money market funds, if their liabilities are included in the definition of broad money), which are equal to the foreign assets and liabilities of the same entities, as recorded in monetary and financial statistics.

14.21 This presentation highlights the effects of international transactions on monetary developments. This may be summarized by the following equations:

- (a) The transactions derived from the balance sheet of deposit-taking corporations (and money market funds, where relevant) can be expressed as follows:

$$NFA + ADC - AM + OTR = 0, \quad (14)$$

where

*NFA* = transactions in foreign assets and liabilities of the deposit-taking corporations

*DC* = domestic credit

*M* = broad money (liabilities)

*OTR* = other (net) transactions vis-à-vis residents

*A* = transactions derived from corresponding positions (i.e., excluding any changes due to revaluation or other changes in volume)

- (b) The identification of transactions by deposit-taking corporations in the balance of payments leads to the following equation:

$$NFA + ETN = 0, \quad (15)$$

where

*ETN* = nonfinancial balance of payments transactions and transactions in foreign assets and liabilities by sectors other than deposit-taking corporations<sup>7</sup>

<sup>6</sup>Available at <http://www.ecb.europa.eu/pub/scpops/ecbocp96.pdf>.

<sup>7</sup>Under this type of analysis, if deposit-taking corporations transact in foreign assets with other resident sectors, for the identities to

- (c) Combining these equations makes explicit the link between developments in broad money and the balance of payments transactions of the sectors other than deposit-taking corporations:

$$AM = -ETN + ADC + OTR. \quad (16)$$

14.22 This presentation highlights the effect of international transactions on domestic liquidity. It emphasizes the links between balance of payments and monetary statistics.

### 5. Partner analysis

14.23 Data by partner economy can assist in the conduct of international trade negotiations. They are also useful in identifying potential vulnerability from excessive reliance on another economy, and in forecasting and analyzing contagion effects. They can be used to monitor data quality, through the study of comparison of bilateral data as reported by each of the partner economies (see, for example, Eurostat's study of asymmetries in EU current account data, cited at the end of this chapter). Such analysis reflects developments such as the need to monitor large payments imbalances between and among certain individual economies and groups of economies, and the analytical interest in the source of balance of payments flows and positions for economies.

14.24 For analysis of IIP by partner, assets are shown according to the residence of the debtor (or issuers of nondebt instruments), and liabilities according to the residence of the creditor (or holders of nondebt instruments). For analysis of balance of payments transactions by partner, data both on a debtor-creditor and a transactor basis may be of interest.<sup>8</sup> The debtor-creditor basis facilitates analyses concerned with such issues as whose securities are being purchased and sold. The transactor basis allows for analysis of where residents engage in financial asset transactions with nonresidents, changes in relative importance and growth of international financial centers, and so forth.

hold, transactions in both NFA and ETN need to be recorded, even those that are resident-to-resident, and therefore not balance of payments, transactions. As noted in paragraph 3.8, in practice balance of payments transactions in financial assets may be derived from data that do not distinguish whether the counterparty is a resident or a nonresident.

<sup>8</sup>The debtor/creditor and the transactor bases differ in the case of secondary market transactions and are discussed in paragraph 4.154.

### D. Financing a Current Account Deficit

14.25 This section examines the financing of a current account deficit by means of net financial inflows and changes in reserve assets, and some of the economic policy issues involved. For such an analysis, it would be helpful to use identity (12), and to assume that initially  $s = i$  (i.e., that the current account is in balance and that net capital and financial account and reserve asset transactions are also zero). From this initial situation, it is instructive to trace the effects, on the current account and the financial account, of an autonomous increase in investment (capital formation), which is generated by a rise in the productivity of capital. If this additional investment is not matched by a corresponding rise in saving, interest rates will tend to rise as long as the monetary authorities do not "control" the rates. The excess of investment over saving will be reflected in a current account deficit, which may be financed by a net financial inflow.

14.26 Whether there is spontaneous financing of a current account deficit—that is, whether the gap between saving and investment is met from autonomous flows—depends on a number of considerations. The functional categories of the international accounts, as well as additional breakdowns (e.g., domestic sector, partner economy, currency of denomination), can be crucial to assess the determinants of such financing, and therefore the appropriate policy measures to foster the most appropriate and sustainable financing sources. In particular, direct investment is frequently characterized by stable and long-lasting economic links, as well as the provision of technology and management. The financial inflow may be directly related to increased capital formation as a result of direct investment, loans obtained from foreign banks, or bonds issued in international financial markets. The foreign financing can be for the purchase of imported goods and services required for an investment project and for the purchase of domestic inputs. Alternatively, additional investment may be financed domestically by means of bank loans or issues of equities and bonds. In this case, there is no direct link between increased domestic expenditures and foreign financing. However, the tendency for domestic interest rates to rise (in comparison with rates abroad) because of the increased investment will provide an incentive for funds to flow into the economy. Whether or not funds do so depends largely on how investors view the economic prospects of the economy. The prevalence of stable economic and political conditions—particularly if it is not likely that the higher interest rate will

be offset by a continuing depreciation of the exchange rate of the economy—will increase the spontaneous movement of funds into the economy.

14.27 The financial inflow associated with the excess of investment over saving involves a reduction in the net foreign asset position of the economy and the reduction, in turn, will change the net investment income flow of the economy. The key analytical issue is whether the economy will be able to service the change in the net foreign investment position without undertaking significant modifications in economic policies or without incurring undesirable changes in interest rates or exchange rates. Servicing is likely to occur without changes if the investment makes a significant contribution to the productivity of the economy. Such a contribution can be manifested in two ways: first, the firm or government enterprise undertaking the investment must be sufficiently profitable to pay the rate of return that will attract the funds to finance the investment; second, the additional investment must enhance the debt-servicing capacity of the economy. As long as funds from abroad are invested productively, external financing for a current account deficit is likely to be forthcoming for a considerable period of time. In this situation, the finance-receiving economy's current account deficit manifests an efficient allocation of resources.

14.28 Alternatively, it is useful to consider a case in which investment is unchanged but saving declines—for example, because of an increase in government spending not matched by a rise in tax and other revenue or because of an increase in private consumption not matched by an offsetting change in government saving. In this situation, domestic interest rates would also tend to rise. However, unlike the previous case, the shift to a current account deficit is not paralleled by an increase in productivity in the economy. Under these conditions, there may not be a spontaneous inflow of funds if investors view the deterioration in the current account as reflecting inappropriate and unsustainable government policies. For example, the decline in saving may reflect an enlarged public sector deficit that is not associated with increased investment. Alternatively, the rise in absorption may be due to higher private spending generated by an expansionary monetary policy. Under these circumstances, investors may not wish to increase their net claims on the economy.

14.29 In the absence of a spontaneous financial inflow, some combination of the following will be necessary: policy actions to attract private funds, the use of reserve assets for balance of payments financing, and the implementation of balance of payments

adjustment measures. From identity (12), it can be seen that, if the current account shifts into deficit, financing must take place either by drawing down the economy's reserve assets or by increasing incentives for attracting private funds. The latter can be achieved by enhancing the domestic economic environment for long-term investment. The adoption of monetary and fiscal policies that support stable economic conditions and encourage direct and other investment would tend to induce financial inflows on a sustained basis. Funds may also be induced to flow in from abroad—and to provide balance of payments financing—by the raising of domestic interest rates. Such a policy may well be appropriate if the current account deficit is caused by aggregate demand pressures; a restrictive monetary policy would have the effect of dampening excess demand and providing short-term financing. However, such financing may not be dependable from a long-term perspective as, for example, changes in foreign monetary conditions may make investment of liquid assets in the domestic economy appear unattractive. Therefore, it is necessary to look at the underlying causes of a current account deficit.

14.30 The appropriateness of using reserve assets to finance a gap between domestic expenditure and income, rather than undertaking adjustment measures to reduce or eliminate this gap, depends on the extent to which the gap is temporary or reversible. As an economy's stock of reserve assets (as well as the resources it can borrow to supplement its reserve assets) is limited, the use of reserve assets to finance a current account deficit is confined within these limits. However, by mitigating the necessity for balance of payments adjustment, official financing can perform a useful buffer function. For example, temporary shocks, such as poor harvests or other temporary supply disruptions, to domestic output do not necessarily require comparable changes in the domestic absorption of goods and services. Thus the financing, through the use of reserve assets, of a temporary excess of consumption and investment over national income can provide a desirable smoothing of the path of expenditures by residents. The reserve assets can also be used to finance seasonal swings in foreign payments and receipts. While the financing of temporary shocks is appropriate, recourse—although it can make the adjustment path smoother and more gradual—to owned or borrowed reserve assets does not obviate the necessity for adjustment if deterioration in the current account persists.

14.31 There are limits to the extent to which private funds and official resources can finance a current

account deficit. The willingness of the private sector to invest in the economy may be directly influenced by ongoing changes in reserve assets. If the existing stock of reserve assets is relatively low in comparison with the current account deficit and the monetary authorities are expected to exhaust the economy's reserve assets within the investment horizon of the investors, then the probability of a depreciation of the exchange rate or the introduction of other policy measures adversely affecting the rate of return expected by investors would tend to increase significantly. Under these circumstances, any private funds from abroad that are financing all or part of a current account deficit could quickly switch from a net inflow to a net outflow. As can be seen from identity (12), unless adjustment measures are implemented to reverse both the current account deficit and the financial account outflow, reserve assets would be required to finance both an excess of domestic investment over saving and a net increase in liabilities to nonresidents. Such a situation would probably result in a loss of confidence in the currency, exacerbation of the financial outflow, and a rapid exhaustion of reserve assets.

14.32 More generally, in a world of high financial mobility, external and domestic private sector willingness to provide financing are influenced by a complex set of expectations about future economic, political, and other developments in the recipient economy and in the rest of the world. Changes in these expectations may result in rapid rebalancing of the composition of balance sheets and cause high volatility in financial flows with significant current account and other macroeconomic implications. Section F provides more extended discussion.

14.33 The previously described framework for analysis of the balance of payments is applicable, irrespective of the exchange rate regime adopted by an economy. For example, if the exchange rate is pegged, then transactions in reserve assets will be determined by the net demand or supply of foreign exchange at that exchange rate (i.e., from identity (13),  $RT = CAB - NKF$ ). At the other extreme, if the exchange rate arrangement involves a pure float so that no exchange market intervention takes place, then  $CAB = NKF$ . In the intermediate case of a managed float, purchases and sales of reserve assets are typically undertaken to achieve a desired exchange rate path for the domestic currency in terms of one or more foreign currencies.

14.34 Financial account transactions, as included in the NKF term in identity (13), can be analyzed in terms of their composition. Direct investment, portfolio invest-

ment, financial derivatives, and other investment can have different implications for the economy, in terms of factors such as volatility, future returns, and effect on capital formation. More detailed data on instruments and maturity are also relevant to understanding the nature of the financing and its future effects.

14.35 There is another connection between the financial account and the current account. Financial flows generate changes in foreign claims and liabilities. In nearly all cases, these financial stocks earn returns (interest, dividends, or reinvested earnings) that appear in the current account as investment income. The rate of these returns can differ between assets and liabilities and between different types of investment. This link between the accounts is particularly relevant in the case of an economy running a current account deficit because there is an important dynamic relationship between an existing deficit and the future current account balance. A deficit in the current account must be financed by some combination of an increase in liabilities to nonresidents and a reduction in claims on nonresidents so that the net result is a decline in net foreign assets. As a consequence, there will be a reduction in net investment income (unless rates of return adjust in an offsetting manner), and this reduction will increase the current account deficit. This interaction between the current account and the financial account can lead to a destabilizing situation in which the current account balance progressively worsens unless changes in economic policies or adjustments in certain variables (e.g., exchange rates) are made to arrest the deterioration.

14.36 In analyzing the balance of payments and, in particular, the sustainability of any specific current account situation, it is important to consider the determinants of financial flows. These relate mainly to factors affecting the rate of return and risk on foreign and domestic assets. Such factors include interest rates, the profitability of direct and other investments, expected changes in exchange rates, and tax considerations. These factors are embodied in the expected real (i.e., adjusted for exchange rates and inflation) after-tax rate of return on the stock of foreign assets held by residents and on the stock of claims held by nonresidents. Residents and nonresidents are subject to different legal and tax considerations, which affect the rates of return on asset holdings. However, both are similarly affected by economic conditions external to the countries in which they are resident. Moreover, these external conditions are exogenous to an individual economy.



14.37 Indeed, whereas in circumstances of low financial mobility and mostly official financing it could be reasonable to focus mostly on domestic conditions, in a world of high financial mobility, external conditions—such as changing world interest rates—are important factors in influencing financial flows.

14.38 Balance of payments statistics use the accrual principle, which reflects underlying resource flows. However, a payments crisis is usually driven by cash flows. It may therefore be useful to consider cash flow dimensions when there are significant timing differences between payments and resource flows, for example, in the cases of accrual of interest, reinvested earnings, and nonperforming loans.

### E. Balance of Payments Adjustment in Response to a Current Account Deficit

14.39 There are many situations in which it may not be feasible to rely on private and official resources to finance a current account deficit on a sustained basis. If a deficit is unsustainable, the adjustment will necessarily happen through change in the willingness of market participants to provide financing or depletion of reserves and other financial assets, or a combination of both. Such adjustments may be abrupt and painful (up to the possibility of a balance of payments crisis). Therefore, policy measures aimed at mitigating the adjustment path may need to be considered.

14.40 For balance of payments analysis, it is therefore important to consider the possible introduction of adjustment measures to achieve a viable external payments position (i.e., conditions under which a deficit on goods, services, and income can be financed by private and official transfers, private financial inflows, and some recourse to reserve and other financial assets). The subsequent discussion illustrates some possible measures, but it is not exhaustive. It examines briefly the roles of exchange rate changes, fiscal measures, and monetary policy in achieving balance of payments adjustment.

14.41 In this analysis, it may be useful to rewrite identity (9) as:

$$\begin{aligned}
 S-I &= CAB \\
 &= BTG + BTS + BPI + BSI \\
 &= NKF + RT
 \end{aligned}
 \tag{17}$$

where

*BTG* = balance on trade in goods

*BTS* = balance on trade in services

*BPI* = balance on primary income

*BSI* = balance on secondary income

The magnitude of the necessary adjustment in the balance of payments depends, to some extent, on the nature of the components of the current account balance. For example, an economy may have been running a persistent deficit on trade in goods that was financed, in part, by borrowing from private and official sources. In this situation, the economy is also likely to be running a deficit on the balance of primary income that reflects the servicing of this debt. A deficit for goods, services, and primary income may, however, be offset by a surplus on secondary income, which could reflect both official and private current transfers. If such inward transfers are expected to be of a long-term nature and can confidently be relied upon to finance all or part of the deficit in other components of the current account, then the extent of the necessary balance of payments adjustment may be rather small.

14.42 However, even in the case of a small adjustment, it is nonetheless important to be fully cognizant of the fact that foreign debt must be repaid. Thus the amortization schedule of the economy is an important factor for judging the sustainability of a particular balance of payments situation. If large amortization payments are due in the near future and expected financial inflows are not sufficient to cover payments falling due, it may be necessary to undertake adjustment measures beforehand to avoid more drastic measures required for dealing with a subsequent balance of payments crisis.

14.43 In the face of an unsustainable current account deficit in an economy with a fixed or managed exchange rate, one adjustment measure that could be considered is a depreciation of the exchange rate of the domestic currency.<sup>9</sup> Such a depreciation may be necessary to offset a domestic price rise (relative to prices abroad) that—by penalizing exports and encouraging imports—worsens the balance on trade in goods. To the extent that the depreciation raises the prices of traded goods and services (i.e., exports and imports) in comparison with the

<sup>9</sup>The application of such a depreciation may be complicated by significant currency balance sheet mismatches, which need to be taken into account. These mismatches are discussed in Section G.

prices of nontraded goods and services, depreciation will promote the substitution of domestic for imported products and stimulate foreign demand for domestic products. However, because the depreciation will be accompanied by a rise in domestic prices in response to the increase in the cost of imported goods and services and the rise in demand for exports and domestically produced import substitutes, the improvement in international competitiveness generated by the exchange rate change will be partially or fully eroded. Such a development underscores the importance of supplementing the exchange rate adjustment with restrictive monetary and fiscal policies to facilitate the shift in resources signaled by the change (caused by the depreciation) in relative prices. Thus, an expenditure-switching policy in the form of exchange rate depreciation must generally be supported by expenditure-reducing measures; indeed, such measures are essential if there is no excess capacity in the economy.

14.44 The effects of such action can be seen from identity (9), which shows that any improvement in the current account must be matched by a corresponding positive change in the difference between saving and investment. An exchange rate depreciation by itself may generate such a change in the desired direction. In particular, if there is no change in the stance of monetary policy, the increase in demand generated by the depreciation will raise the demand for money. With an unchanged money supply, the greater demand for money will tend to increase nominal and real domestic interest rates. As a result, interest-sensitive expenditures will be dampened, and there could be a positive impact on saving. However, it is unlikely that this induced effect on the gap between saving and investment will itself be sufficient, particularly if the economy is at full employment, to achieve the desired improvement in the current account. Therefore, in all likelihood, it will be necessary to accompany the adjustment in the exchange rate with measures to reduce the level of domestic expenditure through tighter monetary and fiscal policies that release resources to expand output in the exporting and import-substitution industries.

14.45 The discussion of identity (11) pointed to fiscal deficits as one potential cause of external imbalances. Changes in government spending and taxation may therefore be necessary to achieve the required reduction in the saving-investment gap—to the extent that an exchange rate depreciation does not induce a sufficient response in the difference between total saving and investment. However, it is important that fis-

cal policy measures be designed to achieve the desired objective and not exacerbate the adjustment problem. For example, cuts in infrastructure investment may have the desired short-run balance of payments effect, but such cuts could have, particularly if the spending reductions are in such areas as transport or electricity, a long-run adverse impact on the supply potential of the economy and the generation and supply of energy designed to relieve bottlenecks. Moreover, tax measures that result in very high marginal tax rates or that are aimed particularly at investment income could have the undesired side effect of inducing offsetting reductions in private saving and reducing incentives to invest in the economy. Such disincentive effects can be avoided by implementing fiscal action aimed at reducing or eliminating subsidies and by cutting back on government activity that can be performed better by the private sector.

14.46 The stance of monetary policy plays an important role in balance of payments adjustment. The existing external imbalance may reflect an excess of domestic investment over saving (or what is the same thing—an excess of domestic spending over income) that results from an excessively expansionary monetary policy. It is, first of all, important to adjust the stance of monetary policy so that interest rates are generally positive in real terms and provide an incentive to savers and so that domestic economic conditions are sufficiently stable to encourage investment. From the perspective of aggregate supply and demand, it can be seen from identity (5) that monetary policy should ensure that the level of domestic expenditure is in line with the productive capacity of the economy. Thus, from the point of view of balance of payments analysis, the objective of monetary and fiscal policies is to limit domestic spending to what is available from domestic resources and foreign financing.

14.47 One important aspect of monetary policy in balance of payments adjustment is the link between reserve asset transactions and domestic monetary conditions. A decline in reserve assets may be associated with a current account deficit or a net financial outflow caused by an expansionary monetary policy or both. The reserve asset decline can lead to a reduction in the monetary base and therefore to a tightening in the stance of monetary policy. A more restrictive monetary policy tends to correct the payments imbalance through higher interest rates that dampen domestic demand and make domestic assets more attractive to investors. However, this built-in adjustment mechanism

can be short-circuited if the monetary authorities offset the effect of the loss of reserve assets on the monetary base by increasing the domestic component of the base (e.g., through open-market purchases of securities held by the banking system). Such offsetting action tends to prevent domestic interest rates from rising and thereby contributes to the persistence of the balance of payments deficit.

## F. Implications of a Current Account Surplus

14.48 The foregoing discussion focuses entirely on an economy that faces an actual or incipient balance of payments problem in the form of a persistent current account deficit.<sup>10</sup> Of course, for the world as a whole, the current account deficits of economies in deficit are exactly offset by the surpluses of other economies. Although surpluses typically do not lead to crises in the countries that run them, an analysis of some aspects of a surplus balance of payments situation is useful as surpluses may raise important issues associated with domestic monetary management and vulnerabilities and the speed of adjustment toward more balanced external accounts. As can be seen from identity (13), a surplus in the current account is reflected in an increase in net claims held by the private sector or government (NKF) on nonresidents or an increase in official reserve assets (NRT), or both. The change in the net foreign asset position may be due to a reduction in liabilities to nonresidents rather than to an increase in gross claims. Such a reduction may well be a desirable development if a previous large buildup of liabilities has imposed a severe debt service burden on the economy. In this case, a current account surplus can be an appropriate step toward achieving a viable balance of payments.

14.49 The case of an economy with no recent current account deficits and an increase in its gross private claims on the rest of the world reflects an excess of aggregate saving over domestic investment. If the government's fiscal balance is in deficit, private sector saving will exceed domestic investment. The allocation

<sup>10</sup>In practice, owing to measurement problems, the sum of the balances of all economies was negative in many years because of measurement problems. For discussion of this issue, see IMF, *Report on the World Current Account Discrepancy*, September 1987, and Jean Godeaux, *Report on the Measurement of International Capital Flows*, September 1992. More recent data are available in most issues of the *Annual Report* of the IMF Committee on Balance of Payments Statistics.

of part of saving to foreign assets presumably reflects the fact that investors find the rate of return on these assets more attractive, at the margin, than investment opportunities in the domestic economy. The provision of resources to the rest of the world in the form of a buildup of net claims on nonresidents will, by and large, result in an efficient allocation of the domestic economy's saving as long as the buildup of net claims reflects the operation of market forces rather than government policies designed directly or indirectly to increase such claims.

14.50 Thus, for analyzing the balance of payments of an economy in persistent surplus, one key consideration is whether government policies distort saving and investment decisions and thereby bias an economy toward a current account surplus. Such distortions can take many forms. First, there are measures that directly influence the current account. Examples are tariffs and quotas that limit imports, restrictions on payments abroad, and export subsidies and government procurement policies that give preference to domestic producers. Moreover, an exchange market intervention policy may bias the value of the currency downward. Finally, there may be measures that limit foreign acquisition of domestic assets—a limitation that would tend to bias the financial account toward a net outflow and thereby shift the current account in the direction of a surplus.

14.51 These measures may, in fact, not lead to a larger current account surplus. Policy actions aimed at particular components of the balance of payments will, over time, lead to offsetting movements in other components in the absence of changes in the underlying determinants of saving and investment. In any event, if a large and persistent current account surplus appears to arise from such distortionary measures, the appropriate policy action is the reduction and eventual removal of these distortions. If a persistent surplus remains after such measures are eliminated, then the accumulation of net claims on the rest of the world would appear to manifest the saving and investment propensities of the economy. If, in this case, one were to identify the surplus as a problem, it would generally be necessary to establish that private saving or government saving was excessively high or that domestic investment was too low. It is considerably more difficult to arrive at such a conclusion than to identify the previously enumerated distortions that relate directly to international transactions.

14.52 A current account surplus, while reflecting entirely a response to market forces, may cause economic difficulties for an economy. For example, an

economy with a "resource curse" experiences either a natural resource discovery or a substantial improvement in the terms of trade for the natural resources sector. The expanding sector or terms of trade gains lead to an improvement in the current account and an appreciation of the exchange rate. This development tends to make other sectors of the economy contract and be less competitive internationally. If the newly discovered resources are expected to be depleted fairly rapidly and the gains in terms of trade to be transitory, it may be appropriate to protect the sectors adversely affected. One way to achieve this objective is through exchange market intervention to prevent or moderate the exchange rate appreciation. The accumulation of reserve assets or special funds tends to insulate the real economy from having to adjust to the short-run disturbance.

14.53 Current account surpluses may also create other difficulties in the domestic economy, such as difficulties in monetary management and increases in vulnerabilities associated with large and rapid monetary expansions. When a current account surplus causes an increase in reserve assets, the economy's monetary aggregates expand and a credit expansion will tend to take place. If this credit expansion is too large and rapid, the economy may overheat (leading to inflationary pressures) or vulnerabilities in the financial sector may emerge, particularly if there are weaknesses in financial sector supervision. Sterilization of the buildup in reserves—that is, offsetting its monetary impact through, typically, sales of domestic securities—can help mitigate this effect, but not forever, and often at significant cost. These costs typically arise because the domestic securities will carry a higher interest rate than the (usually low) rate received by the monetary authorities for their reserves. Moreover, if the currency were to appreciate in the future, the monetary authority would experience a decline in net worth, because the value of the reserves would fall relative to the value of the domestic securities used for the sterilization operations.

14.54 A conclusion of the preceding analysis is that, when a current account surplus is not the result of government policy actions, it may be difficult to establish that an economy is investing too much of its saving abroad and whether, therefore, specific policy changes are needed when a country is facing a current account surplus. Some guidance may be obtained, however, from the behavior of reserve assets. When a current account surplus is reflected in a buildup of foreign reserve assets rather than in a rise in net foreign

assets held by the private sector, the buildup represents specific government policy action in the form of foreign exchange market intervention. Intervention, which involves the sale of domestic currency in exchange for foreign currency, has the tendency to keep the foreign exchange value of the domestic currency lower than it otherwise would be. The accumulation of reserve assets may therefore limit the extent to which the currency appreciates and—particularly when accompanied by sterilization—prevent the operation of the self-correcting mechanism that would tend to reduce the current account surplus.

14.55 Thus, one aspect of balance of payments analysis for an economy with a persistent current account surplus involves an appraisal of the level of reserve assets held by monetary authorities. The accumulation of such assets is excessive if the assets exceed, by a wide margin, the amount required to finance possible future short-run deficits. In such a situation, the economy's resources may well be more efficiently used if devoted to domestic consumption or capital formation rather than exports. If the private and government sectors are unlikely to increase domestic capital formation, cessation of reserve asset accumulation would lead to an increase in domestic absorption or to a rise in net foreign investment by residents or both.<sup>11</sup> In either case, allocation of the economy's resources would tend to be more efficient as the allocation would be responding to market forces.

14.56 As in the case of an economy exhibiting a current account deficit, monetary, fiscal, and exchange rate policies have an important role in the adjustment of an economy with a current account surplus. In principle, the surplus could be reduced through expenditure-expanding policies (e.g., expansionary fiscal and monetary policies) or through expenditure-switching policies that would drive consumption toward foreign goods and away from domestic goods (e.g., a currency appreciation). Nevertheless, expansionary fiscal and monetary policies could have the unwanted implication of fueling the credit boom, which would cause increased inflationary pressures and possibly heighten credit-related vulnerabilities. A currency appreciation would, on the contrary, moderate the credit expansion by increasing consumers'

<sup>11</sup>Economies that are large exporters of nonrenewable resources, such as oil, may have limited domestic investment opportunities. In such cases, the buildup of foreign assets can be viewed not so much as an accumulation of reserve assets for balance of payments financing purposes but rather as a diversification of the economy's stock of wealth. Also, there may be a case for the accumulation of reserve assets in the instance of an economy subject to resource curse if the effects are expected to be transitory.

purchasing power in terms of foreign goods (which would drive demand toward the consumption of foreign goods), and by limiting the creation of new base money (because the monetary authority would be limiting its intervention in the foreign exchange market). Given that the currency appreciation would also make domestic goods less attractive abroad, a gradual appreciation process may be needed in order to achieve a smooth adjustment of the external accounts.

## G. The Balance Sheet Approach

### References:

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- J. Mathisen and A. Pellechio, *Using the Balance Sheet Approach in Surveillance: Framework, Data Sources, and Data Availability*, IMF Working Paper (WP/06/100).
- IMF and others, *External Debt Statistics: Guide for Compilers and Users*, Part III, Use of External Debt Statistics.

14.57 As financial markets in many economies have become increasingly integrated with global markets, foreign borrowing has helped finance higher levels of investment than would be possible with saving by residents alone and contributed to sustained periods of growth. But the opening of financial markets has revealed that private financial flows are sensitive to market conditions, perceived policy weaknesses, and negative shocks. Flows of private finance have been volatile with some economies experiencing financial crises.

14.58 The financial structure of economies—the composition and size of the liabilities and assets on the economy's financial balance sheet—has been an important source of vulnerability to crises. Financial weaknesses, such as a high level of short-term debt, can be a trigger for domestic and external investors to reassess their willingness to finance an economy. The composition of the IIP also helps indicate the vulnerability of the economy to changes in external market conditions. The implications for vulnerability differ among different functional categories and instruments. In the case of direct investment liabilities and portfolio investment equity, the return to the creditor depends on the performance of the issuer. In contrast, in the case of debt liabilities other than for direct investment, the return to the creditor is not

dependent on the performance of the debtor, so the economy of the debtor has a greater risk exposure, in that payments are required to be made even if the debtor faces difficult circumstances.

14.59 The balance sheet approach provides a systematic analytical framework for exploring how balance sheet weaknesses contribute to macrofinancial vulnerabilities, including the origin and propagation of modern-day financial crises. It draws on the growing body of academic work that emphasizes the importance of balance sheets. It pays particular attention to the balance sheets of key sectors of the economy and explores how weaknesses in one sector can cascade and ultimately generate a broader crisis. It is built on the use of harmonized classifications and definitions in different types of economic statistics, so that data can be aggregated and compared. For international accounts compilation, the balance sheet approach requires that institutional sector classifications and the level of detail should match those used for monetary, financial, and government finance statistics.

14.60 Unlike traditional analysis, which is based on the examination of flow variables (such as current account and fiscal balance), the balance sheet approach focuses on the examination of stock variables in an economy's sectoral balance sheets. The economy's aggregate balance sheet—the external assets and liabilities of all sectors of the economy—is vital. The net IIP at the end of a specific period reflects not only financial flows but also valuation changes and other adjustments during the period, all of which affect the current value of a country's total claims on nonresidents and total liabilities to nonresidents.

14.61 Indeed, as the financial assets and liabilities of domestic sectors cancel each other out, a country's balance sheet consists of its stock of domestic nonfinancial assets plus its net IIP. But the balance sheet approach emphasizes that it is often equally important to look inside an economy and to examine the balance sheet of an economy's key sectors, such as general government, the financial sector, and the nonfinancial corporations sector.

14.62 The sources of financial vulnerability are varied: creditors may lose confidence in an economy's ability to earn foreign exchange to service the external debt; in the government's ability to service its debt; in the banking system's ability to meet deposit outflows; or in corporations' ability to repay bank loans and other debt. An entire sector may be unable to attract new

financing or roll over existing short-term liabilities. It must then either find the resources to pay off its debts or seek a restructuring.

14.63 To support this analysis, the framework for assessing balance sheet risks focuses on five types of balance sheet mismatches, all of which help to determine an economy's ability to service debt in the face of shocks:

- (a) Maturity mismatches, where a gap between liabilities due in the short term and liquid assets leaves an institutional sector unable to honor its contractual commitments if creditors decline to roll over debt. They also expose the sector to the risk that interest rates will rise;
- (b) Currency mismatches, where, if unhedged, a change in the exchange rate leads to a holding loss;
- (c) Financial structure problems, where a heavy reliance on debt rather than equity financing leaves a firm or bank less able to weather revenue shocks;
- (d) Solvency problems, where assets—including the present value of future revenue streams—are insufficient to cover liabilities, including contingent liabilities;<sup>12</sup> and
- (e) Dependency problems. IIP by partner economy (and also balance of payments by partner) can help identify overreliance on another economy, and hence potential vulnerability and contagion concerns.

Additional items on the currency composition and residual maturity of debt liabilities are designed to support analysis of these issues. Analysis should also take into account hedging strategy; for example, currency or interest rate exposure may be hedged, or unhedged financial derivatives exposure may imply much greater vulnerability to changes than the value of the derivatives suggests. Maturity mismatches, currency mismatches, and a poor financial structure all can contribute to solvency risk, but solvency risk can also arise from simply borrowing too much or from investing in low-yielding assets.

14.64 Composition of the IIP sheds light on the dynamics. For example, if assets are largely denomi-

nated in foreign currency and liabilities are largely denominated in domestic currency, a depreciation (an appreciation) of the domestic currency will have positive (negative) wealth effects. Currency depreciations (appreciations) usually have expansionary (contractionary) impact on production via the improvement of net exports and a contractionary (expansionary) impact on domestic consumption. The wealth effect associated with the currency composition of foreign assets and liabilities may dampen the impact of a depreciation (appreciation) on domestic consumption. On the contrary, when assets are denominated in the domestic currency and liabilities in a foreign currency the wealth effect associated with a currency change will reinforce the impact of a depreciation (appreciation) on domestic consumption.

14.65 Further, debts among residents that create internal balance sheet mismatches also generate vulnerability to an external balance of payments crisis. The transmission mechanism often works through the domestic banking system. For instance, broad concerns about the government's ability to service its debt, whether denominated in domestic or foreign currency, will quickly destabilize confidence in the banks holding this debt and may lead to a deposit run. Alternatively, a change in the exchange rate coupled with unhedged foreign exchange exposure in the nonfinancial corporations sector can undermine confidence in the banks that have lent to that sector. The run on the banking system can take the form of a withdrawal of cross-border lending by nonresident creditors, or the withdrawal of deposits by domestic residents. Indeed, if the latter results in an increased demand for foreign currency or other foreign assets by domestic residents, this could lead to financial outflows, loss of reserves, or a combination of both.

14.66 Many of the characteristics of a financial account crisis derive from the adjustment in portfolios that follows from an initial shock. Underlying weaknesses in balance sheets can linger for years without triggering a crisis. For example, a currency mismatch can be masked so long as continued financial inflows support the exchange rate. Consequently, the exact timing of a crisis is difficult to predict. However, should a shock undermine confidence, it can trigger a large and disorderly adjustment, as the initial shock reveals additional weaknesses and a broad range of investors, including local residents, seek to reduce their exposure to the economy. If these flows cannot be financed out of reserves, the relative price of foreign and domestic assets has to adjust.

<sup>12</sup>The interpretation of loan asset values is enhanced by taking into account additional information on fair values and nonperforming loans.

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# I Exceptional Financing Transactions

## A. Introduction

Reference:

IMF and others, *External Debt Statistics: Guide for Compilers and Users*, Chapter 8, Debt Reorganization.

A1.1 The identification of exceptional financing transactions is linked to an analytic construct rather than based on precise criteria. *Exceptional financing brings together financial arrangements made by the authorities (or by other sectors fostered by authorities) of an economy to meet balance of payments needs.* These transactions can be viewed as an alternative to the use of reserve assets, IMF credit, and loans to deal with payments imbalances, or in conjunction with such use. Exceptional financing is important for IMF operations, statistics, and member countries, as the use of IMF resources is subject to an analytical requirement of need, which—according to the Articles of Agreement of the IMF—is linked to a member's balance of payments, reserve position, or developments concerning reserves. Exceptional financing is presented in the "analytic" presentation of the balance of payments, such as published in the IMF's *Balance of Payments Statistics Yearbook*, with the relevant transactions reclassified from that shown in the standard components. The analytic presentation is discussed further in paragraphs 14.16-14.17.

A1.2 Determining the need helps to distinguish:

- (a) the above-the-line items (i.e., those that are deemed to be autonomous in the current, capital, and financial accounts and are undertaken for the sake of the transactions) and thus contribute to or result in an overall payments deficit or surplus, and
- (b) the below-the-line items (i.e., those considered to be accommodating or financing the deficit or surplus).

In essence, from the viewpoint of the authorities of the reporting economy, the below-the-line transactions reflect (a) the transactions undertaken for balance of payments needs that finance payments required to be made in the current recording period such as pre-determined debt service payments by the authorities as well as (b) other financial transactions undertaken by the authorities that are related to balance of payments needs (beyond those required) and impact on reserve assets in the current recording period, such as prepayments of debt, drawings on new loans, and receipt of cash transfers. Given that transactions in reserve assets and in IMF credit and loans are always considered as being undertaken to meet a balance of payments need, it is the other below-the-line transactions that are recorded under exceptional financing. There are no below-the-line entries under exceptional financing arising from the provision of financing nor for transactions other than those undertaken to meet balance of payments needs.

A1.3 This appendix provides guidance on distinguishing transactions in the standard presentation that are exceptional financing transactions. Such a distinction involves a degree of judgment. Examples include government-to-government grants provided for debt payment linked to balance of payments needs, and rescheduling or forgiveness of debt falling due in the current period. Also, in cases of arrears, "transactions" are recorded in exceptional financing but are not recorded in the standard presentation. Exceptional financing transactions are usually recorded in the appropriate accounts of the analytic presentation as credit entries below-the-line, with corresponding debit entries shown above-the-line. However, for transactions in arrears past due from previous periods, swaps of such debts (such as described in paragraph A1.9), or where debt is repaid or cancelled through transfers (such as described in paragraph A1.5), the two entries of these transactions are recorded below-the-line.



A1.4 The transactions identified as exceptional financing are presented below under the following sections:

- B. Transfers—such as debt forgiveness and other intergovernmental transfers, including transfers from international organizations;
- C. Direct or other equity investment—such as debt or equity swaps involving debt reduction;
- D. Borrowing (including bond issues) for balance of payments support by the government or central bank, or by other sectors of the economy and induced by the authorities, usually through some form of exchange rate or interest subsidy;
- E. Debt rescheduling or refinancing;
- E Debt prepayment and buybacks; and
- G. Accumulation and repayment of arrears.

Some of these cases involve debt reorganization that is covered in detail in Appendix 2, Debt Reorganization and Related Transactions. Table A1.1 presents selected exceptional financing transactions in the analytic and standard presentation of the balance of payments.

## B. Transfers

### I. Debt forgiveness

A1.5 Debt forgiveness is defined as the voluntary cancellation of all or part of a debt obligation within a contractual arrangement between a creditor and a debtor (*External Debt Statistics: Guide for Compilers and Users*). Debt forgiveness is recorded as a capital transfer (see paragraph 13.23) from the creditor economy to the debtor economy, offset by a reduction in the liability of the debtor (reduction in the asset of the creditor) under the appropriate debt instrument in the financial account, with any interest accruing in current period recorded in the income account.

A1.6 In the analytic presentation, for the debtor economy, the recording of debt forgiveness depends on whether the debt being forgiven is due for payment in the current reporting period, in arrears, or not yet due (Table A1.1, rows 1-6). Forgiveness of obligations due in the current period is recorded as transfers, debt forgiveness (credit item) below-the-line, whereas the reduction of the obligations (debit item) is shown above-the-line. For forgiveness on obligations past due from previous periods, that is, on arrears, the two entries are recorded below-the-line in exceptional

financing,<sup>1</sup> that is, credit (under debt forgiveness) and debit items (under cancellation of arrears). If the obligations not yet due are forgiven, there is no entry under exceptional financing, because these payments were not required to be made in the current period, and the two entries are made above the line.

### 2. Other intergovernmental transfers

A1.7 Other transfers included within exceptional financing are grants in the form of cash from governments and international organizations (including the IMF and the World Bank) to the recipient economy. To the extent that the cash is provided for the purpose of financing a balance of payments need in the recipient country, the grant received (credit item) will be recorded in the analytic presentation as exceptional financing,<sup>2</sup> with a corresponding debit entry under reserve assets (Table A1.1, row 7). An example of other intergovernmental transfers is cash grants from donor governments or multilateral financial institutions to the debtor economy to be used to repay debt and grants to finance a current account need.

A1.8 Only the initial transaction associated with the grant is relevant for exceptional financing. If the proceeds of the grant are used for scheduled debt service payments, no exceptional financing transactions for the debt transactions are recorded. The same applies if the grant is directly used to make advance repayments of debt for balance of payments needs, such as a debt buyback. However, it should be noted that if an advance repayment is made out of reserve assets, an exceptional financing will be recorded for the debt transaction (see Section C).

### C. Debt-for-Equity Swap

A1.9 Exceptional financing transactions related to equity investment involve the exchange, usually at a discount, of debt instruments of an economy for non-resident investors' equity investments in the economy (see paragraphs A2.29-A2.37). Generally, such arrangements result in the extinction (debit item) of a

<sup>1</sup>These entries for arrears arise for two reasons: First, if arrears are repaid from reserves, a credit entry under reserves is recorded below-the-line (see Section D); not recording the "repayment of arrears" through debt forgiveness would create an asymmetry of approach. Second, the accumulation of arrears resulting from balance of payments difficulties is recorded as a credit item in the period in which they arise. The repayment recorded as a debit item ensures intertemporal consistency.

<sup>2</sup>Any interest accruing from the proceeds of the grant should be recorded by the debtor economy as a credit in the income account.

fixed-payment liability, a debt security, or loan (usually denominated in foreign currency), to be recorded under the appropriate instrument, and the creation (credit item) of an equity liability (denominated in domestic currency) to a nonresident, to be recorded under direct or portfolio investment as relevant. These cases include exchanges of a bank loan, or a liability of an enterprise, for equity, or the resident central bank redeeming the outstanding debt owed to a nonresident, at a discount and in local currency (credit item), with the nonresident reinvesting the proceeds as equity in the enterprise.

A1.10 For debt exchanged directly for equity investment in the debtor economy, credit entries should be made under direct investment-equity, if the investor (equity holder) directly holds equity that entitles it to 10 percent or more of the voting power in the direct investment enterprise; otherwise, the equity claim should be recorded under portfolio investment-equity. These transactions should be recorded at the value of the equity acquired, with offsetting debit entries made under the appropriate debt instrument for the reduction in liabilities.

A1.11 For indirect debt-for-equity swaps whereby debt is exchanged, first for a local currency claim (deposit) that is in turn exchanged for equity liability of the debtor, transactions in the balance of payments are recorded for both the initial exchange—debt for deposit at the value of the deposit—and the exchange of deposits for equity. In the IIP, equity liabilities (either direct or portfolio) increase and debt liabilities decrease by the value of the instrument extinguished.

A1.12 In the analytic presentation, only the initial transaction associated with the debt-for-equity swap is relevant. As with debt forgiveness, the recording of the exchange of claims (either debt for equity, or debt for a local currency claim) depends on whether the debt being exchanged is due for payment in the current reporting period, in arrears, or not yet due (Table A1.1, rows 8-16). Swaps of obligations that fall due in the current recording period are recorded under equity (credit item) below-the-line under exceptional financing, with debt repayment (debit item) recorded above-the-line. For arrears swapped, equity (credit item) and repayment of arrears (debit item) are both recorded below-the-line. For debt exchanged that is not yet due, there is no recording under exceptional financing, the two entries being made above-the-line.

A1.13 All transactions should be valued at the market price of the new claim received. If there is a difference in the value between the old and new claims, this

is recorded as a valuation adjustment in the revaluation account rather than as a transaction, except when non-marketable debt owed to official creditors is involved, in which instance any reduction in the value of the old debt is recorded as debt forgiveness (capital transfer).

## D. Borrowing for Balance of Payments Support

A1.14 In the analytic presentation, borrowing (including bond issues) by or on behalf of the authorities to meet balance of payments needs is recorded (credit item) below-the-line under exceptional financing. Subsequent debt payments as scheduled are recorded above-the-line (Table A1.1, rows 17-18). However, advance repayments for balance of payments needs financed from reserve assets are recorded as exceptional financing (debit item), so both the reserve and debt transactions are recorded below-the-line (see also Section E).

A1.15 Regarding short-term borrowing for balance of payments support, only the initial drawing of a loan and any subsequent increases in the amount borrowed need be recorded below-the-line. In other words, a new borrowing is not recorded each time the same amount borrowed under a short-term loan is "rolled-over" and not repaid at the maturity (the debit and credit entries for the loan in such circumstances will cancel each other; see paragraph 3.115). If there is repayment of the borrowing (even partial repayment) this amount is recorded above-the-line (unless it is an advance repayment under the conditions described above). If the loan is rolled over for a number of periods, a judgment should be made as to whether the continual renewal of the amount borrowed represents exceptional financing in that the balance of payments circumstances are such that the debtor is unable to repay the loan (see paragraph A1.2, point (a)).

## E. Debt Rescheduling or Refinancing

A1.16 Debt rescheduling or refinancing involves a change in an existing debt contract and replacement by a new debt contract, generally with extended debt service payments. Thus, payments are recorded as paid on the old debt and a new debt is recorded. *Debt rescheduling refers to the formal deferment of debt service payments and the application of new and generally extended maturities to the deferred amounts. Debt refinancing refers to the replacement of an existing debt instrument or instruments including any arrears, with a new debt*

*instrument or instruments.* If, under a rescheduling, the government assumes the debt of banks or other sectors of the economy, the sector classification of the debtor will change (as described in paragraph 8.45).

A1.17 In the analytic presentation, the recording of debt rescheduling and refinancing, as with debt forgiveness, depends on whether the debt being rescheduled or refinanced is due for payment in the current reporting period, in arrears, or not yet due (Table A1.1, rows 19-30). Rescheduling or refinancing of debt falling due in the current recording period is recorded below-the-line as a debt transaction (credit item) under exceptional financing, and the offsetting debit entry is recorded above-the-line. For arrears rescheduled or refinanced, both the arrears on the old debt (debit item) and the rescheduling of arrears (credit item) are recorded below-the-line. For rescheduling or refinancing of obligations not yet due, there is no recording under exceptional financing, both entries being above-the-line under the relevant debt instruments.

A1.18 All transactions should be valued at the market price of the new claim received.<sup>3</sup> If there is a difference in the value between the old and new claim, this is recorded as a valuation adjustment in the revaluation account rather than as a transaction (e.g., a capital transfer), except when nonmarketable debt owed to official creditors is involved, in which instance any reduction in the nominal value of debt is recorded as debt forgiveness. Where there is no established market price for the new claim, an appropriate proxy is used (see Appendix 2, Debt Reorganization and Related Transactions).

## F. Debt Prepayment and Debt Buyback

A1.19 Debt prepayments consist of a repurchase, or early payment, of debt at conditions that are agreed between the debtor and the creditor; that is, debt is extinguished in return for a cash payment agreed between the debtor and the creditor. When a discount is involved relative to the nominal value of the debt, prepayments are referred to as "buybacks."

A1.20 In the analytic presentation, debt prepayment transactions are recorded as exceptional financing only if they are financed from reserve assets to meet balance of payment needs of the debtor economy (Table A1.1, rows

31-33). In this case, debit entries<sup>4</sup> are recorded below-the-line in the appropriate instrument in exceptional financing with offsetting credit entries in reserve assets also below-the-line. If the prepayment was financed from external donor funds that are placed in the debtor's reserve assets, the debtor economy records all transactions below-the-line in the analytic presentation (Table A1.1, row 31). In the IIP of the debtor economy, reserve assets increase when donor funds are received and decline, along with debt liabilities, when the prepayment takes place. Prepayments of debt using the debtor's own financial assets other than reserve assets are recorded above-the-line in the appropriate accounts (Table A1.1, row 33).

## G. Accumulation and Repayment of Debt Arrears

### I. Accumulation of arrears—current period

A1.21 Debt arrears arise when amounts are past due for payment and are unpaid. If the contract remains unchanged, in the standard presentation, no transactions will be recorded. Debt arrears (both interest accrued and principal) remain in the outstanding amount of the debt instrument for which payments have been missed until the liability is extinguished (see paragraph 3.56).<sup>5</sup> Nonetheless, debt arrears are an arrangement recorded in exceptional financing.

A1.22 In the analytic presentation, arrears are included because this presentation is focused on the actions of the monetary authorities to meet balance of payments needs, and accumulating arrears is an action the monetary authorities can take for this purpose. Arrears in the current period resulting from balance of payments difficulties—that is, arrears resulting from the inability of the authorities to provide foreign exchange (and not from the inability of the original debtor to provide national currency)—are recorded below-the-line as accumulation of arrears (credit) within exceptional financing, as de facto the creditor is financing the payments the debtor was required to make. The contra debit entries to the arrears are recorded in the reporting period above-the-line under the appropriate accounts, that is, accrued interest under the appropriate debt instrument in income in the current

<sup>4</sup>The debit entry is recorded below-the-line because the repayment of the debt instrument affects the level of reserve assets in the reporting period.

<sup>5</sup>If the original contract provided for a change in the characteristics of a financial instrument when it goes into arrears, this change should be recorded as a reclassification in the other change in volume of assets account.

<sup>3</sup>For analytical purposes, supplementary data could be provided on the nominal value of the debt being extinguished.

Table A 1.1. Balance of Payments Accounting for Selected Exceptional Financing Transactions<sup>1</sup>

Type of Transaction <sup>2</sup>	Anal/tic		Standard	
	Credit	Debit	Credit	Debit
<b>A. 1. Transfers—debt forgiveness</b>				
<i>Payments falling due in the current recording period</i>				
1 Interest	Exceptional financing	<i>Investment income, other investment</i>	<i>Capital transfères, debt forgiveness</i>	<i>Investment income, other investment</i>
2 Interest accrued previous period	Exceptional financing	<i>Other investment, liabilities, loans</i>	<i>Capital transfères, debt forgiveness</i>	<i>Other investment liabilities, loans</i>
3 Principal	Exceptional financing	<i>Other investment, liabilities, loans</i>	<i>Capital transfères, debt forgiveness</i>	<i>Other investment, liabilities, loans</i>
<i>Payments in arrears</i>				
4 Interest	Exceptional financing	Exceptional financing	<i>Capital transfères, debt forgiveness</i>	<i>Other investment liabilities, loans</i>
5 Principal	Exceptional financing	Exceptional financing	<i>Capital transfères, debt forgiveness</i>	<i>Other investment, liabilities, loans</i>
<i>Payments not yet due in the current recording period</i>				
6 Principal	<i>Capital transfères, debt forgiveness</i>	<i>Other investment, liabilities, loans</i>	<i>Capital transfères, debt forgiveness</i>	<i>Other investment liabilities, loans</i>
<b>A.2. Transfers—other intergovernmental grants<sup>3</sup></b>				
7	Exceptional financing	<i>Reserve assets</i>	<i>Current/Capital transfères</i>	<i>Reserve assets</i>
<b>B. Debt/equity swaps</b>				
<b>B. 1. Direct swaps</b>				
<i>Payments falling due in the current recording period<sup>4</sup></i>				
8 Principal	Exceptional financing	<i>Other investment, liabilities, loans</i>	<i>Direct investment-equity</i>	<i>Other investment liabilities, loans</i>
<i>Payments in arrears*</i>				
9 Interest	Exceptional financing	Exceptional financing	<i>Direct investment-equity</i>	<i>Other investment, liabilities, loans</i>
10 Principal	Exceptional financing	Exceptional financing	<i>Direct investment-equity</i>	<i>Other investment, liabilities, loans</i>
<i>Payments not yet due<sup>4</sup></i>				
11 Principal	<i>Direct investment-equity</i>	<i>Other investment, liabilities, loans</i>	<i>Direct investment-equity</i>	<i>Other investment liabilities, loans</i>
<b>B.2. Indirect swaps</b>				
<i>Exchange of a fixed-payment liability denominated in foreign currency for a deposit liability denominated in domestic currency<sup>5</sup></i>				
<i>Payments falling due in the current recording period<sup>4</sup></i>				
12 Principal	Exceptional financing	<i>Other investment, liabilities, loans</i>	<i>Other investment, liabilities, currency and deposits</i>	<i>Other investment, liabilities, loans</i>
<i>Payments in arrears<sup>4</sup></i>				
13 Interest	Exceptional financing	Exceptional financing	<i>Other investment, liabilities, currency and deposits</i>	<i>Other investment, liabilities, loans</i>
14 Principal	Exceptional financing	Exceptional financing	<i>Other investment liabilities, currency and deposits</i>	<i>Other investment, liabilities, loans</i>

## BALANCE OF PAYMENTS AND INTERNATIONAL INVESTMENT POSITION MANUAL

**Table A 1.1** (continued)

Type of Transaction <sup>2</sup>	Analytic		Standard	
	Credit	Debit	Credit	Debit
<i>Payments not yet due<sup>4</sup></i>				
15 Principal	<i>Other investment liabilities, currency and deposits</i>	<i>Other investment, liabilities, loans</i>	<i>Other investment, liabilities, currency and deposits</i>	<i>Other investment, liabilities, loans</i>
<i>Subsequent exchange of a deposit liability denominated in domestic currency for equity investment</i>				
16 Principal	<i>Direct investment-equity</i>	<i>Other investment, liabilities, currency and deposits</i>	<i>Direct investment-equity</i>	<i>Other investment, liabilities, currency and deposits</i>
<b>C. Borrowing for balance of payments support<sup>6</sup></b>				
17 Drawing on new loans	Exceptional financing	<i>Reserve assets</i>	<i>Other investment, liabilities loans</i>	<i>Reserve assets</i>
18 Bond issues	Exceptional financing	<i>Reserve assets</i>	<i>Portfolio investment, liabilities, debt securities</i>	<i>Reserve assets</i>
<b>D. Debt rescheduling/refinancing</b>				
<b>D.1 Debt rescheduling</b>				
<i>Payments falling due in the current recording period</i>				
19 Interest	Exceptional financing	<i>Investment income, other investment</i>	<i>Other investment, liabilities, loans</i>	<i>Investment income, other investment</i>
20 Interest accrued previous period	Exceptional financing	<i>Other investment, liabilities, loans</i>	<i>Other investment, liabilities, loans</i>	<i>Other investment, liabilities, loans</i>
21 Principal	Exceptional financing	<i>Other investment, liabilities loans</i>	<i>Other investment, liabilities, loans</i>	<i>Other investment, liabilities, loans</i>
22 Capitalization of moratorium interest (interest as it falls due) <sup>7</sup>	Exceptional financing	<i>Investment income, other investment</i>	<i>Other investment, liabilities, loans</i>	<i>Investment income, other investment</i>
<i>Payments in arrears</i>				
23 Interest	Exceptional financing	Exceptional financing	<i>Other investment, liabilities, loans</i>	<i>Other investment, liabilities, loans</i>
24 Principal	Exceptional financing	Exceptional financing	<i>Other investment, liabilities, loans</i>	<i>Other investment, liabilities, loans</i>
<i>Payments not yet due in the current recording period</i>				
25 Principal	<i>Other investment, liabilities, loans</i>	<i>Other investment, liabilities, loans</i>	<i>Other investment, liabilities, loans</i>	<i>Other investment, liabilities, loans</i>
<b>D.2. Debt refinancing—loan/bond swap</b>				
<i>Payments falling due in the current recording period<sup>1</sup></i>				
26 Interest	Exceptional financing	<i>Other investment, liabilities, loans</i>	<i>Portfolio investment, liabilities, debt securities</i>	<i>Other investment, liabilities, loans</i>
27 Principal	Exceptional financing	<i>Other investment, liabilities, loans</i>	<i>Portfolio investment, liabilities, debt securities</i>	<i>Other investment, liabilities, loans</i>
<i>Payments in arrears<sup>8</sup></i>				
28 Interest	Exceptional financing	Exceptional financing	<i>Portfolio investment, liabilities, debt securities</i>	<i>Other investment, liabilities, loans</i>
29 Principal	Exceptional financing	Exceptional financing	<i>Portfolio investment, liabilities, debt securities</i>	<i>Other investment, liabilities, loans</i>
<i>Payments not yet due</i>				
30 Principal	<i>Portfolio investment, liabilities, debt securities</i>	<i>Other investment, liabilities, loans</i>	<i>Portfolio investment, liabilities, debt securities</i>	<i>Other investment, liabilities, loans</i>

Table A.1.1 (concluded)

Type of Transaction <sup>2</sup>	Anal/tic		Standard	
	Credit	Debit	Credit	Debit
<b>E. Debt prepayment and buyback</b>				
<i>Payments not yet due in the current recording period</i>				
31 Receipt of donor funds	Exceptional financing	Reserve assets	Capital transfères	Reserve assets
32 Principal	Reserve assets	Exceptional financing	Reserve assets	Other investment, liabilities, loans
33 Principal (using debtor financial assets other than reserve assets)	Other investment, assets, currency and deposits	Other investment, liabilities, loans	Other investment, assets, currency and deposits	Other investment, liabilities, loans
<b>F. Accumulation/repayment of arrears</b>				
<b>F.1. Accumulation of arrears</b>				
34 Interest accrued in the current period	Exceptional financing	Investment income, other investment	Other investment, liabilities, loans	Investment income, other investment
35 Interest accrued previous period	Exceptional financing	Other investment, liabilities, loans	No transaction	No transaction
36 Principal due and not paid	Exceptional financing	Other investment, liabilities, loans	No transaction	No transaction
<b>F.2. Repayment of arrears<sup>9</sup></b>				
37 Interest	Reserve assets	Exceptional financing	Reserve assets	Other investment, liabilities, loans
38 Principal	Reserve assets	Exceptional financing	Reserve assets	Other investment, liabilities, loans
<b>G. Debt-for-development swaps<sup>10</sup></b>				
<i>Payments falling due in the current recording period</i>				
39 Interest	Exceptional financing	Investment income, other investment	Other investment, liabilities, currency and deposits	Investment income, other investment
40 Principal	Exceptional financing	Other investment, liabilities, loans	Other investment, liabilities, currency and deposits	Other investment, liabilities, loans
<i>Payments in arrears</i>				
41 Principal	Exceptional financing	Exceptional financing	Other investment, liabilities, currency and deposits	Other investment, liabilities, loans
<i>Payments not yet due in the current recording period</i>				
42 Principal	Other investment, liabilities, currency and deposits	Other investment, liabilities, loans	Other investment, liabilities, currency and deposits	Other investment, liabilities, loans
43 Subsequent use of debt/development swap funds in the debtor economy	Capital transfères	Other investment, liabilities, currency and deposits	Capital transfères	Other investment, liabilities, currency and deposits

<sup>1</sup> For debt rescheduled or refinanced, swapped into equity or bonds, or canceled before maturity, the reduction in the liability should be attributed to the appropriate instrument in the financial account. In this table, it has been assumed that loans are the instrument.

<sup>2</sup> This presentation, for illustrative purposes, shows separate debit and credit entries for financial account items. In practice, because net recording is recommended for financial account items, entries affecting the same item will be offsetting and thus will not appear as separate entries in a balance of payments statement.

<sup>3</sup> Only intergovernmental grants received to finance balance of payments need. (Grants received from IMF subsidy accounts are included since such grants are considered exceptional financing transactions.)

<sup>4</sup> These payments are recorded by using the price at which the new claim on the debtor was acquired by the nonresident investor.

Initially the debtor country exchanges the liability denominated in a foreign currency for a liability denominated in domestic currency. The appropriate credit entry depends on the type of liability for which the liability that is denominated in foreign currency is exchanged for; in this table the liability is assumed to be a deposit.

<sup>5</sup> Borrowing (including bond issues) by authorities or other sectors on the authorities' behalf to finance balance of payments need.

<sup>7</sup> Only moratorium interest linked to balance of payments difficulties. Capitalization of moratorium interest when past due is treated as rescheduling of payment arrears.

<sup>8</sup> These payments are recorded at the value of the new claim received.

<sup>9</sup> Cash settlement only.

<sup>10</sup> Debt-for-development swaps are described in paragraphs A2.38–A2.40.

account, and other arrears (principal arrears, and interest arrears arising in the current period that accrued in earlier periods) under the appropriate debt instrument in the financial account (Table A1.1, rows 34-36).

## **2. Repayment of arrears**

A1.23 In the standard presentation, the repayment of debt arrears to meet a balance of payments need is

recorded as a debit entry under the appropriate debt instrument in the financial account and a corresponding credit entry under reserve assets. In the analytic presentation, repayment of arrears (through currency and deposits) is recorded below-the-line as a debit entry under repayment of arrears within exceptional financing, and a credit entry under reserve assets (Table A1.1, rows 37 and 38).

## Debt Reorganization and Related Transactions

### A. Debt Reorganization

Reference:

IMF and others, *External Debt Statistics: Guide for Compilers and Users*, Chapter 8, Debt Reorganization.

A2.1 This appendix discusses various forms of debt reorganization and related transactions, and how they are recorded in the balance of payments and the international investment position. References are made, where applicable, to exceptional financing when reorganization may arise to finance balance of payments needs, and to debt concessionality when reorganization may involve transfers to account for such concessionality. Table A1.1 in Appendix 1, Exceptional Financing Transactions, provides a summary presentation of the recording of debt reorganization in the standard and analytic presentations of the balance of payments.

A2.2 Debt reorganization (also referred to as debt restructuring) is defined as arrangements involving both the creditor and the debtor (and sometimes third parties) that alter the terms established for servicing an existing debt. Governments are often involved in debt reorganization, as a debtor, creditor or guarantor, but debt reorganization can also involve the private sector, such as through debt exchanges.

A2.3 Debt reorganization usually involves relief for the debtor from the original terms and conditions of debt obligations it has entered into. This may be in response to liquidity issues, where the debtor does not have the cash to meet looming debt service payments, or sustainability issues, where the debtor is unlikely to be able to meet its debt obligations in the medium term.

A2.4 A failure by a debtor economy to honor its debt obligations (default, unilateral moratorium, etc.) is not debt reorganization because it does not involve an arrangement between the creditor and the debtor. Such failure gives rise to arrears, which are also covered in this appendix. Similarly, a creditor can reduce

the value of its debt claims on the debtor in its own books through debt write-offs—unilateral actions that arise, for instance, when the creditor regards a claim as unrecoverable, perhaps because of bankruptcy of the debtor, and so no longer carries it on its books. Again, this is not debt reorganization as defined in *the Manual*.

A2.5 The four main types of debt reorganization are:

- (a) A reduction in the amount of, or the extinguishing of, a debt obligation by the creditor via a contractual arrangement with the debtor. This is *debt forgiveness*.
- (b) A change in the terms and conditions of the amount owed, which may result, or not, in a reduction in burden in present value terms.<sup>1</sup> Depending on the nature of the transaction undertaken, the reorganization is described as *debt rescheduling* or *refinancing* (or debt exchange).
- (c) The creditor exchanges the debt claim for something of economic value, other than another debt claim, on the same debtor. This includes *debt conversion*, such as debt-for-equity swaps, debt-for-real-estate swaps, debt-for-development swaps, and debt-for-nature swaps,<sup>2</sup> and *debt prepayment* (or *debt buybacks for cash*).
- (d) *Debt assumption and debt payments on behalf of others* when a third party is also involved.

<sup>1</sup>Also called "time value of money" or "discounted cash flow," present value is the value today of a future payment or stream of payments discounted at some appropriate compounded interest rate.

<sup>2</sup>Some agreements described as debt swaps are equivalent to debt forgiveness from the creditor and the debtor viewpoint. At the same time, there is a commitment from the debtor country to undertake a number of development, environment, etc., expenses. These transactions should be considered under debt forgiveness, because no value is provided to the creditor.



A2.6 A debt reorganization package may involve more than one of the types mentioned above; for example, most debt reorganization packages involving debt forgiveness also result in a rescheduling of the part of the debt that is not forgiven or cancelled.

## I. Debt forgiveness

### a. Definitions

**A2.7** *"Debt forgiveness" is defined as the voluntary cancellation of all or part of a debt obligation within a contractual arrangement between a creditor and a debtor.*<sup>3</sup> Debt forgiveness is distinguished from debt write-off by the agreement between the parties and the intention to convey a benefit, rather than unilateral recognition by the creditor that the amount is unlikely to be collected. Debt forgiveness is unlikely to arise between commercial entities. Debt forgiven may include all or part of the principal outstanding, inclusive of any accrued interest arrears (interest that fell due in the past) and any other interest costs that have accrued. Debt forgiveness does not arise from the cancellation of future interest payments that have not yet fallen due and have not yet accrued.

### b. Accounting for debt forgiveness

A2.8 In the balance of payments, debt forgiveness, as noted in paragraphs A1.5-A1.6, is recorded (at the time specified in the agreement that the debt forgiveness takes effect) in the standard presentation as a capital transfer receipt of the debtor economy (transfer payment of the creditor economy), with a repayment of the debtor's liability in the financial account (a receipt in the creditor's asset). (See Table A1.1, rows 6-11.) In the IIP, the debtor's liability and creditor's asset are reduced by the amount of debt that is forgiven. As to the value of the debt forgiveness, market prices are the basis of valuation for flows and stocks, except for loans where the nominal value is used.

A2.9 In the analytic presentation, the recording, or not, of debt forgiveness in exceptional financing (below-the-line) depends on whether the debt is due for payment in the current period, in arrears, or not yet due (Table A1.1, rows 1-6). Forgiveness of obligations due in the current period is recorded below-the-line as a credit item under debt forgiveness, whereas the

<sup>3</sup>This includes forgiveness of some or all of the principal amount of a credit-linked note arising from an event affecting the entity on which the embedded credit derivative was written, and forgiveness of principal that arises when a type of event contractually specified in the debt contract occurs, such as forgiveness in the event of a type of catastrophe.

reduction of the obligations is shown above-the-line as a debit item. For forgiveness in arrears from previous periods, a credit entry under debt forgiveness and a debit entry under cancellation of arrears are both recorded below-the-line under exceptional financing. If the obligations not yet due are forgiven, there are no entries under exceptional financing; all entries are above-the-line.

## 2. Debt rescheduling and refinancing

A2.10 Debt rescheduling and refinancing involve a change in an existing debt contract and replacement by a new debt contract, generally with extended debt service payments. Debt rescheduling involves rearrangements on the same type of instrument, with the same principal value and the same creditor as with the old debt. Refinancing entails a different debt instrument, generally at different value, and may be with a creditor different than that from the old debt.<sup>4</sup> For instance, a creditor may choose to apply the terms of a Paris Club agreement either through a debt rescheduling option (that is, changing the terms and conditions of its existing claims on the debtor) or through refinancing (making a new loan to the debtor that is used to repay the existing debt).

### a. Debt rescheduling

#### *Definition*

A2.11 *Debt rescheduling is a bilateral arrangement between the debtor and the creditor that constitutes a formal deferment of debt service payments and the application of new and generally extended maturities.* The new terms normally include one or more of the following elements: extending repayment periods, reductions in the contracted interest rate, adding or extending grace periods for the repayment of principal, fixing the exchange rate at favorable levels for foreign currency debt, and rescheduling the payment of arrears, if any. In the specific instance of zero coupon securities, a reduction in the principal amount to be paid at redemption to an amount that still exceeds the principal amount outstanding at the time the arrangement becomes effective could be classified as either an effective change in the

<sup>4</sup>From the debtor perspective, debt refinancing may involve borrowing from a third party to repay a creditor. The definition of debt refinancing in the *Manual* is a narrower concept reflecting transactions between the debtor and same creditor only. The transactions associated with borrowing from a third party for balance of payments support are set out in Section D, Borrowing for Balance of Payments Support, of Appendix 1, Exceptional Financing Transactions.

contractual rate of interest or a reduction in principal with the contractual rate unchanged. Such a reduction in the principal payment to be made at maturity should be recorded as debt forgiveness, or debt rescheduling if the bilateral agreement explicitly acknowledges a change in the contractual rate of interest. Under Paris Club arrangements, rescheduling can be characterized as "flow" or "stock" rescheduling. A flow rescheduling refers to a rescheduling of specified debt service falling due during a certain period and, in some cases, specified arrears outstanding at the beginning of that period.<sup>5</sup> A stock rescheduling refers to rescheduling the outstanding stock of debt at a particular point in time.

#### *Accounting for debt rescheduling*

A2.12 The balance of payments treatment for debt rescheduling is that the existing contract is extinguished and a new contract created. The applicable existing debt is recorded as being repaid and a new debt instrument (or instruments) created with the new terms and conditions. In the standard presentation for the debtor, a debit entry is recorded under the appropriate instrument representing the repayment of the old debt with a credit entry under the appropriate instrument representing the creation of a new debt (Table A1.1, rows 19-25). This treatment does not apply, however, to interest arrears that are being rescheduled when the conditions in the existing debt contract remain intact. In such a case, the existing debt contract is not considered to be rescheduled, only the interest arrears. The IIP reflects the transactions extinguishing the old debt instrument and creating the new instrument.

A2.13 The transaction is recorded at the time both parties record the change in terms in their books, and is valued at the value of the new debt (which, under a debt rescheduling, is the same value as that of the old debt). If no precise time is determined, the time at which the creditor records the change in terms in its books is decisive. If the rescheduling of obligations due beyond the current period is linked to the fulfillment of certain conditions by the time the obligations fall due (such as multiyear Paris Club rescheduling), entries are recorded in the balance of payments only in the period when the specified conditions are met.

A2.14 In the analytic presentation, as noted in Appendix 1, Exceptional Financing Transactions, the recording of debt rescheduling transactions in excep-

tional financing depends on whether the debt being rescheduled is due for payment in the current period, in arrears, or not yet due. Obligations falling due in the reporting period are recorded under exceptional financing (below-the-line as credit entries under the appropriate instruments), with debit entries made above-the-line under the appropriate debt instruments in the financial account and the income account (for accrued interest) (Table A1.1, rows 19-22). For arrears, the two entries are under exceptional financing, that is, below-the-line, with credit items (under the relevant instrument) and debit items (under rescheduling of arrears) (Table A1.1, rows 23-24). For obligations not yet due, both debit and credit entries are recorded above-the-line under the appropriate instruments in the financial account (Table A1.1, row 25).

#### **b. Debt refinancing**

##### *Definition*

**A215** *Debt refinancing involves the replacement of an existing debt instrument or instruments, including any arrears, with a new debt instrument or instruments. It can involve the exchange of the same type of debt instrument (loan for a loan) or different types of debt instruments (loan for a bond). For instance, the public sector may convert various export credit debts into a single loan. Also, debt refinancing can be said to have taken place when a debtor exchanges existing bonds for new bonds through exchange offers given by its creditor (rather than a change in terms and conditions). So debt refinancing can occur irrespective of whether the debtor is experiencing balance of payments difficulties or not.*

##### *Accounting for debt refinancing*

A2.16 The balance of payments treatment of debt refinancing transactions is similar to debt rescheduling to the extent that the debt being refinanced is extinguished and replaced with a new financial instrument or instruments. However, unlike in rescheduling, the old debt is extinguished at the value of the new debt instrument except for nonmarketable debt owed to official creditors.

A2.17 If the refinancing involves direct debt exchange, such as a loan-for-bond swap, in the standard presentation, debit entries are recorded by the debtor under the appropriate debt instrument in the financial account and the income account (for accrued interest) and a credit entry under portfolio investment liabilities to show the creation of the new obligation (Table A1.1, rows 26-30). The transaction is valued at the value of

<sup>5</sup>In the balance of payments, if the debt falling due during the period is rescheduled, the transaction is treated the same as the rescheduling of a debt stock.

the new debt with the difference between the value of the old debt and that of the new instrument recorded in the revaluation account. However, if the debt is owed to official creditors and is nonmarketable (loan), the old debt is extinguished at its original value with the difference in value with the new instrument recorded as debt forgiveness.

A2.18 Where there is no established market price for the new bond, an appropriate proxy is used. For example, if the bond is similar to other bonds being traded, the market price of a traded bond would be an appropriate proxy for the value of the new bond. If the debt being swapped was recently acquired by the creditor, the acquisition price would be an appropriate proxy. Alternatively, if the interest rate on the new bond is below the prevailing interest rate, the discounted value of the bond, using the prevailing interest rate, could serve as a proxy. If such information is not available, the face value of the bond being issued may be used as a proxy. See also debt-for-equity conversion below.

A2.19 The IIP reflects the transactions extinguishing the old debt instrument and creating the new debt instrument along with any valuation change recorded in the revaluation account. For instance, a loan-for-bond exchange undertaken will generally result in a reduction in the liabilities of the debtor (reduction in the claim of the creditor on the debtor economy) because the loan is recorded at nominal value versus the market value of the bond.

A2.20 In the analytic presentation, debt-for-bond exchange of obligations falling due in the reporting period are recorded below-the-line as credit entries under the appropriate instruments in exceptional financing, with debit entries made above-the-line under the appropriate debt instruments in the financial account and the income account (for accrued interest) (Table A1.1, rows 26-27). For arrears refinanced, there are offsetting credit (under the relevant instrument) and debit items (under rescheduling of arrears) under exceptional financing. For obligations not yet due, both debit and credit entries are recorded above-the-line under the appropriate instruments in the financial account (Table A1.1, row 30). When arrears are cancelled as a result of a debt-for-debt exchange, the two entries are below-the-line: a debit entry under cancellation of arrears (under the relevant debt instrument in the standard presentation) and a credit item under debt forgiveness (Table A1.1, rows 28-29).

A2.21 If the proceeds of the new debt are used to partially pay off existing debt, any remaining debt is recorded as the extinguishment of the old debt and

creation of a new debt, unless it is paid off through a separate transaction.

A2.22 If the terms of any new borrowings are concessional, the creditor could be seen as providing a transfer to the debtor. Debt concessionality is discussed below.

### 3. Debt conversion and debt prepayment

#### a. Definitions

A2.23 *Debt conversion (swap) is an exchange of debt—typically at a discount—for a nondebt claim such as equity, or for counterpart funds that can be used to finance a particular project or policy.* Typically, debt conversion involves an exchange of external debt in foreign currency for a nondebt obligation in domestic currency, at a discount. Debt for equity, debt for exports, debt for nature, and debt for development swaps are all examples of debt conversion. In essence, external debt is extinguished and a nondebt liability created.

A2.24 A debt-for-equity swap results in reduced debt liability and an increase in equity liability of the debtor economy. A third party, usually a nongovernmental organization (NGO) or a corporation, is often involved in a debt-for-equity swap, buying the claims from the foreign creditor and receiving shares in a corporation or local currency (to be used for equity investment) from the debtor economy.

A2.25 Other types of debt swaps, such as external debt obligations for exports (debt for exports) or external debt obligations for counterpart assets that are provided by the debtor to the creditor for a specified purpose, such as wildlife protection, health, education, and environmental conservation (debt for sustainable development) are also debt conversions.

A2.26 It is important to distinguish direct and indirect debt conversion, that is, whether the swap leads directly to the acquisition of a nondebt claim on the debtor, or indirectly via another claim on the economy, such as a deposit that is subsequently used to purchase equity.

#### b. Accounting for debt conversion

A2.27 Where debt is exchanged for another item (e.g., equity or counterpart funds for development purposes), the transaction is recorded at the time both parties record the exchange of value in their books. The general principle is for the old debt to be valued at the value of the item acquired (converted at the pre-

vailing market exchange rate if the item is in foreign currency). Any difference between the value of the debt being extinguished and the corresponding claim or funds provided is recorded as a valuation adjustment in the revaluation account. An exception arises when official creditors are owed nonmarketable debt, and the counterpart claim (assets) has a lower value than the debt, in which case the transaction in the old debt is recorded at its full value and any difference in value between the debt and counterpart item (or assets) is recorded as debt forgiveness, a capital transfer. With debt-for-development swaps, the transactions recorded should be based on the type of debt obligation forgiven rather than the subsequent use of the funds.

A2.28 Debt-for-equity and debt-for-development swaps are the most commonly used debt conversion arrangements.

c. *Debt-for-equity swaps*

***Direct debt conversion***

A2.29 For debt exchanged directly for equity investment in the debtor economy, credit entries should be made under direct investment-equity, or portfolio investment-equity. These transactions should be recorded at the value of the equity acquired, with offsetting debit entries made under the appropriate debt instrument for the reduction in liabilities. The treatment of transactions recorded depends on whether the debt being swapped is due for payment in the current period, is in arrears, or is not yet due (Table A1.1, rows 8-11).

***Debt due for payment in the current period***

A2.30 In the standard presentation, for a debt-for-equity swap there are debit entries under the relevant instrument, such as other investment liabilities, and the income account (for accrued interest) for all payments falling due in the current period. The value of the repayment of the old debt is equal to the market value of the equity liability being swapped, with the contra-entry credit recorded in direct investment-equity, or portfolio investment-equity. If the market value of the new liability is lower than the value of the old debt, a valuation adjustment is recorded under the relevant instrument, such as loan liabilities in the revaluation account (see also paragraph A1.13).

A2.31 In the analytic presentation, the debit entries are recorded above-the-line and the contra-entry credit is recorded below-the-line under direct investment or portfolio investment-equity.

***Debt in arrears***

A2.32 In the standard presentation, debt-for-equity swaps for arrears are recorded as a debit entry under the relevant instrument in the financial account, at the value of the equity liabilities being provided, with the contra-entry credit in direct investment-equity or portfolio investment-equity. In the analytic presentation, a debit entry is recorded in exceptional financing under cancellation of arrears, with the offsetting credit entry also recorded in exceptional financing under direct investment-equity or portfolio investment-equity.

***Debt due for payment in the future***

A2.33 In the standard presentation, debit entries arising from debt-for-equity swap operations for debt due for payment in the future and exchanged at a price below nominal value are recorded as a debit entry in the respective accounts at the value of the equity liabilities being provided with the contra-entry credit in direct investment-equity, if the direct investor (equity holder) directly holds equity that entitles it to 10 percent or more of the voting power in the direct investment enterprise; otherwise, the equity claim should be recorded under portfolio investment-equity. If the market value of the new liability is lower than the value of the old debt, a valuation adjustment is recorded under the relevant instrument, such as loan liabilities in the revaluation account (see also paragraph A1.13). In the analytic presentation, all entries are made above-the-line as in the standard presentation.

A2.34 In all cases, in the IIP, equity liabilities (either direct or portfolio) increase and debt liabilities decrease by the value of the instrument extinguished.

***Indirect debt conversion***

A2.35 A debt-for-equity swap may also involve indirect conversion. An example is when a fixed-payment foreign currency liability (e.g., a debt security or loan) is exchanged at a discount for a domestic financial instrument, such as a domestic currency deposit. The proceeds are then reinvested by the nonresident into the equity of the debtor. These swaps are valued at market prices in the balance of payments.

A2.36 In the standard presentation, this transaction is recorded by the debtor as an increase in liabilities (credit) under the financial instrument provided, with corresponding debit entries under the instrument (liability) being extinguished (Table A1.1, rows 12-16). Subsequently, the nonresident creditor exchanges the

financial instrument received for equity investment in an enterprise of the debtor economy. At this point, a credit entry is recorded under direct investment-equity, if the direct investor (equity holder) directly holds equity that entitles it to 10 percent or more of the voting power in the direct investment enterprise; otherwise, the equity claim should be recorded under portfolio investment-equity. The offsetting debit entry is made under the relevant instrument being exchanged for the equity, such as currency and deposits. In the IIP, equity liabilities (either direct or portfolio) increase and debt liabilities decrease by the value of the instrument extinguished.

A2.37 In the analytic presentation, the treatment is the same as described for direct debt conversion except that only the initial transaction is relevant, so the credit entry is recorded under the relevant financial instrument provided, rather than equity.

d. *Debt-for-development swaps*

A2.38 A debt-for-development swap involves the exchange at a discount of an existing liability (e.g., a debt security or loan) for a claim (such as a domestic deposit) earmarked for a specific development purpose in the debtor economy. For example, an NGO purchases debt from the original creditor at a substantial discount using its own foreign currency resources, and then resells it to the debtor country government for local currency equivalent. The NGO in turn spends the money on a development project, previously agreed on with the debtor country government.

A2.39 In the standard presentation, the debtor economy records the transaction only with the creditor (such as an NGO). The debtor records an increase in liabilities (credit) under the appropriate debt instrument provided to the creditor, with an offsetting debit entry recorded under the appropriate debt instrument being extinguished (Table A1.1, rows 39-43). In the IIP, liabilities decline by the value of the debt extinguished and increase by the value of the other claim provided that it is still outstanding at the end of the period.

A2.40 If a debt-for-development swap is undertaken to meet a balance of payments need, only the initial transaction with the creditor is relevant for the analytic presentation. Subsequent use by the creditor of the assets acquired for development in the debtor economy is not exceptional financing—the credit items are recorded as capital transfers (Table A1.1, row 43).

e. *Debt prepayment*

**Definitions**

**A2.41** *Debt prepayments consist of a repurchase, or early payment, of debt at conditions that are agreed between the debtor and the creditor; that is, debt is extinguished in return for a cash payment agreed between the debtor and the creditor.* When a discount is involved relative to the nominal value of the debt, prepayments are referred to as "buybacks." Debt prepayment could be driven by the debtor's need to reduce the cost of its debt portfolio by taking advantage of favorable economic performance or market conditions to repurchase debt, or for balance of payments purposes, such as a looming balance of payments constraint.

**Accounting for debt prepayment**

A2.42 In the standard presentation, debit entries relating to debt prepayment are recorded by the debtor in the appropriate instrument in the financial account when the transactions take place at the value of the debt prepaid. Credit entries are recorded in reserve assets or in currency and deposits in *other investment-assets* depending on the source of financing. In the IIP, the debtor's liability declines by the amount of debt prepaid. As noted in Appendix 1, Exceptional Financing Transactions, if prepayment of debt is linked to balance of payments needs and is financed from reserve assets, both credit and debit items are recorded below-the-line in exceptional financing and reserve assets, respectively (Table A1.1, rows 31-32). Prepayments of debt using debtor's own financial assets other than reserve assets is recorded above-the-line as in standard presentation (Table A1.1, row 33). If the debt is owed to official creditors and is non-marketable (loan), some element of debt forgiveness could arise—that is, if the prepayment occurs within an agreement between the parties with an intention to convey a benefit (see paragraph A2.7).

A2.43 In the analytic presentation, debt prepayment transactions are recorded as exceptional financing only if they are financed from reserve assets for the balance of payments purposes of the debtor economy. In this case, debit entries are recorded below-the-line in the appropriate instrument in exceptional financing with offsetting credit entries in reserves recorded below-the-line.

A2.44 If the prepayment was financed from external donor funds, transactions could result in a two-stage analysis if cash is provided to the debtor economy that subsequently uses the proceeds to prepay the debt.

*Stage 1*

A2.45 The debtor economy records in the standard presentation a credit entry under capital transfers in the capital account equal to the donor funds provided. An offsetting debit entry is recorded in reserves assets. In the analytic presentation, the debtor economy records a credit entry below-the-line under transfers in exceptional financing, with the offsetting debit entry recorded in reserve assets.

*Stage 2*

A2.46 When the debt prepayment occurs, the debtor economy records in the standard presentation the repayment of the debt instrument as a debit entry at the value paid, with an offsetting credit entry in reserve assets. In the analytic presentation, the debit entry is recorded under the relevant debt instrument below-the-line<sup>6</sup> and the credit entry under reserve assets. Savings arise in future years as a result of the prepayment of the debt. The debit entry is recorded below-the-line as the transaction affects reserve assets in the reporting period.

A2.47 In the IIP of the debtor economy, assets increase in the first stage and decline, along with debt liabilities, when the prepayment takes place.

#### 4. Debt assumption and debt payments on behalf of others

##### a. Debt assumption

###### *Definition*

A2.48 *Debt assumption is a trilateral agreement between a creditor, a former debtor, and a new debtor under which the new debtor assumes the former debtor's outstanding liability to the creditor and is liable for repayment of debt.* Calling a guarantee is an example of debt assumption. If the original debtor defaults on its debt obligations, the creditor may invoke the contract conditions permitting the guarantee from the guarantor to be called. The guarantor unit then must either repay the debt or assume responsibility for the debt as the primary debtor and the liability of the original debtor is extinguished. Governments can be the debtor that is defaulting or the guarantor. Also, a government through agreement can offer to provide funds to pay off the debt obligation of another government owed to a third party.

<sup>6</sup>Advance payments for balance of payments need are recorded below-the-line (see Appendix 1, Exceptional Financing Transactions).

*Accounting for debt assumption*

A2.49 The amount of the debt to be recorded is the full amount of the outstanding debt unless there is an agreement with the creditor to reduce the amount of debt owed. The timing of the recording is at the time the debt is removed from the original debtor's balance sheet.

A2.50 In the standard presentation the transaction recorded between the creditor and debtor is as described in paragraphs 8.42-8.45 and Box 8.1. The creditor records a new loan claim on the new debtor. The extinguishing of the original debt is classified as a transaction if the original debtor continues to exist, or as other volume change (with a capital transfer recorded from the new debtor to the creditor) if the original debtor no longer exists.

A2.51 In many cases it is likely that the entity assuming the debt and the original debtor are resident in the same economy, such as the case of a government assuming the debt of a resident entity. In such instances, the sector classification of the debtor may change.

A2.52 However, if the assuming entity was in a different economy from the original debtor was, then the nature of the transactions recorded would depend on whether the assuming economy obtained a claim on the original debtor and, if not, the relationship between the two entities. The terms of the debt assumption may include a legal obligation for the defaulting entity to pay back to the guaranteeing unit the amount of debt assumed. If so, in the standard presentation, the original debtor economy would record both credit and debit entries under the relevant debt instrument(s) in the financial account. If no claim was established, then a capital transfer (debt forgiveness) would be recorded from the assuming to the original debtor economy. However, if the original debtor was in a direct investment relationship with the entity in the assuming economy, in which instance an increase in the direct investor's equity (or decrease if the parent is the original debtor) would be recorded in the direct investment enterprise. If the new debtor acquires a claim that only partially covers the debt acquired, the difference is classified as debt forgiveness by both the original and new debtors. If the original debtor no longer exists, an other volume change is recorded, as described in paragraph A2.50.

A2.53 In the analytic presentation, if the new debtor and original debtor are resident in different economies, the recording of debt assumption is the same as for debt rescheduling if the new debtor acquires a claim on the original debtor. If not, then

the recording of the debt assumption is the same as for debt forgiveness (except in the case of direct investment as described in the previous paragraph). When a partial claim is acquired, the recording as between debt rescheduling and debt forgiveness is prorated accordingly.

*b. Debt payments on behalf of others*

**Definition**

A2.54 Rather than assume the debt, a government may decide to repay a specific borrowing or make a specific payment on behalf of another institutional unit, without the guarantee being called or the debt being taken over. In this case, the debt stays recorded solely in the balance sheet of the other institutional unit, the only legal debtor. As the existing debt remains extant, and the terms remain unaltered, this is not considered debt reorganization. Such a situation may occur where the debtor is experiencing temporary financial difficulties rather than permanent financial problems.

**Accounting for debt payments on behalf of others**

A2.55 As with debt assumption, the recording of transactions depends on whether the two entities are located in the same economy or not, and whether or not the payer receives a financial claim on the debtor in respect of the debt service payments it has made on behalf of the debtor.

A2.56 If the paying entity and the original debtor are resident in the same economy, then no balance of payments transactions are reported between them. If they are in different economies, and a claim is established on the original debtor, the paying economy records an increase in financial assets and a decrease in reserve assets or currency and deposits, depending on the source of funding. Otherwise, as with debt assumption, a capital transfer or direct investment-equity transaction is recorded. The payment of the debt service is not recorded as a payment of interest or principal by the paying economy because the payments are not related to a liability in its balance sheet.

A2.57 If a financial claim has not been established, and the transactions arise from a balance of payments need, in the analytic presentation the debtor country records a credit entry below-the-line in transfers (other intergovernmental grants) under exceptional financing and a debit entry above-the-line reflecting any interest and principal payments made.

**5. Special cases**

*a. Debt service falling due between Paris Club agreed minute date and specified implementation date<sup>7</sup>*

A2.58 Under Paris Club debt rescheduling arrangements, creditor countries as a group usually agree in the nonbinding "Agreed Minute" that they sign, that payment terms and conditions of applicable debt falling due before the specified effective (implementation) date of the Paris Club bilateral agreement might not be paid on schedule. However, interest continues to accrue based on the existing loan terms, but payments are not made, up until the point when there is a formal bilateral agreement.

A2.59 When such payments fall due, they are considered technical arrears (*External Debt Statistics: Guide for Compilers and Users*, paragraph 3.37). Given that there is a mutually signed understanding between the debtor and the creditor that the terms and conditions in the mother agreement are temporarily suspended, technical arrears are treated in the standard presentation of the debtor economy as rescheduled short-term debt and classified under other investment, other accounts receivable/payable, until the effective date of the bilateral agreement when the new terms apply.<sup>8</sup> When the new terms apply, there may be a need to reclassify technical arrears to the appropriate instruments in the financial account.

A2.60 In the analytic presentation, debit entries are recorded above-the-line as in the standard presentation, while corresponding credit entries are recorded below-the-line as accumulation of arrears, in exceptional financing.

*b. Debt service moratorium extended by creditors*

A2.61 Debt service moratorium involves an individual creditor permitting the debtor a formal suspension of debt service payments falling due within a given period. Debt service moratorium may be granted in the event of natural disasters, such as the moratorium granted to tsunami-affected countries in 2005, and usually involves formal exchange of letters but not necessarily a formal bilateral agreement.

<sup>7</sup>The guidance in this section is based on the Paris Club arrangements because the issue described most commonly arises in that forum. But the guidance is equally applicable to other fora in which the same issue arises.

<sup>8</sup>This approach is applicable to other debt rescheduling arrangements with similar terms.

A2.62 As the intention of the action is to provide the debtor with short-term debt relief, debt service moratorium extended by creditors should be classified as debt rescheduling, provided there is some formal process that demonstrates agreement on behalf of both the debtor and creditor, such as the exchange of letters, to delay payment. In such instances, arrears are not created. In the standard presentation for the debtor, a debit entry is recorded under the appropriate instrument representing the repayment of obligations as they fall due with a credit entry under the same instrument representing the creation of a new debt. In the analytic presentation of the debtor economy, debit entries of obligations falling due in the current period are recorded above-the-line, and contra-entries are recorded as rescheduling of existing debt under other investment liabilities in exceptional financing.

## B. Transactions Related to Debt Reorganization

### I. New money facilities

A2.63 In some debt reorganization arrangements to assist the debtor to overcome temporary balance of payments difficulties, new money facilities are agreed with the creditor to be used to repay maturing debt obligations. In the standard presentation, drawings on the new money facilities are recorded by the debtor as a credit, and offsetting debit entries are made under the appropriate instrument, such as reserve assets. As the maturing debt obligations are paid, debit entries are recorded under the debt instrument for principal amounts falling due and under income for interest accrued in the current period. In the IIP the liabilities (assets) of the debtor (creditor) are increased by the new borrowing.

A2.64 In the analytic presentation, a credit entry for the full amount borrowed is recorded under drawings on new loans within exceptional financing, with the offsetting debit entry under reserve assets. Scheduled debt payments out of the proceeds of the new borrowings are not regarded as exceptional financing; that is, debit entries are made above-the-line and offsetting entries under reserve assets, but advance repayments of debt for balance of payments purposes from reserve assets are recorded as debit items under exceptional financing under the relevant financial instrument. If the terms of the new borrowings are concessional, the creditor is providing a transfer to the debtor. Debt concessionality is discussed below.

### 2. Defeasance

A2.65 Defeasance is a technique by which a debtor exactly matches debt service outflows from a set of its liabilities with financial assets with the same debt service inflows, and removes both the asset and liabilities from its balance sheet (see paragraphs 8.30-8.31). Although a debtor may wish to regard the defeased debt as being effectively extinguished, the *Manual* does not recognize defeasance as affecting the debt of the debtor as long as there has been no change in the legal obligations of the debtor. That is, the debt should continue to be shown on the liabilities side and the financial assets recorded on the asset side of the balance sheet, and the transactions associated with those assets and liabilities recorded in the balance of payments provided they are with nonresidents. If a separate unit is created to hold the assets and liabilities, the transactions by which the assets and liabilities are moved to the second institutional unit are recorded in the financial account, if the second unit is resident of another economy. If the two units are resident in the same economy but are classified in different sectors, a reclassification in other changes in volume account is recorded.

### 3. Debt write-offs

A2.66 A creditor can unilaterally decide to write off debt owed to it. No transactions are recorded but the creditor economy records the reduction in its financial assets through the other changes in the volume of assets account. (The corresponding liability should also be removed from the balance sheet of the debtor, through the other changes in volume account.)

### 4. Debt concessionality

A2.67 Debt concessionality has gained increasing importance in discussions relating to debt relief to the heavily indebted poor countries. However, there is no consistent definition or measure of debt concessionality in economic accounts. In debt reorganization through the Paris Club, such as the Heavily Indebted Poor Countries Initiative and similar arrangements, debt reduction in present value terms is calculated using a market-based discount rate, usually the OECD's Commercial Interest Reference Rate (CIRR).<sup>9</sup> The difference between the nominal value of the applicable debt

<sup>9</sup>These rates are determined on the fifteenth day of each month for applicable currencies on the basis of secondary market yields on government bonds with residual maturity of five years and, in addition, three and seven years for the Canadian dollar, the U.S. dollar, and the euro.



and its present value is the amount of capital transfer derived from the debt reorganization arrangements.

A2.68 Where such transfers are significant, countries are encouraged to provide these data as a supplementary<sup>10</sup> item to the standard components. The recording should be made as a one-off transaction 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 such as the CIRR). For a new loan, this approach would require information on the market interest rate at inception and the contractual interest rate—with the market interest rate as the discount rate and the difference the value of the transfer. This approach has the advantage of considering all the possible sources of transfers in debt concessionality—maturity period, grace period, frequency of payments, interest rate, and other applicable costs—and is consistent with nominal valuation of loans. In addition, this approach is consistent with the economic equivalence between a concessional loan of say, 100 units with an embedded grant element of 35 percent, and a commercial loan of 100 units combined with a direct grant of 35

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<sup>10</sup>The advantage of a supplementary item in the accounts as opposed to the main body is that while it allows these transfers to be measured and data disseminated, it would also allow compilers to develop their approaches over time without affecting the main accounts.

units. The transfer value is calculated at the time it happens, that is, at the inception of the debt, as the difference between its nominal value and its present value using the payment stream and the current market interest rate as the discount factor.

A2.69 If the loan is retired before maturity and replaced by a new loan, adjustment of the previously recorded transfers is required. This means that the value of any transfers not yet received on the original loan that is replaced would need to be subtracted from the original transfer value calculated; otherwise, the amount of concessionality recorded over time would be overstated.

A2.70 This can be done by recalculating the transfer at inception using the actual payment schedule outcome, including the retirement of the entire remaining loan at the time of rescheduling.<sup>11</sup> This recalculated value should replace the originally calculated value in the historical supplementary series, so the historical data reflect the actual transfers received and do not mix any new concessional transfer with the value not received on the original loan, when there may have been a different set of market-related interest rates.

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<sup>11</sup>This retirement value would include any amount that is forgiven because such forgiveness is recorded as a capital transfer in the period given.

## Regional Arrangements: Currency Unions, Economic Unions, and Other Regional Statements

### A. Introduction

A3.1 Since the previous edition of the *Manual*, a growth in regional arrangements for monetary and economic cooperation has been evident, with a particularly notable development being the creation of the euro in the broader framework of the European Union. Such regional arrangements include customs unions, which have common tariff and other trade policies with non-member economies; economic unions, which harmonize certain economic policies to foster greater economic integration; and monetary and currency unions, which provide for a single monetary policy across an area. Concepts and recommendations noted in the chapters of the *Manual* for compilation of balance of payments and IIP statements also apply to these regional arrangements, but beyond these, specific statistical issues arise that are addressed in this appendix.

A3.2 This appendix begins by addressing issues relating to currency unions (CUs), because such unions raise most of the methodological issues and there is the essential policy need for CU balance of payments and IIP statistics.<sup>1</sup> Methodological guidance is provided for the compilation at both the CU and member-economy levels. The appendix also covers economic unions (EcUns) and customs unions. As indicated by Table A3.1, which lists various methodological issues that can arise from regional arrangements, those issues relevant for EcUn and customs unions are largely a subset of those relevant to a CU.

A3.3 Compiling balance of payments and international investment position statistics for regional arrangements such as CUs and EcUns involves the aggregation of data for two or more economies.<sup>2</sup> In contrast,

<sup>1</sup>References to specific statistical issues that apply to unilateral adoption of a foreign currency (such as dollarization) are also included in this section.

<sup>2</sup>In this context, "regional" is not used to mean a region within an economy.

"regional statements" are compiled by an economy vis-à-vis a grouping of selected economies (geographical breakdown of statistics). Issues pertaining to this category of statement are also addressed at the end of this appendix.

A3.4 IIP data by partner are shown according to the debtor-creditor approach. In addition, national contributions for compiling financial flows data in CU and EcUn balance of payments are allocated along the debtor-creditor approach as a way to ensure bilateral symmetry.<sup>3</sup> This convention means that cross-border transactions in financial claims are allocated to the economy of residence of the nonresident debtor, and cross-border transactions in liabilities are allocated to the economy of residence of the nonresident creditor.

### B. Currency Unions

A3.S In a CU, full balance of payments and IIP statements are essential to support the policy analysis at the CU level. The single monetary policy of the CU requires the availability of information for the main variables that affect monetary and foreign exchange conditions for the union as a whole, among which balance of payments statistics are of primary importance. In that sense, the statistical requirements for a CU are the same as for an economy that issues its own currency.

A3.6 As monetary policy is no longer conducted at an economy level, the statistical requirements might appear less necessary for economies that are members of a CU. However, because economic and fiscal policies are often still largely defined at the national level,

<sup>3</sup>As opposed to the transactor principle. Under the transactor principle, cross-border transactions in claims are allocated to the economy of residence of the nonresident party to the transaction (the transactor). Information on the location of counterparties can be of analytical interest, such as the markets in which or with which residents transact.

**Table A3.1. Methodological Issues Relevant for Different Types of Regional Cooperation**

Issue	Customs Union	Economic Union	Currency Union (CU)
1. Definition of a CU central bank	n.a.	n.a.	X
2. Domestic/foreign status of the common currency*	n.a.	n.a.	X
3. Allocation of intra-CU claims among CU's central banks	n.a.	n.a.	X
4. Reserve assets*	n.a.	n.a.	X
5. Regional organizations	X	X	X
6. Economic territory	n.a.	X	X
7. Debtor/creditor versus transactor principle*	X	X	X
8. Geographic allocation of goods	X	X	X

\*These three items also raise statistical issues in "dollarized economies."

**X = relevant issue.**

**n.a. = not applicable issue.**

experience has demonstrated the need for a continuation of national balance of payments and IIP statement for member economies in a CU.

A3.7 The specific statistical issues that need to be addressed are of three types:

- Definitional issues that are central to any discussion of CU balance of payments and IIP statement.
- Application of core balance of payments concepts to the context of a CU.
- Methodological issues arising from the operational and technical aspects of a CU.

## I. Definitional issues

### a. Definition of a currency union

A3.8 The adoption of a single monetary policy by more than one economy can be facilitated through a range of different types of monetary arrangements. A situation in which there is the presence of a single monetary policy among economies, established by an intergovernmental legal agreement, is defined in the *Manual* as a *monetary union*.<sup>4</sup> A monetary union that replaces national currencies with a common currency to form a *currency union* raises specific methodological issues for the compilation of a balance of payments and IIP. These issues include treatment of the central monetary authority, the arrangements for reserves management, and the definition of a domestic currency.

<sup>4</sup>In compiling data for a monetary union that is not a currency union, account would need to be taken of the specific institutional arrangements to determine which principles set out in this appendix need to be applied.

**A39** For statistical purposes, a currency union is defined as a union to which two or more economies belong and that has a regional central decision-making body, commonly a currency union central bank (CUCB), endowed with the legal authority to conduct a single monetary policy and issue the single currency of the union. A CU is established by means of an inter-governmental legal agreement (e.g., a treaty). To belong to a CU, the economy must be a member of the central decision-making body, participate in its regular monetary policy decision-making process, and be subject to its monetary policy decisions. Participation in the monetary policy decision-making process includes representation and voting rights, possibly on a rotating basis, in the central decision-making body.

A3.10 Monetary arrangements reached by any CU economy (on behalf of and in line with guidelines set up by the CUCB) with an economy outside the CU, such as overseas dependent territories, to regulate the use of the common currency do not qualify the other economies to CU membership under this definition. Similarly, the unilateral adoption of another currency by third-party economies (e.g., dollarization, euroization) is not considered sufficient to regard the economy, or economies, to be a member, or members, of a currency union for statistical purposes. Where different economies establish a common monetary area (CMA) that allows free movement of finance and a common exchange control regime with the rest of the world, but different national currencies remain legal tender in their respective economies, even if one currency is a reference currency against which the other currencies are pegged, the arrangement does not meet the above criteria to be classified as a CU. The same applies for a CMA established among members by coordinating the peg with a third economy.

*b. The Currency Union Central Bank*

A3.11 The regional central decision-making body in a CU referred to above is usually the CUCB. A CUCB is a regional financial institution that acts as the common central bank for the member economies of the CU. The CUCB is an institutional unit in its own right, owning assets and liabilities on own account, and is nonresident of any CU member economy but resident in the CU.

*c. Regional organizations*

A3.12 More generally, regional organizations are a type of international organization. They consist of those institutions whose members are governments or monetary authorities of economies that are located in a specific region of the world. Regional organizations, which include CUCBs, are created for many purposes including supporting, guiding, and even governing aspects of the economic relationships or integration processes among the region's economies. Regional organizations are established by means of an inter-governmental legal arrangement (e.g., a treaty). They can be financial (e.g., regional development banks) or nonfinancial (e.g., relating to the administration of an economic union) organizations.

*a. Centralized and decentralized CU*

A3.13 At the time of drafting this *Manual*, two kinds of CU are identified. In one model, the CU has a CUCB owned by the governments of the member economies with the common currency issued by the CUCB and central bank operations in each economy carried out by branches or agencies of the CUCB. This model, referred to as a "centralized" model, is of the type observed in Africa and the Caribbean and was in existence at the time of the publication of the previous edition of the *Manual*.

A3.14 In the other model, the CU comprises a CUCB and CU national central banks (CUNCBs) of the member economies with the CUCB being owned by the CUNCBs. The monetary policy decisions are taken by the decision-making body of the CUCB, which also coordinates the implementation of the decisions, a primary responsibility of the CUNCBs. This model, referred to as a "decentralized" model, is the type developed by the euro area in the 1990s.

A3.15 In some instances, as described ahead, the specific guidance for reporting differs between the two models because of the differing institutional arrangements.

*e. Definition of a domestic currency in a CU*

A3.16 A domestic currency is defined in paragraph 3.95. The currency issued in a CU is the domestic currency of the CU. It should always be considered a domestic currency from the viewpoint of each member economy, even though this currency can be issued by a nonresident institution (either another CUNCB or the CUCB). One consequence is that, in a CU, from a national perspective, holdings of domestic currency can be a claim on a nonresident.<sup>5</sup>

*f. Application of core balance of payments concepts*

**Residence**

Residence in a currency union

A3.17 The economic territory of a CU consists of the economic territory of the CU economies that comprise the CU, plus the CUCB. Any other regional organizations that comprise the same or a subset of the same economies are included in the CU. Within this territory, the same principles of residence apply as described in paragraphs 4.113-4.144.

A3.18 So, being a resident of an economy of a CU necessarily implies being a resident of the CU, along with the CUCB. Other regional organizations that are within the CU territory are also resident, except those whose membership of economies is not the same as, nor a subset of, those in the CU. Such regional organizations should be regarded as nonresident of the CU.

Residence status of multiterritory enterprise located in a CU (or EcUn)

A3.19 Union-wide incorporation for multiterritory enterprises might create problems in determining the residence of units and the allocation of activities across member economies in which the company has operations, and so present difficulties for national statistics. In some instances, the location of incorporation or registration may not be easily allocated to one specific economy, if the jurisdiction that allows the creation and regulates the entity is at the union level. However, the attribution of residence of multiterritory enterprises also arises in other circumstances, and so the treatment described in paragraphs 4.41-4.44 should be applied to multiterritory enterprises located in a CU (or EcUn).

<sup>5</sup>In the case of a "dollarized economy," the banknotes and coins of legal tender should be considered foreign currency as stated in paragraph 3.96.

*Institutional sector allocation*

A3.20 The institutional sector (and, where relevant, subsector) classification of regional organizations in the CU or EcUn balance of payments and IIP that are nonresident of member economies but resident of the CU or EcUn should be decided on a case-by-case basis. However, in the CU international accounts, the CUCB should always be attributed to the central bank sector and, for example, a regional investment bank could be classified as a financial corporation.

*Geographical allocation of stocks and flows*

A3.21 The compilation of the balance of payments and IIP statement of a CU or EcUn has implications for the collection of data at the national level in that the issue of geographical allocation of stocks and flows, not essential for national data, becomes fundamental for the compilation of a CU balance of payments and IIP. Compiling the balance of payments and IIP of a CU from the simple aggregation of national data would not be appropriate.

A3.22 There are several reasons for this. The compilation of a CU balance of payments and IIP by the simple addition of gross national data would unduly inflate the gross flows and stocks of the CU because these would also include transactions and positions between CU members ("intra" transactions). The addition of only the net national transactions or positions of the CU members would solve this problem, but would provide only net aggregates, because only net balances could be shown, without separating out debits from credits in the current account and assets from liabilities in the financial account. In addition, it is very likely that, in practice, intra transactions would not cancel out entirely because of asymmetries in bilateral figures, which would result in erroneous aggregate data.

A3.23 Therefore, the compilation of the balance of payments and IIP of the CU is typically undertaken by aggregating the national contributions for compiling the transactions and positions of the CU with nonresidents of the CU, the so-called extra-CU data. Given the aggregation of data from different economies, it is essential that the CU member economies consistently follow the internationally agreed standards for the classification of transactions and assets and liabilities, and provide adequate metadata describing their methodology.

A3.24 Data on intra transactions and positions can also be essential. An example is with portfolio investment, where liabilities vis-à-vis nonresidents of the CU may need to be calculated as the difference between total national securities liabilities to nonresidents and

the transactions and positions in these securities by residents in the other CU economies. The reason for this is that national balance of payments and IIP collection systems may not be able to identify whether nonresident purchasers and owners of domestic securities are resident of other economies of the CU, or not.<sup>6</sup> In such instances, asymmetries in intra data would affect the quality of balance of payments and IIP data of the CU.

A3.25 For direct investment, intra-CU transactions between a parent company and a branch or subsidiary located within different economies of the CU would be classified as domestic transactions of the CU. Given the different treatment of entities in a direct investment relationship in the external and domestic accounts, close cooperation among compilers may be required; for example, reinvested earnings among entities in different CU member economies are recorded as cross-border transactions in national balance of payments, but are not recorded as transactions in CU national accounts.

*Geographic allocation of transactions in goods (imports and exports)*

A3.26 In balance of payments methodology, the change of ownership is the principle determining the coverage and time of recording of international transactions. The consequence of applying the change-of-ownership concept to merchandise trade is that goods exports will be allocated to the region of residence of the new owner and imports to the region of residence of the former owner. However, international standards for international merchandise trade statistics, as well as customs returns in most economies, are based instead on physical movements of goods across national or customs frontiers, and the recording of these movements does not necessarily coincide with changes in ownership.

A3.27 For the recording of goods in customs data, three concepts are usually used: the economy of origin, the economy of final destination, and the economy of consignment (see paragraph 4.150). The concepts of "economy of origin" (imports) and "economy of last destination" (exports) are generally acceptable approximations to the change of ownership principle. However, in the context of a CU or EcUn, where customs declarations are in many cases completed in a third economy

<sup>6</sup>For securities, the issuer may not know the identity or residence of the creditor. Such information can be obtained only from the intermediary or the creditor. Because of the importance of this information, economies are increasingly developing reporting systems to capture data on a debtor-creditor basis, often through cooperative efforts, including the IMF's Coordinated Portfolio Investment Survey and Coordinated Direct Investment Survey.

### Box A3.1. Recording of Trade Transactions in Currency and Economic Unions

To compile trade data, gross transactions of the member economies with partner economies outside the CU or EcUn area are aggregated. This approach allows for a CU or EcUn's balance of payments statement to be compiled on a gross (credits and debits) basis. This is evidenced in the example below, where economy A is not a member of the union, and economies B and C are members of the union. Economy A (economy of origin) exports goods to economy C (economy of last known destination), and B is the economy of consignment.

#### 1. Use of economy of origin and economy of last known destination:

Reporting economy	Partner economy attribution		
	Extra-union Economy A	Intra-union Economy B Economy C	
Economy A records			export: 10
<b>Economy B records</b>	<b>import: 10</b>		<b>export: 10</b>
<b>Economy C records</b>	<b>import: 10</b>		
Union	import: 20		export 10

In this example, the compilation of trade data for the union (economies B and C) leads to an overestimation of imports (double counting of imports from A) and also to an unbalanced intra-trade (export of B to C, not recorded as an import by C). However, if the union is without internal customs borders and the goods are cleared on the external border of the union and released into free circulation, then only the customs data of Economy B would record the transaction (imports from A but not exports to C). Subsequent dispatches and arrivals need to be collected through enterprise surveys.

(economy of consignment) that does not itself obtain ownership of the goods, double recording of "extra" trade flows is likely: first at the port of entry into the CU or EcUn, second at the economy of final destination. In these circumstances, a combination of the three concepts is necessary to arrive at a proper recording of both extra- and intra-union trade. Box A3.1 provides a numerical example.

A3.28 From a recording perspective, in CUs and EcUns that still have internal customs border, reliance on customs data, with economy of consignment data as supplementary, is feasible. In CUs and EcUns without national customs borders (the most likely situation), data on economy of origin, the economy of last known destination, and the economy of consignment are required from reporters.

#### 2. Use of economy of consignment:

Reporting economy	Partner economy attribution		
	Extra-union Economy A	Intra-union Economy B Economy C	
Economy A records			export: 10
<b>Economy B records</b>	<b>import: 10</b>		<b>export: 10</b>
<b>Economy C records</b>		<b>import: 10</b>	
Union	import: 10	import: 10	export: 10

If, instead, the concept of economy of consignment is used, this results in an appropriate recording of extra-union trade, but not a proper recording of intra-union trade which is artificially inflated. In addition, in balance of payments of member economies, the geographic allocation of flows is inaccurate.

#### 3. Combination of the two methods:

In this case, economies record goods transactions of the economy of origin and the economy of last destination as imports/exports. Additionally, goods transactions with intermediary economies are recorded as arrivals/dispatches. Arrivals and dispatches can be disregarded when compiling the extra-union transactions of the union.

Reporting economy	Partner economy attribution		
	Extra-union Economy A	Intra-union Economy B Economy C	
Economy A records		dispatch: 10	export: 10
<b>Economy B records</b>	<b>arrival: 10</b>		<b>dispatch: 10</b>
<b>Economy C records</b>	<b>import: 10</b>	<b>arrival: 10</b>	
Union	import: 10		

Therefore, only a combination of the two methods will achieve a proper recording of trade flows.

#### Definition of reserve assets

A3.29 Reserve assets shown in the balance of payments and IIP of the CU should include only those assets that (a) represent claims on nonresidents of the CU and (b) meet the criteria described in Chapter 6. Also, the definition of the reserve assets at the CU level and at the member economy level should be the same; in other words, with respect to national data, reserve assets should include only those assets that qualify as reserve assets at the CU level.<sup>7</sup>

A3.30 Similarly, liabilities classified as reserve-related liabilities in the national data should include

<sup>7</sup>In the case of a dollarized economy, reserve assets shown in the balance of payments and IIP should meet the criteria described in Chapter 6, Functional Categories.

only those liabilities that qualify as reserve-related liabilities at the CU level.

## 2. Issues related to the operational aspects of a currency union

A3.31 Issues arise from the operational aspects of the functioning of a CU that relate mostly to the attribution of transactions and positions among member economies and the CUCB, and do not affect the CU balance of payments and IIP statements.

### *a. Treatment of national agencies in a centralized currency union*

A3.32 In a centralized CU, in each member economy the monetary authority functions are deemed to be carried out by a national (resident) monetary authority. Typically, the CUCB maintains national offices in each member economy.<sup>8</sup> This institutional unit, called "the national agency," acts as the central bank for that economy and must be treated for statistical purposes as an institutional unit that is separate from the headquarters of the CUCB.

A3.33 Transactions among resident units of the same member economy settled through accounts at the CUCB are not to be recorded in the national balance of payments but attributed to the national agency as domestic transactions and positions.

A3.34 Transactions with nonresidents settled through the CUCB are to be recorded as transactions of the national agency in the national balance of payments according to the nature of the transaction, with the corresponding entry in the relevant financing item attributed by the CUCB, such as reserve assets (to illustrate this, see numerical example at the end of this appendix). As changes in reserve assets of a CUCB in a centralized system for the most part reflect member economies underlying external transactions, these transactions and positions in reserve assets should continue to be shown in the balance of payments and IIP of member economies.

A3.35 Transactions of residents with the CUCB, where the CUCB is acting on its own account, should be recorded in the national balance of payments according to the nature of the transaction. For example, debt secu-

<sup>8</sup>In rare occurrences where this is not the case, for statistical purposes an institutional unit is to be created to record the central bank transactions and positions with the residents of the economy described in this section.

rities issued by the CUCB and subscribed by residents of an economy of the CU are recorded as portfolio investment in the national balance of payments.

A3.36 Transactions and positions of the CUCB with nonresidents of the CU, where the CUCB is acting on its own account, such as interest on the part of reserve assets that are not allocated to any member economy or bonds issued by the CUCB and subscribed by nonresidents of the CU, should not be recorded in any national balance of payments of member economies but are included in the balance of payments of the CU.

A3.37 Gross assets and liabilities of member economies at the end of the period should reflect the position at the beginning of the period together with any transactions and other flows recorded during the period between residents and nonresidents (including the CUCB). Usually, the member economies will have a net claim on the CUCB, which represents its share of the reserve assets of the CUCB. However, if an economy has a net liability position, transactions in liabilities, other investment, loans, central bank, short-term (and in the memo item "reserve-related liabilities"), rather than reserve assets, should be recorded because the position has the nature of an overdraft.

A3.38 The above approach to recording these transactions and positions reflects current practice in centralized CUs where a monetary survey is established in each member economy. In compiling CU data, compilers will need to ensure that assets and liabilities of the CUCB are not double counted.

A3.39 Any assets held by the CUCB on behalf of member economies, such as gold, reserve position at the IMF and SDRs, and more generally foreign assets that are assigned to member economies in the accounts of the CUCB, are to be shown in the balance of payments and IIP of the member economy. Any liabilities attributable to the economy, such as use of IMF credit, are to be shown in the balance of payments of the member economy.

### *b. Treatment of national agencies and reserve assets in a decentralized currency union*

A3.40 The methodology recommended for a centralized CU is de facto applied in the decentralized system where, in each economy, monetary activities with residents of the CU are carried out by national central banks having their own assets and liabilities.

A3.41 Where reserve assets are held by the CUNCBs (i.e., the assets are actually recorded on their balance sheets), the institutional setting may in certain

circumstances result in some restrictions on the effective control over these assets by the CUNCBs. That is, CUNCBs may be able to transact in some of the reserve assets only with the agreement of the CUCB, such as to ensure appropriate coordination of reserve activity among CUNCBs. Provided there has been no transfer of ownership to the CUCB and the foreign assets owned by the CUNCBs can be mobilized by the CU to meet balance of payments needs, that is, are reserve assets of the CU, the CUNCB of the member economy should classify them as reserve assets in their national balance of payments and IIP, even though the CUNCB may not have complete control of their use because of operational constraint at the CU level.

#### *c. Transactions and positions in banknotes*

A3.42 For CU balance of payments and IIP statistics, transactions and positions in banknotes should be treated according to the same principles as for national data, with nonresident purchases recorded as an increase in external liabilities (credit) and the corresponding entry, such as travel, recorded as appropriate. From a national perspective, holdings of the CU banknotes issued by a CUNCB in another member economy are external assets at the same time, even though the currency is classified as a domestic currency.

A3.43 If the issuer of the banknotes can be identified, such as in the African and the Caribbean currency unions at the time of writing, the methodology described in paragraph A3.42 above can be applied in the national balance of payments and IIP data. However, when the issuer of the banknotes cannot be identified, such as presently in Europe where the banknotes are collectively issued by the system without any indication of the economy of origin, this methodology cannot be strictly applied among the CU members, and approximations in national data are needed.

#### *d. Other intra-currency union claims and liabilities*

##### *Initial subscription of the CUCB's capital*

A3.44 Initial subscriptions to a CUCB's capital are to be recorded in the balance of payments and IIP of member economies as assets, other investment, other equity. All the member economies and the CUCB of a CU must classify this transaction and position the same.

##### *Initial transfer of reserve assets*

A3.45 Claims arising from a transfer of reserve assets to the CUCB are to be classified as assets, other invest-

ment, under either other equity or currency and deposits, depending on the nature of the claim. If a CU member does not fully meet its obligations to transfer reserve assets to the CUCB, the CUCB reports a claim on the member economy. Such claims on the member economy should be classified in its balance of payments and IIP as liabilities, other investment, other accounts payable—other, central bank (or general government), short-term.

##### *Intra-CUNCBs and CUCB balances*

A3.46 Transactions and positions corresponding to claims and liabilities among CUNCBs and the CUCB (including those arising from settlement and clearing arrangements) are to be recorded for the central bank under other investment, currency and deposits or loans (depending on the nature of the claim) in the balance of payments and IIP of member economies. If changes in these intra-CU claims and liabilities do not arise from transactions, relevant entries are to be made under the "other adjustment" column of the IIP. Remuneration of these claims and liabilities is to be recorded in the balance of payments of CU member economies as income on a gross basis under investment income, other investment.

##### *Allocation of seigniorage*

A3.47 Seigniorage is monetary income accruing from the issuance of currency. Reallocations of monetary income among member economies and the CUCB where no underlying asset and liability positions are recognized are to be recorded as a current transfer.

##### *Distribution of profits*

A3.48 Distribution of profits of the CUCB should be classified as income on the financial asset to which member economies' subscriptions are attributed.

## **C. Economic Unions**

A3.49 For the purpose of macroeconomic coordination and cooperation, EcUns formulate specific data requirements including for balance of payments statistics, which help assess aspects such as the degree of integration of the EcUn internal market and share of trade with economies outside the EcUn.

A3.50 At the EcUn level, the current account, the capital account, and the direct investment account are relevant for monitoring economic performance of the EcUn. However, as different currencies continue to coexist, and the respective monetary authorities set their monetary policy objectives in terms of



developments of monetary variables, interest rates, and exchange rates, the portfolio and other investment categories are less meaningful at the EcUn level. For instance, reserve assets of a union other than a CU are the sum of the total of the national reserves (without consolidation) and this total has no specific meaning at the union level.

## I. Definition issues

### a. Definition of an economic union

A3.51 For statistical purposes, an EcUn is a union to which two or more economies belong. EcUns are established by means of an intergovernmental legal agreement among sovereign countries or jurisdictions with the intention of fostering greater economic integration. In an economic union some of the legal and economic characteristics associated with a national economic territory are shared among the different countries or jurisdictions. These elements include (a) the free movement of goods and services within the EcUn and a common tax regime for imports from non-EcUn economies (free trade zone); (b) the free movement of finance within the EcUn; and (c) the free movement of (individual and legal) persons within the EcUn.<sup>9</sup> Also in an EcUn, specific regional organizations are created to support the functioning of the EcUn under points (a) to (c). Some form of cooperation and coordination in fiscal and monetary policy usually exists within an EcUn.

### b. Residence in an economic union

A3.52 The economic territory of an economic union consists of the economic territory of the member countries or jurisdictions, and the regional institutions that comprise the same or a subset of the same economies and are set up to manage the functioning of the EcUn.

A3.53 So, being a resident of an economy of an EcUn necessarily implies being a resident of the EcUn, and regional organizations that are within the definition of the EcUn territory are also resident. However, regional organizations whose membership of economies is not the same as, nor a subset of, those in the EcUn should be regarded as nonresident of the EcUn.

<sup>9</sup>As noted in Chapter 4, an economy, and by extension, an economic union, can include physical or legal (special) zones to which, to some extent, separate laws are applied.

## 2. Recording issues

A3.54 Because the compilation of EcUn balance of payments statistics relies on national contributions, as with the data for currency unions, it is essential that the EcUn member economies consistently follow internationally agreed standards for the classification of transactions and assets and liabilities, and provide adequate metadata describing their methodology. The discussion in paragraphs A3.27-A3.28 on the geographic allocation of transactions in goods also applies to EcUns.

## D. Customs Arrangements

A3.55 Regional integration can take the form of customs arrangements between several economies. In general, these customs arrangements, based on a common customs tariff vis-à-vis nonmember economies, do not raise specific balance of payments issues. However, when customs unions generate cross-border flows, such as through a revenue-sharing formula, the recording of transactions and positions in the international accounts is affected by the institutional and administrative arrangements of the customs union.

A3.56 In customs unions such as the Southern African Customs Union, there may be a cooperative approach among members to levying, collecting, and distributing customs duties. How and when these functions are undertaken is important for determining the appropriate recording approach. One or all of these functions may be assigned to one economy specifically, to all the member economies collectively, or to a designated international agency created by the members. Most important, economies in a customs union are encouraged to agree on common, appropriate, statistical recording for the benefit of regional consistency and comparability.

A3.57 The following paragraphs set out some of the possible types of arrangements.

### I. A designated agency levies, collects, and distributes the proceeds from the duties

A3.58 In this scenario, the designated agency has the right to levy and collect the customs duties, and distribute the proceeds. If it is recognized as an institutional unit, in the international accounts the customs duties are classified as its own tax revenue (primary income), and recorded at the time the underlying economic event occurs that gives rise to the customs

duties, along with an increase in financial assets (such as cash received). The importing economy reports the accrual of taxes (given that in the balance of payments import taxes are payable by the importer) and a reduction in financial assets or increase in liabilities. If the payment of customs duties occurs after the underlying economic event, the designated agency records an accounts receivable claim (debit) on the importer in the importing economy, recorded in the financial account. The importing economy records an accounts payable liability (credit).

A3.59 If the designated agency is to distribute the revenue pool to member economies on the basis of an underlying economic event (import of goods), it records a current transfer (debit) (member economies record a current transfer (credit)) and accounts payable (credit) (member economies, accounts receivable) at the time the underlying economic event occurs, the size of which depends on the nature of the revenue-sharing agreement. However, if the distributions are made to an agreed and negotiated formula, the current transfer should be recorded at the time the member economy acquires an unconditional claim on the designated agency.<sup>10</sup> At the time of distribution, the designated agency extinguishes the accounts payable (member economies extinguish the accounts receivable), with a corresponding entry of a reduction in foreign assets (member economies record increase in foreign assets).

A3.60 The institutional unit could be an international agency in which all the transactions described in the previous paragraphs are between the international agency and the member economies, or be a resident of one member economy, in which case all the transactions described in the previous paragraphs are between that economy and all the other member economies.

## 2. A designated agency levies duties but member economies collect duties

A3.61 In a variant, if member economies act as collecting agents on behalf of the designated agency for the customs duties from importers in their own economy, the

<sup>10</sup>Sometimes, the revenue-sharing distributions are based on preliminary estimates and require final adjustments to the distributed revenue at a later stage. Such adjustments to the estimates of the distributed revenue should be recorded in the periods in which they are made. So if the revenue to be received by an economy is increased, a current transfer credit and accounts receivable debit (or cash if paid when the adjustment is made) for the amount of the increase is recorded in that period; if revenue to be received is reduced, a current transfer debit and a negative accounts receivable (or cash if repaid when the adjustment is made) are recorded in that period.

collecting member economy records an accounts payable liability in the financial account (credit) to the designated agency, which records an accounts receivable claim as the customs duties accrue. The contra-entry will be reflected as an increase in taxes (primary income) payable by the importing economy and receivable by the designated agency. When the member economy makes the payment to the designated agency, the member economy will record a reduction in cash, with a contra-entry in the financial account to eliminate the accounts payable liability.

A3.62 If the collecting economy collects customs revenue due from importers outside their own economy—that is, it collects customs duties from importers in other economies in the customs union—it records accounts payable to the designated agency as well as an increase in financial assets reflecting the cash received; the importing economy records taxes payable to the designated agency unit and a reduction in financial assets (increase in foreign liabilities) to the collecting economy, reflecting, say, the cash paid; and the designated agency records taxes (primary income) from the importing economy and account receivable from the collecting economy.

A3.63 Distributions of revenue by the designated agency are treated as described in paragraph A3.59.

## 3. Member economies have collective rights to levy and collect the duties

A3.64 If member economies have collective rights to levy the customs duties under the agreement, the revenue attributed to each member economy is either in proportion to the respective underlying economic activity that gives rise to the customs duties, or not. Each member economy records customs duties due on their imports on an accrual basis, regardless of how the revenue is to be shared or where the customs duties are collected.

A3.6S Should the customs agreement provide for any member economy to receive a larger share of the customs pool than is evidenced by the underlying economic activities, a current transfer element exists between member economies. The current transfer is recorded at the time unconditional claims are established, with a corresponding entry in accounts receivable/payable.

A3.66 It could be that the ports of entry for the customs union are situated in one or a small group of member economies. If so, there could be a discrepancy between the revenue collected by a member state and that member's share of the customs pool. In these circumstances, an accounts receivable (importing economy) and

accounts payable (collecting economy)<sup>11</sup> are recorded at the time that such a claim can be established, with the corresponding entry in a reduction in financial assets of the importing economy and an increase in financial assets for the economy that collects more customs revenue than that member's share of the customs pool. The discrepancies between the customs revenue collected by each of the customs union members and the total of each member's share of the customs pool share should sum to zero across the customs union, as the customs revenue collected by the customs union equals the revenue to be shared out among member economies.

#### 4. Member economies have collective rights to levy the duty, but only one member collects the duties

**A3.67** If one of the member economies collects all the customs revenue, the recording is as described in the previous paragraphs. Only the collecting economy will record accounts payable, as all other economies will have claims on the collecting economy for their share of the customs revenue.

**A3.68** In all the above circumstances, where there are economic arrangements involving a small group of economies, to avoid bilateral asymmetries, it is recommended that all the economies involved agree and follow the same recording procedures.

### E. Other Regional Statements

**A3.69** Similar statements can be compiled on a regional basis to show the CU's or EcUn's external transactions with, or position vis-à-vis, another selected group of economies or a particular economy. These are known in the *Manual* as data by partner economy and are covered in paragraphs 4.146-4.164.

#### I. Recording principles

##### a. General

**A3.70** Concepts and recommendations noted in the chapters of the *Manual* for compilation of balance of payments and IIP statements also apply to regional statements, but specific references to residents of the relevant foreign economy or group of economies should be substituted for the general references to nonresidents

<sup>11</sup>Net recording of accounts payable or receivable might be appropriate when a member economy both is to receive more (less) of the customs pool than is evidenced by the underlying economic activities, and collects more (less) of the revenue than its share of the revenue pool.

or the rest of the world. This substitution should be made for all transactions and positions.

##### b. Current and capital accounts

**A3.71** In the current account, as noted in previous paragraphs, trade in goods—reflecting the change of ownership principle associated with coverage of this item—generally would show exports allocated to the region of residence of the new owner and imports allocated to the region of residence of the former owner. For trade in services, allocation would be to the region where the provider or acquirer of the service is resident and, for income, the region on which the resident has the associated financial claim or liability. For transfers (current and capital), allocation would be to the region of the donor or recipient, as appropriate.

##### c. Financial account and positions

**A3.72** In the financial account and position data, consistent with paragraph A3.4, allocation should be on the basis of the debtor-creditor principle.<sup>12</sup>

### 2. Specific recording issues

#### a. Multilateral settlements

**A3.73** Although a balance of payments statement vis-à-vis the rest of the world, whether for an economy or for a CU or EcUn, should in concept balance, any statement vis-à-vis a subset of nonresidents generally does not. For instance, a resident in the compiling economy may make payment to or accept payment from a nonresident (resident of economy A) in the form of a claim on another nonresident (resident of economy B). This situation occurs when a currency is used in international transactions by other economies for making settlements. The discrepancies resulting from the allocation of transactions in real resources to the region of the nonresident owner or transactor and changes in financial items to the region of the nonresident creditor or debtor, however, are explicitly recognized by presenting a regional statement compiled in that way. Thus, an entry is provided under the item *multilateral settlements* to restore an accounting balance by serving as an offset to the discrepancies in the regional statement. That item may be seen to represent, in concept, the settlement of an imbalance in the compiling economy's transactions with one region by a transfer to or from that region of claims on, or liabilities to, some other region or regions.

<sup>12</sup>As noted above, information on the basis of the transactor principle can also be of analytical interest.

A3.74 The data needed to compile statistics on multilateral settlements, however, are seldom available. In practice, therefore, the item is usually derived as a residual; however, it can be calculated only in combination with the item for net errors and omissions, which is also a residual or balancing item. Inconsistencies or errors of this or any other kind in classifying entries regionally should not have any effect on a global statement, which represents the sum total of all regional statements, because multilateral settlements appearing in individual regional statements cancel each other when all regions are combined.

#### b. Selection of regions

A3.75 Guidelines on residence in Chapter 4 are applicable for determining the residence of the entity. A region would then comprise an economic territory or a group of economic territories, because the residence of any entity is attributed to a specific economic territory. For transactions and positions vis-à-vis CUs and EcUn, the territories are as defined above.

A3.76 Because most international organizations are not included in the economic territory of a economy or region and so are not considered resident in that economy, a separate region for international organizations would be appropriate for allocation purposes. The regional breakdown that will be relevant for a particular economy or group of economies depends primarily on how the statement is to be used. The *Manual* does not contain a standard list of economies or regions for which the reporting economy or group should compile separate statements.

### Numerical Example: International Transactions and Positions in the National Data for a Member Economy of a Centralized Currency Union

#### I. Opening period

Let us assume that A and B are the only members of the CU and that the opening position is as follows:

##### CUCB Balance Sheet

Assets		Liabilities	
Foreign assets (reserve assets)	500	Banknotes	1,600
Claims on CU residents	1,500	Deposits of CU banks	400
Total	2,000	Total	2,000

The creation of a notional monetary authority in each economy entails the attribution of domestic assets (credit to governments and banks) and liabilities (banknotes) to each economy as follows:

##### National Agency Balance Sheet Economy A

Assets		Liabilities	
Net claim on CUCB (reserve assets)	300	Banknotes	1,000
Domestic assets (residents of A)	950	Bank deposits (residents of A)	250
Total	1,250	Total	1,250

##### National Agency Balance Sheet Economy B

Assets		Liabilities	
Net claim on CUCB (reserve assets)	200	Banknotes	600
Domestic assets (residents of B)	550	Bank deposits (residents of B)	150
Total	750	Total	750

The CUCB has foreign assets of 500, which in this instance are all reserve assets, the total reserves for the union. In turn, the net claim<sup>13</sup> of the national monetary authority on the CUCB represents the foreign assets (again, all reserve assets in this instance) of the economy: A and B have reserve assets of 300 and 200, respectively.

In this example, it is assumed that the CUCB has no assets and liabilities on "own account," that is, no assets or liabilities other than those that reflect positions with the national economies.

During the periods 1, 2, and 3, the following operations take place:

<sup>13</sup>Net is meant in terms of the difference between the assets and liabilities.

2. Period 1

**Economy A imports 100 of goods from Economy Y (not a member of the CU), which are paid in foreign exchange (U.S. dollars).**

Typically, the resident of A will acquire the foreign currencies he needs from the CUCB, through his domestic bank. The transactions are as follows:

- The bank account at the importer's resident commercial bank is debited (100) and the importer acquires foreign currency (100).
- The commercial bank acquires foreign currency from the CUCB (100) and the commercial bank's account at the CUCB is debited (from 250 to 150). For statistical purposes, it will be assumed that the national agency in economy A holds the account of the commercial bank, and that in turn the national agency acquires the foreign currency from the CUCB.
- The CUCB draws down its reserve assets (from 500 to 400), and the account of the national agency is debited in the books of the CUCB.
- Net claims of economy A on the CUCB decline because of the debiting of the national agency's account. This decline in net claims reflects transactions in reserve assets (from 300 to 200).

So under the proposed treatment, imports increase with the corresponding entry in reserve assets. The balance of payments transactions and the balance sheet of economy A would be as follows:

<b>Economy A Balance of Payments</b>			
	Credit	Debit	
<b>Current Account</b>			
Goods		100	
<b>Financial Account</b>			
Reserve assets	100		

<b>National Agency Balance Sheet Economy A</b>			
Assets		Liabilities	
Net claim on CUCB (reserve assets)	200	Banknotes	1,000
Domestic assets (residents of A)	950	Bank deposits (residents of A)	150
<b>Total</b>	<b>1,150</b>	<b>Total</b>	<b>1,150</b>

3. Period 2

**Economy A exports the same goods to B for an amount of 120 domestic currency.**

The transaction is settled in domestic currency through the banking system. The transactions are as follows:

- The resident importer's bank in B settles in domestic currency with the exporter's bank through its accounts at the CUCB. So B's commercial bank account at the CUCB is debited (from 150 to 30), while A's commercial bank account is credited (from 150 to 270). As in period 1, for statistical purposes, it is assumed that the accounts of the commercial banks are held in their respective national agencies.
- Net claims of economy A on the CUCB increase (from 200 to 320) as a result of the crediting of the national agency's account and net claims of B decline (from 200 to 80) as a result of the debiting of the national agency's account.
- The transaction is neutral for the CUCB as a whole, but does affect the intra-CU composition of net claims on the CUCB, which in this instance is reflected in changes in reserve assets.

In the proposed treatment of the balance of payments of A and B, the entries would be as follows:

<b>Balance of Payments Economy A</b>		<b>Balance of Payments Economy B</b>	
	Credit	Debit	
<b>Current Account</b>			
Goods	120		120
<b>Financial Account</b>			
Reserve assets		120	120

<b>National Agency Balance Sheet Economy A</b>			
Assets		Liabilities	
Net claim on CUCB (reserve assets)	320	Banknotes	1,000
Domestic assets (residents of A)	950	Bank deposits (residents of A)	270
<b>Total</b>	<b>1,270</b>	<b>Total</b>	<b>1,270</b>

**National Agency Balance Sheet  
Economy B**

Assets		Liabilities	
Net claim on CUCB (reserve assets)	80	Banknotes	600
Domestic assets (residents of B)	550	Bank deposits (residents of B)	30
<b>Total</b>	<b>630</b>	<b>Total</b>	<b>630</b>

**National Agency Balance Sheet  
Economy B**

Assets		Liabilities	
Net claim on CUCB (reserve assets)	230	Banknotes	600
Domestic assets (residents of B)	550	Bank deposits (residents of B)	180
<b>Total</b>	<b>780</b>	<b>Total</b>	<b>780</b>

**4. Period 3**

**Economy B exports the same goods to economy Z (not a member of the CU) for the amount of 150.**

The transaction is settled in foreign currency (U.S. dollars).

- Then the resident of B sells the foreign exchange receipts to his resident commercial bank in B and his account is credited (150).
- The commercial bank sells foreign currency to the CUCB (150) and the commercial bank's account at the CUCB is credited (from 30 to 180). As in periods 1 and 2, for statistical purposes, it is assumed that the national agency holds the account of the commercial bank.
- The CUCB increases its reserve assets (from 400 to 550), and the account of the national agency is credited in the books of the CUCB.
- Net claims of economy B on the CUCB increase as a result of the crediting of the national agency's account.

So, under the proposed treatment, exports increase with the corresponding entry in reserve assets. The balance of payments transactions and the balance sheet of economy B would be as follows:

**Economy B Balance of Payments**

	Credit	Debit
<b>Current Account</b>		
Goods	150	
<b>Financial Account</b>		
Reserve assets		150

**5. Conclusion**

At the end of period 3, the balance of payments of A and B shows the following entries:

	Economy A		Economy B	
	Credit	Debit	Credit	Debit
<b>Current Account</b>	120	100	150	120
<b>Financial Account</b>				
Reserve assets		20		30

These transactions result in an increase of the reserve assets of the CUCB of 50, and its balance sheet has changed as follows:

**CUCB Balance Sheet**

Assets		Liabilities	
Foreign assets (reserve assets)	550	Banknotes	1,600
Claims on CU residents	1,500	Deposits of CU banks	450
<b>Total</b>	<b>2,050</b>	<b>Total</b>	<b>2,050</b>

As can be seen in this numeric example, the change in reserve assets of the CUCB (+50) from the opening period to the end of period 3 reflects only transactions with nonresidents of the CU: import of goods of 100 from economy Y and export of goods of 150 to economy Z.

**BALANCE OF PAYMENTS AND INTERNATIONAL INVESTMENT POSITION MANUAL**

<b>National Agency Balance Sheet Economy A</b>				<b>National Agency Balance Sheet Economy B</b>			
Assets		Liabilities		Assets		Liabilities	
Net claim on CUCB (reserve assets)	320	Banknotes	1000	Net claim on CUCB (reserve assets)	230	Banknotes	600
Domestic assets (residents of A)	950	Bank deposits (residents of A)	270	Domestic assets (residents of B)	550	Bank deposits (residents of B)	180
Total	1,270	Total	1,270	Total	780	Total	780

# Statistics on the Activities of Multinational Enterprises

## A. Introduction

### References:

Eurostat, *Recommendations Manual on the Production of Foreign Affiliates Statistics*.

Organization for Economic Cooperation and Development (OECD), *OECD Benchmark Definition of Foreign Direct Investment* (fourth edition), Chapter 8, FDI and Globalisation.

OECD, *OECD Handbook on Economic Globalisation Indicators*, Chapter 3, The Economic Activity of Multinational Enterprises.

United Nations, *Manual on Statistics of International Trade in Services*, Chapter IV, Foreign Affiliates Statistics and the International Supply of Services.

A4.1 In addition to the statistics on direct investment (DI) described in this *Manual*, information on foreign-controlled enterprises is provided through statistics on the Activities of Multinational Enterprises (AMNE statistics) and the closely related Foreign Affiliates Statistics (FATS). AMNE statistics cover a range of variables on these direct investment enterprises, described below. This wider dataset is compiled separately from balance of payments and international investment position statistics (although the data may be collected in the framework of DI compilation), as the data relate to the overall holdings and activities of direct investment enterprises rather than just positions and transactions by them with related enterprises. That is, the objective of AMNE statistics is to provide an additional perspective on the impact of direct investment that is complementary to data on international flows and positions. This appendix is designed to give an overview of the nature and compilation of AMNE statistics for the information of balance of payments compilers and users who may be considering this extended range of information.

A4.2 AMNE statistics may be produced for both foreign-controlled enterprises in the compiling economy (a subset of inward foreign direct investment; so

called "inward AMNE") and foreign affiliates controlled by the compiling economy (a subset of outward foreign direct investment; so called "outward AMNE"). In addition, outward AMNE also may cover the activities of resident direct investors.

A4.3 AMNE statistics can be important for the analysis of the performance of domestically and foreign-controlled enterprises, both in absolute terms and relative to the larger domestic and foreign universes of enterprises. Direct investment enterprises may be involved in activities such as research and development that benefit the domestic economy but may not be recorded as balance of payments transactions. Also, data on transactions in goods and services (with both residents and nonresidents) can provide an additional perspective to balance of payments data, as transactions by direct investment enterprises with unrelated persons could be significant.

A4.4 When the General Agreement on Trade in Services (GATS) was negotiated, four modes of supplying services were identified.<sup>1</sup> One of these is mode 3, the supply of services through commercial presence, i.e., direct investment. AMNE statistics for enterprises that produce services provide information that allows for the negotiation and monitoring of GATS agreements and other trade agreements. However, AMNE statistics are not limited to suppliers of services, and also cover manufacturing, mining, and other activities.

A4.5 Detailed discussion and recommendations for measuring AMNE and for FATS is found in the *Manual on Statistics of International Trade in Services* (Chapter IV, Foreign Affiliates Trade in Services Statistics),<sup>2</sup> in the *OECD Handbook on Economic Glo-*

<sup>1</sup>For a discussion on GATS and modes of supply, refer to the *Manual on Statistics of International Trade in Services* (Chapter V Modes of Supply).

<sup>2</sup>*MSITS* focuses on foreign affiliates producing services, but notes that most of its recommendations (all other than those related to industry/product groupings) for compiling these statistics are equally applicable to goods and services.



*balisation Indicators*, and in the fourth edition of the *OECD Benchmark Definition of Foreign Direct Investment*, Chapter 8, FDI and Globalization. A summary is provided here.

## B. Coverage

### 1. Universe or population

A4.6 AMNE statistics cover those direct investment enterprises in which the direct investor (or a group of investors in combination) directly or indirectly holds or controls a majority of the voting power (i.e., subsidiaries). This differs from the scope of direct investment enterprises due to the exclusion of associates. These statistics follow the definition of direct investment discussed in this *Manual* (paragraphs 6.8-6.24)<sup>3</sup> in that coverage is defined as those enterprises with majority foreign ownership of the voting power by a single investor or a group of investors acting together; only those enterprises with foreign control are covered.

A4.7 Countries that are able to do so may wish to provide supplemental statistics covering cases in which foreign control may be deemed to be present, even though no single foreign direct investor holds a majority stake.

### 2. Economic variables for AMNE statistics

A4.8 Basic variables of substantial interest may include: sales (turnover) and/or output; employment; value added; exports and imports of goods and services; and number of enterprises.

A4.9 Other variables that might be collected to supplement these data include: assets (both financial and nonfinancial); compensation of employees; net worth; net operating surplus; gross fixed capital formation; taxes on income; research and development expenditures; total purchases of goods and services; and intra-group exports and imports.

A4.10 The definitions of these variables are given in the *2008 SNA* and in the documents referenced above. It is also useful to have data for the total population or for the domestically-controlled enterprises on the same basis as AMNE statistics on inward DI, so performance can be compared with foreign-controlled enterprises.

<sup>3</sup>And the *OECD Benchmark Definition of Foreign Direct Investment* (fourth edition) (*BD4*).

## C. Statistical Units

A4.11 In principle, most AMNE statistics could be collected at the enterprise group or enterprise level, or the level of individual business locations or establishments. Some indicators, such as total assets, are more naturally collected from enterprise groups or enterprises than from establishments. DI statistics are usually collected from enterprise groups or enterprises, so collection of AMNE statistics at this same level facilitates linkages between the two types of data. However, because enterprise groups and enterprises are more likely than establishments to have activities in multiple industries, data that are classified on the basis of primary activity can be more difficult to interpret for enterprise groups and enterprises than for establishments. There are thus advantages and disadvantages associated with every basis of collection, and no recommendation is made as to the appropriate statistical collection unit. AMNE statistics often will be developed in the context of existing statistical systems, in which the statistical units are already defined, and in these cases there may be little choice in the units used.

## D. Time of Recording and Valuation

A4.12 Time of recording and valuation are consistent with the *Manual*. Flow variables, such as output or value added, should cover the whole of the reference period (usually a year), and should be measured on an accruals basis. Stock variables, such as assets and net worth, should be as at the end of the reference period. All transactions and position variables in principle should be measured at market value.

## E. Attribution of AMNE Variables

### 1. Geographic

A4.13 For statistics on foreign-controlled enterprises in the compiling economy (inward AMNE statistics), the geographical attribution should be by the economy of the ultimate controlling investor. However, to facilitate links with DI data, compilers are encouraged also to provide some data in which attribution is based on the economy of the immediate investor (that is, the first foreign parent). Statistics for foreign enterprises controlled by investors resident in the compiling economy (outward AMNE statistics) should be attributed based on the location of the enterprises whose activities are being described.

### 2. By activity and by product

A4.14 Ideally, all AMNE variables should be attributed on the basis of the industrial activities of the estab-

lishment or enterprise, according to the United Nations *International Standard Industrial Classification of All Economic Activities* (ISIC).

A4.15 In addition, particular variables such as sales or output, exports, and imports may be attributed by the types of products produced and sold. Data on a product basis would identify the specific types of goods and services delivered through foreign-controlled enterprises and could most readily be compared with data on goods and services delivered through trade between residents and nonresidents, and to domestic production. However, some variables, such as value added and employment, do not readily lend themselves to a product classification.

A4.16 As a longer-term goal, compilers are encouraged to work toward disaggregating by product some or all of the variables that lend themselves to this basis of attribution (such as sales (turnover) or output, exports, and imports). Product-based statistics are free of problems of interpretation related to secondary activities and are consistent with the basis of classification used for trade in goods and services in the balance of payments.

## F. Compilation Issues

A4.17 There are two basic approaches, not necessarily mutually exclusive, to developing AMNE statistics. The first is to conduct surveys that directly request information on the operations of the covered

enterprises (appropriate for both inward and outward AMNE statistics). The second identifies the subset of existing domestic enterprise data that is accounted for by foreign-owned firms (for inward AMNE statistics only). DI registers may be used in either case to identify the units to be covered (as well as the economy of attribution, in the case of inward AMNE statistics).

A4.18 For both inward and outward AMNE statistics, questions about key AMNE variables might be added to existing surveys of direct investment transactions and positions. However, because DI surveys may be conducted more frequently than AMNE statistics are required (for example, quarterly rather than annually) and require a quick turnaround, and also because AMNE statistics are needed for only the controlled portion of the DI universe, separate surveys may be a more appropriate way to proceed.

A4.19 For inward AMNE statistics, it should be possible to link the DI statistics to the existing domestic economic statistics (for example, as collected for national accounts purposes) through the use of information on ownership structure to identify those resident enterprises that are foreign-controlled, as well as identifying the residence of the owner. AMNE statistics would be obtained as an aggregation of statistical variables across the foreign-controlled statistical population.

A4.20 Additional questions may have to be added to DI surveys if information on the ultimate controlling parent is to be obtained.

## 5 Remittances

### A. Economic Concept of Remittances and Why They Are Important

A5.1 Remittances represent household income from foreign economies arising mainly from the temporary or permanent movement of people to those economies.<sup>1</sup> Remittances include cash and noncash items that flow through formal channels, such as via electronic wire, or through informal channels, such as money or goods carried across borders. They largely consist of funds and noncash items sent or given by individuals who have migrated to a new economy and become residents there, and the net compensation of border, seasonal, or other short-term workers who are employed in an economy in which they are not resident.

A5.2 For many economies, remittances represent a sizable and stable source of funds that sometimes exceed official aid or financial inflows from foreign direct investment. Remittances may have a significant impact on poverty reduction and can finance economic growth in receiving economies.

A5.3 The *Manual* identifies standard components and provides supplementary items to allow compilation of remittance aggregates. No single data item in the balance of payments framework comprehensively captures transactions in remittances. This appendix explains the different items needed to calculate remittance aggregates and the relationships between the different aggregates.

A5.4 Remittances are mainly derived from two items in the balance of payments framework: income earned by workers in economies where they are not resident (or from nonresident employers) and transfers from residents of one economy to residents of another. The definitions of those items, as well as other relevant

<sup>1</sup>The balance of payments accounts definitions of remittances are somewhat broader than those resulting from movement of persons, because they are not based on the concepts of migration, employment, or family relationships.

definitions and concepts, are set out below. The standard components related to remittances are discussed in Section B, and supplementary items are covered in Section C. Section D identifies related data series that are often raised in the context of remittances but are not included in the definitions as such. Section E discusses the application of balance of payments concepts on remittances, and Section F considers data by partner economy. Table A5.1 shows components required for compiling remittance items and their source. Table A5.2 shows the relationship between the different items.

### B. Standard Components in the Balance of Payments Framework Related to Remittances

Reference:

IMF, 2009, *International Transactions in Remittances: Guide for Compilers and Users*.

A5.5 The two items in the balance of payments framework that substantially relate to remittances are "compensation of employees" and "personal transfers." Both of these standard components are recorded in the current account.

#### I. Compensation of employees

A5.6 Compensation of employees refers to the income of border, seasonal, and other short-term workers who are employed in an economy where they are not resident and of residents employed by nonresident entities.<sup>2</sup> Compensation of employees represents "remuneration in return for the labor input to the production process contributed by an individual in an employer-

<sup>2</sup>Nonresident employers include embassies and international institutions as well as nonresident companies (paragraphs 4.131-4.134). In some economies, income obtained from nonresident employers is significant.

**Table A5.1. Components Required for Compiling Remittance Items and Their Source**

Item	Source and description
1. Compensation of employees	Primary income account, standard component
2. Personal transfers	Secondary income account, standard component
3. Travel and transport related to employment of border, seasonal, and other short-term workers	Goods and services account, supplementary item
4. Taxes and social contributions related to employment of border, seasonal, and other short-term workers	Secondary income account, supplementary item
5. Compensation of employees less expenses related to border, seasonal, and other short-term workers	Primary income account (for compensation of employees), standard component  Goods and services account (for travel and transport expenses) and secondary income account (for taxes and social contributions), supplementary items
6. Capital transfers between households	Capital account, supplementary item
7. Social benefits	Secondary income account, supplementary item
8. Current transfers to NPISHs	Secondary income account, supplementary item
9. Capital transfers to NPISHs	Capital account, supplementary item
<b>Important relationships are:</b>	
<b>"Net" compensation of employees (#5): #1 minus the sum of #3 and #4</b>	
<b>Personal remittances: #2 plus #5 plus #6</b>	
<b>Total remittances: #2 plus #5 plus #6 plus #7</b>	
<b>Total remittances plus transfers to NPISHs: #2 plus #5 plus #6 plus #7 plus #8 plus #9.</b>	

employee relationship with the enterprise." Compensation of employees is recorded gross, before taxes and other expenses incurred in the economy where the work is performed. Paragraphs 11.10-11.23 provide more details. (However, in the derivation of personal remittances, a net measure of compensation of employees is derived, as discussed in paragraph A5.12.)

## 2. Personal transfers

*A5.7 Personal transfers consist of all current transfers in cash or in kind made or received by resident households to or from nonresident households. Personal transfers thus include all current transfers between resident and nonresident individuals (paragraph 12.21). Therefore, personal transfers are a subset of current transfers. They cover all current transfers that are sent by individuals to individuals.<sup>3</sup>*

A5.8 "Personal transfers" replaces an item called "workers' remittances" in the standard presentation.

<sup>3</sup>Families may provide financial support to relatives who are located but not resident in another economy, such as families supporting relatives who are students or medical patients abroad. Such transactions involve residents of the same economy and are therefore not included in personal transfers. The spending of the relative abroad will be included in travel.

According to *BPM5*, workers' remittances are current transfers by migrants who are employed in new economies and considered residents there. To ensure consistency of time series, workers' remittances are continued as a supplementary item. Unlike this previous item, personal transfers are defined independently of the source of income of the sending household, the relationship between the households, and the purpose for which the transfer is made. This simplifies the definition and brings it in line with compilation practices applied in many economies (which did not take account of factors such as source of income and purpose). So, although it is recognized that personal transfers will often originate from migrants sending resources to support their relatives in their economy of origin, personal transfers as defined in this *Manual* are not limited to such activity.

## C. Supplementary Items Related to Remittances

A5.9 There are several supplementary data items in the international accounts including personal remittances, total remittances, and total remittances and transfers to nonprofit institutions serving households (NPISHs). They are cumulative measures, as illustrated

**Table A5.2. Tabular Presentation of the Definitions of Remittances**

Total Remittances and Transfers to NPISHs: a+b+c+d+e+f					
Total Remittances: a+b+c+d				e	f
Personal Remittances: a+b+c			d		
a	b	c	Social benefits	Current transfers to NPISHs	Capital transfers to NPISHs
Personal transfers (part of current transfers)	Compensation of employees less taxes, social contributions, transport, and travel	Capital transfers between households			

Note: Personal transfers is a standard item; other items are supplementary.

in Table A5.2. As supplementary items, their compilation and dissemination is encouraged but voluntary, depending on the data needs of the compiling economy.

### I. Personal remittances

A 5.10 Personal remittances are defined as current and capital transfers in cash or in kind between resident households and nonresident households, plus compensation of employees, less taxes and social contributions paid by nonresident workers in the economy of employment, less transport and travel expenditures related to working abroad (paragraph 12.27). In short, this item includes all household-to-household transfers and the net earnings of nonresident workers.

A5.11 Household-to-household transfers are included within current or capital transfers, as appropriate, in the balance of payments accounts. Compilers in both economies are required to be aware of the sector of the transacting party on both sides. Personal transfers are a standard item under current transfers, while capital transfers between households are a supplementary item in the capital account.

A 5.12 The gross earnings of nonresident workers are recorded under "compensation of employees," a standard component. To derive the relevant component for the calculation of personal remittances, compensation is adjusted by deducting taxes, social contributions, and transport and travel of border, seasonal, and other short-term workers outside their economy of residence. The three items that are deducted are all supplementary items in the balance of payments framework. Social contributions are defined as "the actual or imputed contributions made by households to social insurance schemes to make provision for social benefits to be paid" (paragraph 12.32). Compensation of employees is considered part of

personal remittances because it refers to the earnings of geographically mobile workers and benefits households in a territory other than that where the work is performed. Data users are not always concerned with the length of stay of a migrant worker (which defines residence), but instead with all earnings of migrant workers that benefit their economies of origin, regardless of their residence status in the host economy.

A 5.13 It should be noted that "personal remittances" also include transfers originating from individuals who are not migrant workers. On the other hand, the earnings of individuals from the provision of services to another economy are not included. Paragraph 11.13 provides the definition of an employer-employee relationship which clarifies the difference between "compensation of employees" and payments for services.

### 2. Total remittances

A 5.14 Total remittances are the sum of personal remittances and social benefits. Social benefits include "benefits payable under social security funds and pension funds. They may be in cash or in kind" (paragraph 12.40). Total remittances include income from individuals working abroad for short periods, from individuals residing abroad and sending transfers, and social benefits from abroad. Social benefits is a supplementary item in the balance of payments framework within secondary income. Total remittances are a supplementary item in the balance of payments statement.

### 3. Total remittances and transfers to NPISHs

A 5.15 This item includes total remittances and both current and capital transfers to NPISHs from any sector of the sending economy. It therefore includes donations, in cash or kind, from government and enterprise sectors

to charitable organizations in another economy. Therefore it has a very wide definition that is not closely linked to migration. In fact, much private and official aid as well as cross-border sponsorship of educational and cultural activities (including scholarships) will be included in this item. Current transfers received by NPISHs and to NPISHs are supplementary items under secondary income, whereas capital transfers received by NPISHs and to NPISHs are supplementary items under the capital account.<sup>4</sup>

A5.16 The identification of NPISHs is not without problems. Whereas NPISHs are part of the wider household sector, nonprofit institutions serving other sectors are not. Although compilers will be able to appropriately identify the NPISHs resident in their economy, they will find it more problematic to identify NPISHs in partner economies. This makes the compilation of debit transactions of "total remittances and transfers to NPISHs" particularly challenging because the definition is partially based on identifying the sector of the transacting party in the partner economy. "Total remittances and transfers to NPISHs" is a supplementary item in the balance of payments statement.

## D. Related Data Series

### I. Investment by migrants

A5.17 Migrants frequently invest in their economy of origin, whether they intend to return or have left permanently.<sup>5</sup> Sometimes the attachment to the economy of origin, and the willingness to invest there, carries over to subsequent generations of the migrants. Such investments can take numerous forms, but financial investments (notably bank deposits and portfolio investment) and investments in real estate are probably most common. Small enterprises, located in the economy of origin and sometimes managed by relatives, can also benefit from investments by migrants. These transactions are considered cross-border investments and are therefore

<sup>4</sup>Of the new supplementary remittance aggregates in the international accounts, some data users consider "total remittances and transfers to NPISHs" to most closely match the economic concept of remittances (see Section A). This measure is broader than the other remittance aggregates, because it includes current and capital transfers to NPISHs from any sector of the sending economy (households, corporations, governments, and nonprofit institutions). Thus, unlike the other supplementary remittance aggregates, it includes funds and noncash items that flow indirectly to households, through nonprofit institutions.

<sup>5</sup>In this appendix, the term "migrant" refers to a person who emigrates from an economy of origin and becomes a resident in another economy.

included in the financial account. Although these investment flows are of analytical interest in the context of the economic effects of migration, they are not remittances in the balance of payments framework.

A5.18 However, in some cases, investment transactions by migrants may be vehicles for the provision of remittances. When a migrant deposits funds in an account in the economy of origin, and relatives have access to these funds, this can be a personal transfer. For joint accounts a transfer can be recorded when the funds move across borders rather than when they are withdrawn (see paragraph 4.145). When a migrant purchases real estate and relatives occupy it without paying market rents, or when a migrant sets up an enterprise and relatives are employed and paid above-market incomes by this enterprise, personal transfers could be imputed. In the individual case, the value of the transfers would be calculated as the difference between actual transactions and market equivalent values. In practice, it is difficult to identify such transfers and calculate their value. If larger patterns are known to compilers—if, for example, there are large numbers of migrants buying real estate for use by their relatives in the home economy—estimates can be made on the basis of aggregate transactions data and benchmarks.

### 1. Travel

A5.19 Travel refers to the acquisition of goods and services in an economy by individuals who are visiting but not resident in that economy. Acquisitions of goods and services by border, seasonal, and other short-term workers in their economy of employment are also included in travel (paragraph 10.89). But travel excludes the acquisition of valuables, consumer durables, and other consumer purchases that are included in general merchandise (paragraph 10.90). The compilation of the supplementary definitions of remittances requires that the travel expenses of border, seasonal, and other short-term workers are subtracted from compensation of employees. In practice, it may be difficult to separate travel related to employment from all other travel.

## E. Concepts

### I. Residence

A5.20 The balance of payments and national accounts frameworks rest on the identification of residents and nonresidents respective to each reporting economy. Because the concepts of personal transfers and remittances are based on the concept of residence rather than

migration status, the concept of migration is not defined in the balance of payments. This is consistent with the use of residence criteria elsewhere in the balance of payments and national accounts frameworks.

A5.21 The residence of households is determined according to the center of predominant economic interest of its members. The general guideline for applying this principle—being present for one year or more in a territory or intending to do so—is sufficient to qualify as being a resident of that economy (paragraph 4.117). Short trips to other economies—for recreation or work—do not lead to a change of residence, but going abroad with the intention of staying one year or longer does. "If a member of an existing household ceases to reside in the territory where this household is resident, the individual ceases to be a member of that household" (paragraph 4.118). Migrants going abroad to work thus become residents of the host economy (assuming they plan to stay for a year or longer), but they can join their original household on return. In addition, there are guidelines for the residence of specific cases of students, medical patients, and ships' crews as well as diplomats, military personnel, and civil servants employed abroad in government enclaves. Regardless of the length of stay in a host economy, these groups are considered residents of the originating economy (see paragraphs 4.120-4.123).

A5.22 Residence is important for remittance data because transactions are recorded differently depending on the residence status of the individual in his or her host economy. Border, seasonal, and other short-term workers are not resident in the economy where they work and their gross income is recorded as "compensation of employees." There are no entries in the balance of payments for the wages of migrant workers who stay for at least a year and thus are residents of the same economy as their employer (assuming that their employer is a resident entity). However, when they send remittances to a household in another economy, these are recorded as "personal transfers."

A5.23 In many cases, it is assumed that the entities employing workers are resident in the economy where the work is performed. However, nonresident employers can have a substantial impact on remittance data. Nonresident employers include embassies and other diplomatic missions, international organizations, and numerous enterprises (see paragraphs 4.131-4.144). When resident workers work for nonresident employers, their wages and other benefits are recorded as "compensation of employees."

A5.24 In addition to current and capital transfers, some other resource flows may be of analytical interest. While migrant workers reside in a host economy, their remittances will be recorded as current or capital transfers. These include gifts in cash and kind to their household of origin. When returning home to reside, many migrants bring goods or own assets that will, on return, be owned by their household of origin. However, assets that migrants bring with them on return are excluded from balance of payments transactions, and so are not transfers. Rather, because the residence of the owner changes but not the ownership, the change in assets (such as bank balances and real estate ownership) between economies is recorded as a reclassification change, not a transaction.

A5.25 Although the distinction between a transaction and a reclassification of residence is important for the structure of the system, the effect on the asset position of households and economies is much the same whether the resources come through remittances or through migrants returning home. Data users who are interested in understanding all contributions that migrant workers may make to their households and economies of origin should note this potential misalignment of their data needs and balance of payments definitions, and should seek to make appropriate additional estimations.

## **2. Valuation**

A5.26 All valuations in the balance of payments framework are based on market values (paragraph 3.68).

A5.27 Compensation of employees comprises wages and salaries in cash, wages and salaries in kind, and employers' social contributions. Also included are all forms of bonuses and allowances (paragraphs 11.18-11.19). All transactions in kind should be valued at current market prices, that is, the current exchange value.

A5.28 Transfers in kind should be valued at the market value of the goods or services provided to the recipient (see paragraphs 3.71-3.72). The valuation of cash transfers is clear while transfers of other financial assets should be recorded at market value.

## **3. Timing**

A5.29 Compensation of employees is recorded on an accrual basis (paragraph 11.16). Transfers are also recorded on an accrual basis (discussed in paragraph 3.50). In the case of voluntary transfers, accrual and settlement are often identical (paragraph 3.52 pro-

vides details on the time of recording of transfers). However, this is not the case with involuntary transfers (such as taxes or alimony) and they should in principle be recorded when accrued, although this can be difficult in practice. Remittances are mostly voluntary transfers.

## **F. Data by Partner Economy**

A5.30 Reporting of remittance flows to and from major partner economies in balance of payments data may be provided on a supplementary basis, especially for major "corridors."



## Topical Summary— Direct Investment

### A. Purpose of Topical Summaries

**A6a.1** Appendixes 6a-6e bring together topics that cut across different chapters. They seek to give an overview of these topics, in contrast to the main part of the *Manual*, which is organized according to accounts rather than topics. These appendices are designed in a "signpost" style—that is, they give only a brief introduction and give references as to where more information is available in the chapters, rather than duplicate that information.

### B. Overview of Direct Investment

Reference:

*OECD Benchmark Definition of Foreign Direct Investment*, fourth edition.

**A6a.2** Direct investment arises when an investor resident in one economy makes an investment that gives control or a significant degree of influence on the management of an enterprise that is resident in another economy. Direct investment refers to the flows and positions that arise between parties in a direct investment relationship.

**A6a.3** In operational terms, a direct investment relationship is defined as arising when an entity has equity that gives it voting power of 10 percent or more in the enterprise (paragraph 6.12). The definition also spells out how control or a significant degree of influence may be achieved by immediate ownership or indirect ownership, by a chain of ownership of enterprises that in turn own other enterprises (paragraph 6.12).

**A6a.4** Direct investment relationships and associated concepts are defined in paragraphs 6.8-6.24. More details are available in the Framework for Direct Investment relationships in the *OECD Benchmark Definition of Foreign Direct Investment*. Some important terms are defined briefly in Box A6a.1.

**A6a.5** Whereas a direct investment relationship is defined in terms of voting power, most flows and positions between the entities, including loans and trade credit, are classified as direct investment (paragraphs 6.25-6.36). The only financial flows and positions excluded are debt between selected affiliated financial corporations and financial derivatives (paragraphs 6.28-6.29). Debt included in direct investment is called "inter-company lending" (paragraph 6.26). "Funds in transit" or "pass-through funds" refer to funds that pass through an enterprise in one economy to other affiliates, with the funds not staying in that economy. Unless classified as debt between affiliated financial intermediaries, such debt is included in direct investment data but may be identified separately (paragraphs 6.33-6.34).

**A6a.6** The typical direction of direct investment is from the direct investor to its direct investment enterprise. However, there may also be flows in the reverse direction, and between fellow enterprises, as discussed in paragraphs 6.39-6.41. Whereas the primary presentation of data in this *Manual* is according to whether the item relates to an asset or liability, an alternative presentation called the directional principle, based on the direction of the direct investment relationship, can be derived from the components and is of analytical interest—see paragraphs 6.42-6.45 and Box 6.4.

**A6a.7** Issues associated with direct investment positions are discussed in paragraphs 7.14-7.25. Valuation of equity not listed on a market is discussed in paragraphs 7.15-7.19. Entities that borrow on behalf of their affiliates are discussed in paragraphs 7.20-7.22.

**A6a.8** Issues associated with financial account transactions in direct investment are discussed in Chapter 8. Reinvestment of earnings is the corresponding entry to reinvested earnings in the primary income account, and is discussed in paragraphs 8.15-8.16. The possibility of imputed direct investment flows arising from goods, services, or other items supplied above or below value or with no payment is discussed in paragraph 8.17. Cor-

### Box A6a.1. Direct Investment Terms

**Direct investment:** is a category of cross-border investment associated with a resident in one economy having control or a significant degree of influence on the management of an enterprise that is resident in another economy. As well as the equity that gives rise to control or influence, direct investment also includes associated debt (except debt between affiliated financial intermediaries, specified in paragraph 6.28) and other debt and equity between enterprises that have the same direct investor.

**Direct investment relationship:** A direct investment arises when an investor resident in one economy makes an investment that gives control or a significant degree of influence on the management of an enterprise that is resident in another economy (paragraph 6.9). Direct investment covers positions and transactions in equity and selected debt instruments between entities in a direct investment relationship.

**Direct investor:** An entity or group of related entities that is able to exercise control or a significant degree of influence over another entity that is resident of a different economy (paragraph 6.11).

**Direct investment enterprise:** An entity subject to control or a significant degree of influence by a direct investor is called a direct investment enterprise (paragraph 6.11). A direct investment enterprise is either a subsidiary or an *associate* (paragraph 6.15).

**Control and influence:** *Control* is determined to exist if the direct investor owns more than 50 per cent of the voting power in the direct investment enterprise. Such a direct investment enterprise is a subsidiary. A *significant degree of influence* is determined to exist if the direct investor owns from 10 to 50 percent of the voting power in the direct investment enterprise. Such a direct investment enterprise is an associate. The control or influence may be immediate (through ownership of voting power) or indirect (through ownership of enterprises that in turn have voting power). More detail on the identification of control and influence is given in paragraphs 6.11-6.14.

**Fellow enterprise:** An enterprise is a fellow enterprise of another if the two enterprises have the same immediate or indirect direct investor, but neither is an immediate or indirect direct investor in the other (paragraph 6.17).

**Affiliate:** Entities in an immediate or indirect direct investment relationship with each other, or that have the same immediate or indirect direct investor are all affiliates of each other. That is, affiliates of an enterprise consist of its immediate or indirect direct investor(s), its immediate or indirect direct investment enterprise(s), and its fellow enterprise (s).

**Reverse investment:** Reverse investment arises when a direct investment enterprise owns some, but less than 10 percent of the voting power in, or has lent funds to, its immediate or indirect direct investor (paragraph 6.40).

porate inversion and other restructuring are discussed in paragraphs 8.19-8.22.

**A6a.9** Issues associated with income on direct investment are discussed in Chapter 11. Reinvested earnings are discussed in paragraphs 11.33-11.36, 11.40-11.47, and 11.96-11.102.

**A6a.10** In addition, the general accounting principles, issues of units and residence, and classification of instruments are also applicable to direct investment. They are dealt with in Chapters 3,4, and 5 respectively. The case of transfer pricing between affiliated enterprises is discussed in paragraphs 3.77-3.78.

**A6a.11** The identification of institutional units in the case of branches; notional resident units for ownership of land, other natural resources, or buildings; multiterritory enterprises; joint ventures; quasicorporations identified prior to incorporation; trusts; and special purpose entities are dealt with in paragraphs 4.26-4.52 and pertain particularly to direct investment.

**A6a.12** Standard components and selected supplementary items are shown in Appendix 9. Because of interest in different types of direct investment, additional breakdowns could be provided on a supplementary basis for components of particular relevance to an economy. Examples include partner data, mergers and acquisitions, funds in transit, industry data, and private equity. Industry classification is discussed in paragraph 6.50. Identification of mergers and acquisitions is discussed in paragraph 8.18.

**A6a.13** Direct investment data may be classified by partner economy, as discussed in paragraphs 4.156-4.157. The partner may be on the basis of the immediate investor or the ultimate investor or host economy.

**A6a.14** Whereas balance of payments and international investment position data show the international flows and positions, another aspect of the impact of direct investment is on domestic variables, such as employment, sales, value added, and gross fixed capital formation. These statistics are called Activities of Multi-national Enterprises and are discussed in Appendix 4.

## Topical Summary— Financial Leases

### Reference:

2008 SNA, Chapter 17, Cross-Cutting and Other Special Issues.

**A6b.1** *A financial lease is a contract under which the lessor as legal owner of an asset conveys substantially all the risks and rewards of ownership of the asset to the lessee.* The economic nature of the arrangement is that the lessor is providing a loan to allow the lessee to acquire the risk and rewards of ownership, but the lessor retains legal title as collateral for the loan. Therefore, a financial lease is an example of where economic ownership differs from legal ownership. The arrangement is treated as a transaction in the relevant asset financed by a loan, which is repaid in full or in most part by payments by the lessee. Financial leases are also called finance leases or capital leases. For further details of the definition, see paragraphs 5.56-5.57.

**A6b.2** Financial leases are distinguished from operating leases (see paragraphs 10.153-10.157), in which neither legal nor economic ownership changes, and the rentals are recorded as services. In terms of underlying economic processes, although both operating and financial leases have similar forms, the essence of a financial lease is seen as being a loan, whereas the operating lease is seen as providing a service. That is, the operating lease provider has a stock of assets, which

it wants to provide to other entities, and provides varying degrees of backup support. In contrast, the financial lease provider is usually a financier and operates a lot like a lender except that the lessor has the additional collateral of legal ownership of the assets. Accounting standards also recognize this distinction.

**A6b.3** As a result of this treatment, a cross-border financial lease will give rise to the following entries in different accounts:

- A loan liability of the lessee and a loan asset of the lessor are recorded to the total value of the asset acquired. The outstanding amount is shown in the IIP (see paragraph 7.57);
- The creation of the loan and the subsequent repayments of the loan (including, at maturity, the return of the asset to the lessor or its purchase by the lessee) are recorded under loan transactions in the financial account;
- The asset subject to the lease is regarded as being purchased by the lessee, so there is a change of economic ownership of the asset (usually goods) from the lessor to lessee. If cross-border and involving a produced asset, this change of ownership is shown in the goods and services account (see paragraph 10.17(f)). If the produced asset is returned to the lessor at the maturity of the contract, there is a change of economic ownership from the lessee

to lessor, which is also recorded in the goods and services account;

- Explicit fees and FISIM are incurred on the loan if the lender is a financial corporation and these

amounts are included in "financial services" (see paragraphs 10.118-10.136); and

- Interest is accrued on the loan (see paragraph 11.73).

**Box A6b.1. Numerical Example of Financial Lease**

A piece of imported equipment worth 1,000 is provided under a financial lease from a nonresident financial corporation. The lease begins on January 1, an annual payment of 140 is made on December 31 each year for 10 years, at which time the lessee has the option to purchase the equipment at an agreed price. The contract is based on an interest rate of 7 percent per annum, while the reference rate of interest is 5 percent per annum.

For the economy of the lessee, the following entries are made in the first two and final years:

Year 1	Credit	Debit
<i>Current Account</i>		
Goods		1,000
Services—Financial services (FISIM)		20
Primary Income—Investment income		50
<i>Financial Account</i>		
Other investment—Loans	1,000	70
Other investment—Currency and deposits	140	

Accrued interest is 70, of which 20 is FISIM and 50 is pure interest. The value of the loan debt is 930 at the end of year 1 ( $1000 + 20 + 50 - 140$ )

Year 2	Credit	Debit
<i>Current Account</i>		
Services—Financial services (FISIM)		18.6
Primary Income—Investment income		46.5
<i>Financial Account</i>		
Other investment—Loans		74.9
Other investment—Currency and deposits	140	

Accrued interest is 65.1, of which 18.6 is FISIM and 46.5 is pure interest. The value of the loan debt is 855.1 at the end of year 2 ( $930 + 18.6 + 46.5 - 140$ )

...

Year 10	Credit	Debit
<i>Current Account</i>		
Goods	32.8	
Services—Financial services (FISIM)		3.2
Primary Income—Investment income		8.1
<i>Financial Account</i>		
Other investment—Loans		161.55
Other investment—Currency and deposits	140	

Accrued interest is 11.3, of which 3.2 is FISIM and 8.1 is pure interest. The residual value of the good purchased is 32.8, which is recorded as a goods transaction if the good is returned to the lessor (as in the example) rather than the lessee purchasing it.

## Topical Summary—Insurance, Pension Schemes, and Standardized Guarantees

### A. General Issues

Reference:

2008 SNA, Chapter 17, Cross-Cutting and Other Special Issues.

A6c.1 Insurance provides individual institutional units exposed to certain risks with financial protection against the consequences of the occurrence of specified events. In addition, insurers often act as financial intermediaries who invest funds collected from policyholders in financial or other assets to meet future claims.<sup>1</sup>

A6c.2 Pension schemes are established for the purpose of providing benefits for retirement or for invalidity of specific groups of employees. Pension schemes may be operated by a separately constituted fund or by a fund that is part of the employer, or be unfunded. Pension funds are similar to insurance in that they act as intermediaries for investing the funds for their beneficiaries and redistribute some risks.

A6c.3 Insurance and pension fund operation have common features, but can be distinguished in that life insurance and pension funds include a large saving component, whereas the objective of nonlife insurance (including term life insurance) is largely undertaken to pool risk.

A6c.4 The transactions undertaken by insurers include charging premiums, paying claims, and investing funds. Similarly, pension funds' transactions include receiving contributions, paying benefits, and investing funds. To analyze the underlying economic nature of these operations, it is necessary to rearrange these processes to derive the service, investment income, transfer, and investment elements. Users may also be interested in supplementary data on insurance transactions before the

adjustments discussed in this section, particularly data on premiums and claims. (Box A6c.1 provides a numerical example to show the calculation of the derived items for service, investment income, transfers, and investment.)

A6c.5 Aspects of insurance are dealt with in several chapters:

- Insurance corporations and pension funds are defined as institutional subsectors in paragraphs 4.88-4.89;
- Insurance reserves, pension entitlements, and provisions for standardized guarantees are defined as financial instruments in paragraphs 5.62-5.68 and as part of the other investment functional category in paragraph 6.61;
- The measurement of insurance reserves in the IIP is discussed in paragraphs 7.63-7.68;
- Financial account entries are discussed in paragraphs 8.46-8.49;
- Other changes in volume associated with insurance reserves and provisions are discussed in paragraph 9.24;
- Insurance and pension services are discussed in paragraphs 10.109-10.117;
- The investment income accruing to policyholders and contributors is discussed in paragraphs 11.77-11.84; and
- The transfers associated with these schemes are discussed in paragraphs 12.41-12.46 and 13.24.

A6c.6 Cross-border insurance is particularly common in specialized areas such as reinsurance and high-value items such as insurance of ships and aircraft. For some small economies, the small size of their risk pool means that a wider range of items tends to be insured with nonresidents. With international mobility of population, life insurance and pensions can also occur cross-border on a significant scale.

<sup>1</sup>In the context of insurance, a claim is the obligation of an insurance company to pay the policyholder under the terms of the policy because an insured event has occurred. "Claim" is also used in this *Manual* to mean financial asset.

**Box A6c.1. Numerical Example of Calculations for Nonlife Insurance****1. Basic information**

This example covers policies of resident insurers with nonresident policyholders; the same principles apply for nonresident insurers with resident policyholders, although the availability of data is less in practice, so that ratios may be needed for some items, as discussed in Box 10.4.

Gross premiums receivable from abroad = 135  
 Gross premiums received from abroad = 150  
 Reserves relating to prepayments—beginning of period = 40  
 Reserves relating to prepayments—end of period = 55  
 Net increase in reserves relating to prepayments = 15

Investment income attributable to nonresident policyholders = 8  
 Claims payable abroad = 160  
 Claims paid to abroad = 155  
 Reserves relating to claims incurred—beginning of period = 10  
 Reserves relating to claims incurred—end of period = 15  
 Net increase in reserves for claims incurred but not paid = 5

Adjustment for volatility in claims payable = -40  
 (i.e., expected long-term level of claims would be 120, that is 160 - 40)

**2. Derived items****Goods and services account:**

Insurance service (credits)  
 = gross premiums receivable plus premium supplements less expected claims (i.e., expected claims is derived as actual claims payable plus adjustment for volatility)  
 = 135 + 8 - 120  
 = 23

(Note: not taking into account the volatility would lead to a negative value of services: -17.)

**Primary income account:**

Investment income attributable to policyholders (debits) = 8

**Secondary income account:**

Net premiums receivable (credits)  
 = gross premiums receivable less service = 135 + 8 - 23 = 120

Claims payable (debits) = 160

**Financial account:**

Insurance reserves (increase in liabilities to policyholders) = 20 (= 15 + 5)

Currency and deposits (increase in assets of resident insurers) = -5 (= 150 - 155)

**IP—Liabilities**

Insurance reserves (prepayments and claims incurred)—beginning of period = 50 (= 40 + 10)

Insurance reserves (prepayments and claims incurred)—end of period = 70 (= 55 + 15)

**B. Nonlife Insurance**

Reference:

2008 SNA, Chapter 17, Cross-Cutting and Other Special Issues, Part 1.

**I. Types of nonlife insurance**

A6c.7 Types of nonlife insurance include accident and health; term life; marine, aviation, and other transport; fire and other property damage; pecuniary loss; general liability; and credit insurance.

A6c.8 *Direct insurance is between an insurance company and the public. Reinsurance is insurance where both parties to the policy are providers of insurance services.* That is, reinsurance allows insurance risk to be transferred from one insurer to another. Many insurers act as both direct insurers and reinsurers. There may be chains of transferring risk, from insurer to reinsurer to secondary reinsurer and so on. Reinsurance companies and their policyholders are often residents of different economies because of the specialized functions of reinsurance and the objective to spread risk. A direct insurer may pass on an entire set of risks (i.e., the

direct insurer is like a retailer), a proportion of risks, or the risk of claims being more than a specified amount (e.g., arising from a catastrophic loss) to a reinsurer. Because it is often used as protection against exposure to large losses, reinsurance is particularly likely to be subject to lumpy transactions.

A6c.9 The principles for measurement of reinsurance and direct insurance services are the same. They are shown as separate items on a supplementary basis, as can other components such as auxiliary services and standardized guarantees.

A6c.10 Freight insurance is a form of nonlife insurance that raises particular issues for valuation of goods. Like freight transport, as discussed in paragraph 10.78, the identification of who pays the insurance and whether it is included in the price of the good is determined by the FOB valuation concept, as discussed in paragraph 10.116.

A6c.11 Nonlife insurance is distinguished from life insurance in that it pays benefits only if an insured event occurs. That is, nonlife insurance is designed primarily for pooling risk, rather than as an investment. For that reason, nonlife insurance claims and net premiums are recorded as transfers, while the equivalents for life insurance are recorded in the financial account. In contrast to life insurance, term life insurance benefits are payable only on the death or incapacity of the insured, and so term life insurance is included in nonlife insurance.

## 2. Role of reserves in insurance

A6c.12 Insurance policies are paid in advance, while claims are paid only after the insured events happen, sometimes much later. Insurance technical reserves represent the amounts identified by insurance companies to account for these prepayments of premiums and claims incurred but not yet paid. That is, reserves can be seen as the application of usual accrual accounting principles. Reserves for claims reported but not yet resolved, and estimates of claims incurred but not yet reported, are correctly included, as they relate to insurable events that have already occurred.

A6c.13 Insurance corporations in some economies may also set aside other reserves, such as amounts to cover fluctuations in claims between periods (e.g., the increase in claims in the event of a natural disaster). However, if there is no entitlement by any counterparty to these reserves, they cannot be recognized as an asset of the policyholders.

A6c.14 Insurance companies hold assets to meet the liabilities to policyholders represented by the reserves. The management of these financial and nonfinancial assets is an integral part of the business of insurance. The income generated by these investments has a considerable influence on the level of premiums that insurance enterprises need to charge (indeed, in some cases, they have allowed claims to exceed gross premiums earned). Consequently, the income earned on the investment of the reserves is treated as being receivable by the policyholders who are then treated as paying it back to the insurance enterprises as premium supplements.

## 3. Value of insurance service output

A6c.15 Premiums and investment income represent the inflow of resources to the insurance company, whereas the claims due are the resources allocated to the policyholders. The margin between these inflows and outflows is the amount available to the insurance company to cover its costs and provide an operating surplus. This margin represents the value of insurance services provided.

A6c.16 The value of output of nonlife insurance services can be expressed with the following formula:

$$\begin{aligned} & \text{Gross premiums earned;} \\ & + \text{Premium supplements;} \\ & - \text{Claims payable;} \\ & - \text{Adjustment for claims volatility, if necessary.}^2 \end{aligned}$$

### a. Gross premiums earned

A6c.17 "Gross premiums earned" refers to those parts of the premiums payable in the current or previous periods that cover the risks incurred during the accounting

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Alternatively, the formula can be expressed as:

$$\begin{aligned} & \text{Gross premiums earned;} \\ & + \text{Premium supplements;} \\ & - \text{Expected claims;} \end{aligned}$$

where expected claims are based on longer term measures of claims, taking out the effects of volatility.

The formula can also be expressed in terms of payments:

$$\begin{aligned} & \text{Gross premiums paid;} \\ & + \text{Premium supplements;} \\ & - \text{Claims paid;} \\ & - \text{Net increase in technical reserves (including reserves for claims volatility);} \end{aligned}$$

where the technical reserves account for prepayments of premiums and delays in paying out claims as well taking out the effects of volatility.

See Box A6c.1 for a numerical example of these calculations.

period. Premiums earned are on an accrual basis, so differ from premiums received because insurance policies are usually paid in advance. In the case of a reinsurer accepting risks on proportional reinsurance contracts, gross premiums earned are recorded after deducting the reinsurance commissions payable to the direct insurer. Similarly, other gross premiums should be calculated by deducting any rebates payable to the policyholder.

**A6c.18** Insurance premiums are normally paid in advance, so a measure on an accrual basis differs from premiums paid by the deduction of prepayments for insurance cover in future periods and adds back cover for the current period that was prepaid in previous periods.

b. *Premium supplements*

**A6c.19** Investment income earned on the assets invested to meet insurance companies' provision liabilities is attributable to insurance policyholders. The income is recorded in the primary income account as discussed in paragraphs 11.77-11.84 and A6c.26. The same value is then treated as being paid back to the insurance companies as premium supplements. Premium supplements are added to premiums in the calculation of the value of insurance services, as shown in Box A6c.1.

c. *Claims payable*

**A6c.20** Claims payable are claims for events that occurred within the accounting period. Claims payable include claims paid within the accounting period plus changes in the reserves against outstanding claims. That is, claims on an accrual basis are recognized as due when an event takes place that gives rise to a valid claim, whether or not paid, settled, or reported during that period.

a. *Adjustments for claims volatility*

**A6c.21** Adjustments for claims volatility should be included in the calculation for lines of insurance subject to fluctuations. For example, major catastrophes such as earthquakes and hurricanes may be expected to occur, on average, once in each several years. If only claims incurred during a single accounting period are used in the formula, the resulting values of insurance services could be erratic, and even negative in catastrophic periods, and so are an inadequate measure of the production and pricing of insurance. In such cases, an adjustment to claims due should be made, to reflect a longer-term view of claims behavior, in line with insurance decision making. In periods when large values of

claims are incurred, the adjustment would be negative (thus causing an increased value of the service), while in other periods, the adjustment would be positive (thus reducing the value of the service). However, for some types of insurance, there is limited volatility and no adjustment is necessary.

**A6c.22** The adjustments for claims volatility show the difference between actual claims in a particular period and a normally expected level of claims. The expected level of claims may be calculated according to one of the following methods:

- (a) The **expectations approach** is based on an estimate of expected claims, using smoothed past figures of gross claims incurred or smoothed past ratios of gross claims incurred over premiums, applied to current premiums. It replicates the ex ante model used by insurers to price their premiums on the basis of their expectations. When accepting risk and setting premiums, insurers consider their expectation of loss;
- (b) The **accounting approach** is based on changes in insurers' equalization reserves and changes in own funds to account for the volatility of claims. In contrast to the expectation approach, the accounting approach uses ex post data, that is, observed claims incurred. It is to be noted that if changes in own funds are introduced in one given period to dampen the volatility of a claim in case of catastrophe, the rebuilding of own funds after this period will also intervene (with an inverse sign) in the formula for the next periods. Practices for calculation of equalization reserves vary, so they may not be sufficient to cover all volatility in claims; or
- (c) The **sum of costs plus "normal" profit** approach consists in obtaining a measure of output as the sum of costs plus an estimate of "normal" profit. The estimate of "normal" profit generally implies the use of smoothed past actual profits. Thus this approach is, in practice, similar to the expectation approach. "Normal" profit is indeed equal to premiums + adjusted premium supplements - adjusted claims - costs.

e. *Reinsurance*

**A6c.23** As explained in paragraph A6c.8, reinsurance allows insurance risk to be transferred from one insurer to another. The transactions between the direct insurer and the reinsurer are recorded as an entirely



separate set of transactions and no consolidation takes place between the transactions of the direct insurer as issuer of policies to its clients on the one hand and the holder of a policy with the reinsurer on the other. The output of reinsurance is measured in a way similar to that for direct nonlife insurance. However, there are some payments peculiar to reinsurance. These are commissions payable to the direct insurer under proportionate reinsurance and profit sharing in excess of loss reinsurance. Once these are taken into account the output of reinsurance can be calculated as:

- Total actual premiums earned less commissions payable;
- + Premium supplements;
- Adjusted claims incurred and profit sharing.

#### 4. Exports and imports of insurance services

A6c.24 The formula for total production of insurance services stated in paragraph A6c.16 includes elements that may only be able to be observed by insurers in aggregate. For exported and imported insurance services, which represent the output provided to a subset of policyholders, additional methods are required to allocate totals.

A6c.25 Usually, ratios will be able to be used to make estimates. The case of imports is particularly difficult, as the insurance companies are not residents in the economy of compilation and so data collection is constrained. In each case, the objective is to find a result consistent with the overall method, after taking into account which information is available in the circumstances. Possible methods are discussed in paragraph 10.114 and Box 10.4.

#### 5. Investment income attributable to insurance policyholders (primary income account)

A6c.26 Investment income earned on the assets invested to meet insurance companies' provision liabilities is attributable to insurance policyholders. The income is recorded in the primary income account as discussed in paragraphs 11.77-11.84. The same value is then treated as being paid back to the insurance companies as premium supplements in the calculation of the value of insurance services, as shown in paragraph A6c.19 and Box A6c.1 (and consequently increases the value of net premiums, which is gross premiums less the value of insurance services).

#### 6. Net insurance premiums (secondary income account)

A6c.27 Net insurance premiums are gross premiums earned less the service charge. (Gross premiums were discussed in paragraph A6c.17 in the context of deriving the service charge.) Net insurance premiums are shown as current transfers. They are discussed in paragraphs 12.41-12.42.

#### 7. Claims receivable or payable (secondary income account)

A6c.28 Claims incurred during the period are generally shown as current transfers. They are discussed in paragraphs 12.44-12.46 and in paragraph A6c.20 in the context of deriving the service charge. In exceptional cases, they may be classified as capital transfers, as discussed in paragraph 13.24. The stock of claims outstanding is recognized as a financial asset or liability and is shown in the IIP (see paragraphs 5.64 and 7.63-7.68).

### C. Life Insurance and Annuities

Reference:

2008 SNA, Chapter 17, Cross-Cutting and Other Special Issues, Part I.D.

A6c.29 Life insurance is distinguished from nonlife insurance in paragraph A6c.11. Life insurance involves a stream of payments by the policyholder in return for a lump sum at the end of the policy. Annuities are the reverse, where a stream of payments is made by the insurer in return for a lump sum at the beginning of the policy. Both direct insurance and reinsurance also exist for life insurance and annuities.

A6c.30 The principles for the measurement of life and nonlife insurance are similar. However, in the case of life insurance, the net premiums and payments of benefits are recorded in the financial account, rather than the secondary income account. This treatment follows from the role of life insurance as paying benefits even without an insured event occurring, and therefore operating mainly as a way for policyholders to build assets; in contrast, nonlife insurance operates to redistribute costs among policyholders by transfers. Because life insurance is based on managing large values of assets, the premium supplements can be relatively large.

A6c.31 The value of output of life insurance and annuity services can be expressed with the following formula:

- Gross premiums earned;
- + Premium supplements;
- Benefits due;
- Increases (+ decreases) in life insurance reserves (actuarial reserves and reserves for with-profits insurance).

The formula is basically the same as for nonlife insurance, except that the payments to policyholders are called benefits instead of claims, and reserves are added to account for the accrual of future benefits. Also, changes in reserves are taken into account.

A6c.32 The item for actuarial reserves in the formula for life insurance reflects the amounts that are payable at the end of the policy, rather than claims in the current period. They are shown as accruing to particular policyholders because they consist of allocations to the actuarial reserves and reserves for with-profits insurance policies to build up the sums guaranteed under these policies. Changes in the actuarial reserves and reserves for with-profits insurance include the provision made for bonuses payable in future.

A6c.33 It is common with life insurance policies for amounts to be explicitly attributed by the insurance corporation to the policyholders in each year. These sums are often described as bonuses. The sums involved are not actually paid to the policy holders but the liabilities of the insurance corporation toward the policyholders increase by this amount. This amount is shown as investment income attributed to the policyholders. The fact that some of it may derive from holding gains does not change this designation; as far as the policyholders are concerned it is the return for making the financial asset available to the insurance corporation. In addition, all the income from the investment of nonlife reserves and any excess of income from the investment of life reserves over any amounts explicitly attributed to the policyholders are shown as investment income attributed to policyholders, regardless of the source of the income.

A6c.34 In the case of annuities, the same principles apply, but the calculation is different because of the opposite cash flow, and is elaborated in *2008 SNA*, Chapter 17, Cross-Cutting and Other Special Issues.

A6c.35 In the current account, in addition to services, life insurance gives rise to investment income attributable to policyholders, as discussed in paragraph 11.81, of equivalent value to premium supplements. For life insurance, net premiums and benefits are shown as

increases and reductions in insurance reserves in the financial account. (In contrast, for nonlife insurance, net premiums and claims are shown as transfers.)

A6c.36 Life insurance technical reserves are defined as a financial instrument in paragraph 5.65. They are classified as other investment in the functional classification; see paragraph 6.61. More details are provided on recording them in the IIP in paragraphs 7.63-7.64, the financial account in paragraph 8.48, and other changes in volumes in paragraph 9.24.

## D. Pension Schemes

Reference:

*2008 SNA*, Chapter 17, Cross-Cutting and Other Special Issues, Part 2.J.

A6c.37 Pension schemes include those operated with an autonomous fund as well as funds that are not separate units and unfunded pension schemes. Pensions may be provided by social security schemes, employer-related schemes other than social security, and social assistance schemes.

A6c.38 Social contributions to social security schemes are discussed in paragraphs 12.32-12.33. Social benefits under social security and social assistance schemes are dealt with in paragraph 12.40. These schemes operate through transfers and do not have financial account entries because an obligation to pay is not recognized. For further information on social security and social assistance schemes, and for employer-related schemes through social security schemes, see *2008 SNA*, Chapter 17. The remainder of this section deals with employer-related schemes other than social security.

A6c.39 Pension funds are defined as an institutional subsector in paragraphs 4.89-4.90. Pension entitlements are defined as a financial instrument in paragraphs 5.66-5.67. These entitlements may be liabilities of pension funds or unfunded schemes. They are classified as other investment in the functional classification; see paragraph 6.61. The valuation of pension entitlements in the IIP is discussed in paragraph 7.65. Financial account entries are discussed in paragraphs 8.48-8.49. Changes to pension entitlements as a result of changes in model assumptions are shown as other changes in volume, whereas changes negotiated between the parties are transfers, as discussed in paragraph 9.24. Insurance and pension services are discussed in paragraphs 10.109-10.117.

**A6c.40** There may be explicit or implicit service charges for pension schemes. If the charges are implicit, they are measured in a similar way to those for life insurance and annuities, namely:

- Gross contributions;
- + Contribution supplements;
- Benefits payable;
- Adjustment for change in pension entitlements.

**A6c.41** Investment income is attributable to beneficiaries of pension schemes and is repaid to the pension fund as contribution supplements, as discussed in paragraph 11.82. The investment income payable

- (a) for defined contribution schemes is equal to the investment income on the funds plus any net operating surplus earned by renting land or buildings owned by the fund; and
- (b) for defined benefit schemes, is equal to the increase in benefits payable because the date when the entitlements become payable is closer. The amount of the increase is not affected by whether the pension scheme actually has earned sufficient income to meet its obligations.

The adjustment for change in pension entitlements is discussed in paragraph 12.38.

**A6c.42** Social contributions to pension schemes are discussed in paragraphs 12.32-12.37. Social benefits are the amounts payable to the beneficiaries and are discussed in paragraph 12.40. In the *SNA*, social contributions are viewed as both transfers and an investment in the scheme; similarly, social benefits are viewed as both transfers

and a withdrawal of investment from the scheme. These different views require an entry for change in pension entitlements, discussed in paragraphs 12.38-12.39.

## E. Standardized Guarantees

Reference:

*2008 SNA*, Chapter 17, Cross-Cutting and Other Special Issues, Part 3.

**A6c.43** Standardized guarantees are issued in large numbers along similar lines. Examples include export credit guarantees and student loan guarantees. Standardized guarantees are contrasted with other guarantees in paragraph 5.68. The guarantors are usually general government units or financial corporations. Because the guarantor provides large numbers of guarantees, it is possible to estimate the risk of default. A guarantor operating on a commercial basis will charge fees, meet claims, and earn investment income in a way parallel to nonlife insurance, and the value of services, income, and provisions are calculated in the same way as described for nonlife insurance in Section B of this appendix.

**A6c.44** Provisions for calls under standardized guarantees are defined as a financial instrument and contrasted with one-off guarantees and financial derivatives in paragraph 5.68. They are classified as other investment in the functional classification; see paragraph 6.61. Changes to provisions for calls under standardized guarantee schemes not resulting from transactions are shown as other changes in volume and are discussed in paragraph 9.24.

# APPENDIX 7

## Relationship of the *SNA* Accounts for the Rest of the World to the International Accounts

### Introduction

References:

2008 *SNA*, Chapter 26, The Rest of the World Accounts (external transactions accounts).

IMF and others, *External Debt Statistics: Guide for Compilers and Users*, Appendix IV, Relationship Between the National Accounts and the International Investment Position (IIP).

A7.1 International accounts are closely linked to the *SNA*. This linkage is reinforced by the fact that, in most countries, data on the balance of payments and the IIP are compiled first and subsequently incorporated in relevant external account components of the *SNA* rest of the world account. There is complete concordance between the *SNA* and this *Manual* with respect to the delineation of resident units, valuation, time of recording, conversion procedures, and coverage of goods, services, income, capital transfers, and foreign financial assets and liabilities.

### Accounting System

A7.2 The *SNA* uses an underlying accounting system similar to that used for the balance of payments. However, the entries for both parties to a transaction (such as a resident and a nonresident) are included in the *SNA*, rather than just one party (the resident) as in the balance of payments. As a result, each transaction gives rise to four entries in the *SNA*, that is, two entries for each party.

A7.3 Credits in the balance of payments are called resources in the *SNA*, and debits are called uses. The *SNA* rest of the world accounts are presented from the point of view of the nonresident units, whereas the balance of payments presents the same transactions from the point of view of resident units. As an illustration, imports of an economy are shown as resources in the *SNA*, that is, an outflow from the rest of the world and an inflow or use for the resident units.

### Classification

A7.4 In general, the classification system is the same in the *SNA* and the *Manual*. The coverage and terminology of major aggregates have been fully harmonized. There is a major presentational difference in that the international accounts use functional categories as the primary level of classification for investment income, the financial account, and the IIP, whereas the *SNA* uses instruments and sectors. The functional categories are not applicable to domestic relationships. However, the instrument and institutional sector detail in the international accounts allows the data to be converted or compared with *SNA* data. In addition, differences in classification or level of detail exist between the rest of the world accounts and international accounts. These reflect differences in analytical requirements and the necessity of using, in the *SNA*, a uniform classification scheme for all sectors of the economy. Because of the use of consistent terminology, links can be seen between international accounts items and the corresponding *SNA* items. In addition, to assist in comparisons or linking, the listing of standard components in Appendix 9 includes *SNA* codes. (Because of the use of functional categories as the primary classification in the international accounts, a letter has been added to the *SNA* codes for investment income, financial account, and IIP items to denote the functional category.)

### Linkages between Accounts

A7.5 The terminology of the *SNA* rest of the world accounts and the international accounts is the same, except for some minor differences (e.g., the *SNA* uses the external account of goods and services for the goods and services account, and external assets and liabilities for the IIP).

A7.6 The *SNA* coverage of exports and imports of goods and exports and imports of services is identical to balance of payments coverage of corresponding

**Table A7.1. Correspondence between SNA and International Accounts Items***(Financial Account and IIP)*

2008 SNA Classification of Financial Instruments	SNA Code	BPM6 Classification of Financial Instruments
Monetary gold and special drawing rights	F1	
Monetary gold	FN	Monetary gold (RA)
Special drawing rights	F12	Special drawing rights (assets-RA; liabilities-OI)
Currency and deposits	F2	Currency and deposits (DI, OI, RA)
Currency	F21	
Transferable deposits	F22	
Interbank positions	F221	<i>Interbank positions (O1)</i>
Other transferable deposits	F229	
Other deposits	F29	
Debt securities	F3	Debt securities (DI, PI, RA)
Short-term	F31	Short-term (DI, PI, RA)
Long-term	F32	Long-term (DI, PI, RA)
Loans	F4	Loans (D/, OI, RA)
Short-term	F41	Short-term (DI, OI, RA)
Long-term	F42	Long-term (DI, OI, RA)
Equity and investment fund shares	FS	Equity and investment fund shares (DI, PI, OI, RA)
Equity	D43	Reinvestment of earnings (DI, PI, OI, RA)
Investment fund shares/units	FS1	<i>Equity (DI, PI, OI, RA)</i>
Money market fund shares/units		Reinvestment of <del>earnings</del> <i>(DI, PI, OI)</i>
Other investment fund shares/units	FS2	<i>Investment fund shares/units (DI, PI, OI, RA)</i>
Other investment fund shares/units	FS21	<i>Reinvestment of earnings (DI, PI, OI)</i>
Other investment fund shares/units	FS29	<i>Money market fund shares/units (DI, PI, OI, RA)</i>
Other investment fund shares/units	FS29	<i>Other investment fund shares/units (DI, PI, OI, RA)</i>
Insurance, pension, and standardized guarantee schemes	F6	Insurance, pension, and standardized guarantee schemes (DI, OI)
Nonlife insurance reserves	F61	<i>Nonlife insurance reserves (DI, OI)</i>
Life insurance and annuity entitlements	F62	<i>Life insurance and annuity entitlements (DI, OI)</i>
Pension entitlements	F63	<i>Pension entitlements (O1)</i>
Claims of pension funds on pension managers	F64	<i>Claims of pension funds on pension managers (DI, OI)</i>
Entitlements to nonpension benefits	F65	<i>Entitlements to nonpension benefits (O1)</i>
Provisions for calls under standardized guarantees	F66	<i>Provisions for calls under standardized guarantees (DI, OI)</i>
Financial derivatives and employee stock options	F7	Financial derivatives and employee stock options (FD, RA)
Financial derivatives	F71	Financial derivatives (FD, RA)
Employee stock options	F72	<i>Employee stock options (FD)</i>
Other accounts receivable/payable	F8	Other accounts receivable/payable (DI, OI)
Trade credits and advances	F81	Trade credits and advances (DI, OI)
Other accounts receivable/payable - other	F89	Other accounts receivable/payable-other (DI, OI)

Note: DI—direct investment; PI—portfolio investment; FD—financial derivatives (other than reserves) and employee stock options; OI—other investment; RA—reserve assets. Supplementary items are in italics. SNA codes are for financial account items; codes for balance sheets/IIP have an initial A, but are otherwise the same (e.g., financial account entries for currency and deposits are F2, while the corresponding asset and liability positions are AF2). In addition, reinvestment of earnings is not applicable in the IIP.

items. In balance of payments statistics, exports and imports of services are disaggregated in more detail to provide data for analysis and policy decisions—particularly for negotiations in international trade in services within the framework of international agreements. The services identified in the balance of payments are consistent with those of the Central Product Classification (CPC)—except for the transactor-based items for travel, construction, and government goods and services n.i.e.

A7.7 Compensation of employees, property income, and current transfers are defined identically, although the functional category is used for disaggregation of investment income in the international accounts. The major elements of the capital account of the external accumulation accounts are identical with the capital account of the balance of payments. The balancing item net lending/net borrowing in account is identical to the balance of payments item.

A7.8 The coverage of the *SNA* financial account is identical with that of the financial account in the balance of payments, although the level of detail is different. Similarly, the coverage of the *SNA* external assets and liabilities account is identical with that of the IIP. However, in the *SNA*, financial assets are classified primarily by type of instrument. In the balance of payments, financial items are classified primarily by functional category: direct investment, portfolio investment, financial derivatives (other than reserves) and employee stock options, other investment, and reserve assets. The financial instruments classification used in

the *SNA* and its relationship with the functional categories and their instrument components used in the international accounts are set out in Table A7.1.

A7.9 In addition to categories identifying types of financial instruments, the balance of payments contains an abbreviated sector breakdown (central bank, other deposit-taking corporations, general government, other financial corporations, and other sectors) to provide links with other bodies of economic and financial statistics such as money and banking, government finance, international banking, and external debt.

## 8 Changes from BP/VI5

A detailed list of individual changes made in this edition of the *Manual* is provided below. The comparison is with *BPM5*, as amended by *The Recommended Treatment of Selected Direct Investment Transactions* (1999), *Financial Derivatives, a Supplement to the Fifth Edition (1993) of the Balance of Payments Manual* (2002), and *IMF Committee on Balance of Payments Statistics Annual Report* (2001). The main themes behind the changes in *BPM6* are discussed in paragraphs 1.32-1.35.

### Chapter 1. Introduction

The title of the *Manual* is changed to *Balance of Payments and International Investment Position Manual* (paragraph 1.1).

Procedures are introduced for updating the *Manual* (paragraphs 1.37-1.41).

A research agenda for future work is identified (paragraph 1.43).

### Chapter 2. Overview of the Framework

The definition of balance of payments statistics is limited to transactions between residents and nonresidents (paragraph 2.2; however, practical dimensions are discussed in paragraphs 3.7-3.8 and 4.152-4.154; *BPM5* paragraphs 13-14).

The Data Quality Assessment Framework, metadata, and dissemination issues are introduced (paragraphs 2.37-2.39).

Time series issues are discussed explicitly (paragraphs 2.40-2.41).

Explicit recognition is given to the use of satellite accounts and other supplemental presentations (paragraphs 2.42-2.43).

### Chapter 3. Accounting Principles

Transactions in external assets between two resident institutional units and transactions in external liabilities between two nonresidents are not recorded in the balance of payments as transactions. However, it is clarified that these transactions can affect sectoral positions; these changes are reflected through reclassification (paragraphs 3.7-3.8; *BPM5* paragraphs 485-487).

Imputed transactions are clarified and specified (paragraph 3.18).

Changes in financial assets and liabilities due to change in residence of individuals are treated as other changes in the volume of assets (reclassifications) rather than as transactions (paragraph 3.21; *BPM5* paragraphs 352-353).

Bookkeeping conventions (vertical double-entry bookkeeping, horizontal double-entry bookkeeping, and quadruple-entry bookkeeping) are explained in the context of international accounts (paragraphs 3.26-3.29; *BPM5* paragraphs 16-19).

The financial account uses the headings "net acquisition of financial assets" and "net incurrence of liabilities" instead of "debits" and "credits" (paragraph 3.31).

The term "economic ownership" is introduced (paragraph 3.41; *BPM5* paragraph 114).

The time of recording of dividends is defined as when the stocks or shares go ex-dividend (paragraph 3.48, also paragraph 11.31; *BPM5* paragraph 121).

According to the accrual basis, repayments of debts are recorded when they are extinguished (when they are paid, or rescheduled, or forgiven by the creditor) rather than when due (paragraphs 3.54-3.57; *BPM5* paragraph 123).

The time of recording of flows arising from activation of one-off guarantees is clarified (paragraph 3.58).

Definitions of domestic and foreign currencies are provided (paragraphs 3.95-3.97).

Currency union issues related to definition of domestic and foreign currency are discussed (paragraph 3.95 and Appendix 3).

Currency conversion is clarified for exchanges; continuous transactions; other flows, including revaluations; and positions (paragraphs 3.104-3.105; *BPM5* paragraphs 132-133).

Terms "currency of denomination" and "currency of settlement" are introduced and their use explained (paragraphs 3.98-3.103).

Income flows arising from reverse investment where the direct investment enterprise owns less than 10 percent of the voting power of its direct investor are also to be recorded on a gross basis (paragraph 3.113, also paragraph 11.97; *BPM5* paragraph 276).

All capital account transactions are to be recorded on a gross basis (paragraph 3.113; *BPM5* paragraph 312).

Currency union issues related to consolidated regional international accounts are discussed (paragraph 3.121).

Symmetry of reporting and derived measures are dealt with explicitly (paragraphs 3.122-3.129).

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

The definition of economic territory no longer has the requirement that persons, goods, and capital circulate freely (paragraph 4.4; *BPM5* paragraph 59).

Currency and economic unions are considered as economic territories (paragraph 4.4 and Appendix 3).

Special zones should not be omitted but separate data may be prepared for zones and the remainder of the economy (paragraph 4.8).

Treatments for changes of sovereignty (paragraph 4.9) and joint administration zones (paragraph 4.10) are provided.

A discussion of units provides a basis for links with micro statistics and other macroeconomic statistics (paragraphs 4.13-4.56).

The requirements for recognizing a branch as a separate unit are amended (paragraph 4.27; *BPM5* paragraphs 75 and 80).

There is no imputed institutional unit for the employment of staff of nonresident enterprises or

technical assistance personnel resident in the recipient economy. Therefore, technical assistance personnel should be treated as employed by the institutional unit that actually employs them, which may be the donor, a contractor, or the recipient; see paragraph 4.30 for general principles, also Box 10.6. (Previously, units may have been imputed; see *BPM5* paragraph 69.)

The treatment of notional units for land is elaborated and its application extended to leases for long periods (paragraphs 4.34-4.40; *BPM5* paragraph 65).

Possible treatments of multiterritory enterprises are stated (paragraphs 4.41-4.44; *BPM5* paragraph 82).

The nature and treatment of special purpose entities and other similar structures are discussed (paragraphs 4.50-4.52, 4.87, 4.93, and 4.134-4.135; *BPM5* paragraph 79).

The local enterprise group is identified and the implications of the use of different types of units are noted (paragraphs 4.54-4.56).

The *SMA* institutional sector classification is adopted, with a condensed version adopted for the standard components (paragraph 4.59, Tables 4.1 and 4.2; *BPM5* paragraphs 512-517).

The sector classification is amended to be consistent with the *SMA* in the cases of the central bank and deposit-taking corporations except the central bank, although the continued use of monetary authorities is endorsed in some cases (paragraphs 4.67-4.72; *BPM5* paragraphs 514-516).

The classification of the financial sector is linked to the treatment of debt between affiliated financial intermediaries (paragraphs 4.63-4.90 and 6.28; *BPM5* paragraph 372).

The sector classification of holding companies is elaborated (paragraphs 4.84-4.85).

The definition of residence is expressed as "center of predominant economic interest," although this is not a change in substance. The residence concept is applied to institutional units, rather than production, ships, and so forth (paragraph 4.113; *BPM5* paragraphs 62, 78, 80-81).

Residence criteria are specified for various mobile individuals who do not spend or intend to spend a year in one place (paragraphs 4.126<sup>^</sup>.127; *BPM5* paragraph 72).

The residence of entities with little or no physical presence is to be determined from the jurisdiction of



incorporation or registration (paragraphs 4.134-4.135; *BPM5* paragraph 79).

Additional guidance is provided on partner data (paragraphs 4.146-4.164; *BPM5* paragraphs 478-498).

Corporate migration is discussed (paragraphs 4.166-4.167).

## **Chapter 5. Classifications of Financial Assets and Liabilities**

The possibility of supplementary data on contingent assets and liabilities is raised (paragraph 5.10).

The detailed classification of financial assets and liabilities is harmonized with the *SNA* and *MF5M 2000* in terms of detail and terminology (Table 5.3; in the *BPM5* standard components, instruments are combined and different names for them are used in different places). These classifications are linked to broad groups—equity, debt, and other (paragraph 5.17).

Equity may be split into listed shares, unlisted shares, and other equity (paragraph 5.24).

Investment fund shares and money market fund shares are separately identified (paragraphs 5.28-5.30).

SDR allocations represent a liability of the recipient (paragraph 5.35, also paragraphs 6.61(g) and 7.70, and applied to income in paragraphs 11.106 and 11.110; *BPM5* paragraph 440).

Interbank positions are shown as an additional financial instrument category on a supplementary basis (paragraph 5.42).

"Bonds and notes" and "money market instruments" are replaced as terms by long-term and short-term debt securities, respectively (paragraphs 5.44 and 5.103; *BPM5* paragraphs 390-391).

The conditions for traded loans to be reclassified as securities are clarified (paragraph 5.45).

The treatment of loans involved in repos and gold swaps is elaborated (paragraphs 5.52-5.55; *BPM5* paragraph 418).

Pension entitlements are recognized as a financial instrument. The accrued obligations of unfunded pension schemes are also recognized as economic assets and liabilities (paragraph 5.66).

Provisions for calls under standardized guarantees are identified and treated similarly to insurance technical reserves (paragraph 5.68).

"Trade credit and advances" replaces the term "trade credits" (paragraph 5.70; *BPM5* paragraph 414).

Monetary gold is defined in terms of gold bullion (which includes allocated gold accounts) and unallocated gold accounts (paragraph 5.74; *BPM5* paragraph 438).

The classification of unallocated and allocated gold accounts is clarified (paragraphs 5.76-5.77).

The content of *Financial Derivatives, a Supplement to the Fifth Edition (1993) of the Balance of Payments Manual* (2002) is incorporated (paragraphs 5.80-5.95).

Margin payments where these are liabilities of deposit-taking corporations are classified as deposits or in other accounts receivable/payable (paragraph 5.94(a)).

Supplementary additional breakdowns of financial derivatives are introduced (paragraph 5.95).

Employee stock options are recognized as an instrument (paragraphs 5.96-5.98).

Arrears are identified as a supplementary category of the original asset or liability, rather than in repayment of the original liability and the creation of a new short-term loan (paragraphs 5.99-5.102; *BPM5* paragraph 458).

Details of currency composition and remaining maturity are included for selected position data in memorandum and supplementary tables (paragraph 5.104, also Appendix 9 tables; *BPM5* paragraph 338).

A classification by type of interest is included (paragraphs 5.109-5.114).

## **Chapter 6. Functional Categories**

The Framework for Direct Investment Relationships is adopted for identifying direct investment relationships (paragraphs 6.8-6.18).

Ownership of ordinary shares is removed from the operational definition of direct investment and replaced by ownership of equity that gives rise to voting power (paragraphs 6.12 and 6.19; *BPM5* paragraph 362).

The coverage of direct investment relationships due to indirect voting power and fellow enterprises is elaborated (paragraph 6.14; *BPM5* paragraph 362).

Insurance technical reserves are potentially included in direct investment (paragraph 6.27).

The exclusion of debt positions between affiliated financial corporations is specified as being for deposit-taking corporations, investment funds, and other financial intermediaries except insurance companies and pension funds. Permanent debt between affiliated financial intermediaries is treated in the same way as nonpermanent debt (paragraph 6.28; *BPM5* paragraph 372).

The concept of pass-through funds is introduced (paragraphs 6.33-6.34).

Direct investment is broken down into three categories—investment by a direct investor in its direct investment enterprise, reverse investment, and investment between fellow enterprises; the final category is added in this edition (paragraph 6.37; *BPM5* paragraphs 368 and 371).

The main presentation uses direct investment assets and direct investment liabilities (so that, for example, the netting of reverse investment is not built in). However, data on the basis of the directional principle are explained (paragraphs 6.42-6.45 and Box 6.4; *BPM5* paragraph 375). The treatment of fellow enterprises in data on a directional basis is explained, with both a preferred and practical alternative suggested (paragraph 6.43). Data on a directional principle basis and the details needed to compile these data are shown as supplementary items in Appendix 9.

The functional category "financial derivatives" is renamed. "(Other than reserves)" is added to distinguish it from the instrument classification financial derivatives and employee stock options, which has different coverage. Employee stock options are also included (paragraph 6.58).

The content of the *Financial Derivatives, a Supplement to the Fifth Edition (1993) of the Balance of Payments Manual* (2002) is incorporated (paragraphs 6.58-6.60).

SDR allocation liabilities are included in other investment as a separate item; previously, no liabilities were recognized (paragraph 6.61(g), also paragraphs 5.35 and 7.70; *BPM5* paragraph 440).

Other equity not included in direct investment is included in other investment as a separate item (paragraph 6.62; *BPM5* paragraph 422).

In the definition of reserve assets, "and/or other purposes" replaced by "and for other related purposes" (paragraph 6.64; *BPM5* paragraph 424).

The concept of ready availability is clarified (paragraphs 6.69-6.70; *BPM5* paragraph 431).

The meaning of foreign currency for reserve assets is elaborated (paragraphs 6.71-6.75; *BPM5* paragraph 442). Convertibility (including treatment of currencies of neighboring countries) is clarified (paragraphs 6.72-6.73).

The treatments of allocated and unallocated gold accounts in reserve assets, and changes in the coverage of monetary gold, are elaborated (paragraphs 6.78-6.80).

The treatments of gold lending (paragraph 6.81; *BPM5* paragraph 434), repos (paragraph 6.88), special-purpose government funds (paragraphs 6.93-6.98), pooled assets (paragraphs 6.99-6.101), central bank swap arrangements (paragraphs 6.102-6.104), and pledged assets (paragraphs 6.107-6.109) in reserve assets are elaborated.

Frozen assets are discussed (paragraph 6.110).

The treatment of net creditor positions in regional payment agreements is modified (paragraph 6.112).

Working balances of government agencies are not included in reserve assets (paragraph 6.112; *BPM5* paragraph 433).

Reserve-related liabilities are introduced as a classification (paragraphs 6.115-6.116).

Liabilities constituting foreign authorities' reserves are not shown as separate items (*BPM5* paragraph 447).

## Chapter 7. International Investment Position

There is emphasis that the classification, netting, and ordering in the IIP should be consistent with the equivalent items for the financial account, primary income, and other changes so as to facilitate reconciliation and calculation of rates of return (paragraph 7.13; also paragraph 8.5).

The main presentation uses direct investment assets and direct investment liabilities (so that reverse investment is not netted in totals) (Table 7.1; *BPM5* paragraph 375).

Direct investment is valued at the best indicator of market prices. (*BPM5* adopted market valuation in principle, while noting that book values "generally are utilized" in practice.) For equity that is not regularly

traded, proxy methods are identified for when book values are inadequate and the limitations in the analytical usefulness of historic cost data are emphasized (paragraphs 7.15-7.18; *BPM5* paragraph 467).

A treatment for short positions is provided (paragraph 7.28).

Traded loans are valued at nominal value in the IIP, like other loans; in *BPM5*, they were recorded at transaction value by the creditor (paragraph 7.40; *BPM5* paragraph 471).

Memorandum and supplementary items for the effect of impaired loan assets are introduced, showing fair values of loans, the values of nonperforming loans, and loan loss provisions (paragraphs 7.45-7.54).

The treatment of overnight deposits (or sweep accounts) is discussed (paragraph 7.62).

Insurance reserves and pension entitlements are recognized as assets and liabilities (paragraphs 7.63-7.68).

SDR allocations are recognized as liabilities (paragraph 7.70, also paragraphs 5.35 and 6.61(g); *BPM5* paragraph 440).

Reserve-related liabilities are introduced as a memorandum item (paragraph 7.71).

Significant off-balance-sheet commitments should be recorded (paragraph 7.74).

Guidance on transactions and positions with the IMF is provided (Annex 7.1).

## Chapter 8. Financial Account

The column headings are changed to net acquisitions of financial assets and net incurrence of liabilities (instead of credits and debits, respectively) consistent with their contents. Consequently, negative signs are not used for an increase in assets and positive signs are not used for a reduction in assets (paragraph 8.1, Table 8.1, also paragraph 3.31).

Financial account entries no longer use the word "capital," bringing consistency with the more restrictive meaning used in the capital account (Table 8.1).

The balancing item for the financial account is called "net lending/net borrowing" (paragraph 8.3).

The terminology for the financial account entry is changed to "reinvestment of earnings" (to distinguish

it from reinvested earnings, which continues to be used for the corresponding income item) (paragraph 8.15).

Mergers and acquisitions are discussed (paragraph 8.18).

The treatment for corporate inversion and other corporate restructuring is stated (paragraphs 8.19-8.22).

Superdividends are treated as a withdrawal of equity (paragraph 8.23; *BPM5* paragraph 290).

Special rules are introduced for entities owned or controlled by general government when that entity is resident in another territory and is used for fiscal purposes (paragraphs 8.24-8.26).

Reinvestment of earnings in investment funds is recorded in the financial account (paragraph 8.28 and also paragraphs 11.37-11.39 for the corresponding income entry; *BPM5* paragraphs 277-278).

The treatment of debt defeasance is stated (paragraphs 8.30-8.31).

The treatment of share buybacks is stated (paragraph 8.32).

A treatment of one-off guarantees and debt assumption is included (paragraphs 8.42-8.45).

The allocation of SDRs is shown as a financial account flow in other investment (paragraph 8.50; *BPM5* paragraph 440).

For liabilities in arrears, repayment and creation of new liability are not imputed (paragraph 8.58; *BPM5* paragraph 458).

Imputed financial account entries for trade credit required by the imputed flows for goods for processing are eliminated (as an implication of removing the previous imputation of change of ownership; new treatments shown in paragraphs 10.41-10.49; *BPM5* paragraph 205).

## Chapter 9. Other Changes in Financial Assets and Liabilities Account

The other changes in financial assets and liabilities account is highlighted and explained (paragraphs 9.1-9.35).

A convention for distinction between write-offs and debt forgiveness in commercial situations is introduced (paragraph 9.10; *BPM5* paragraph 348).

Financial assets and liabilities of entities changing residence are included as other changes in volume (previously included as capital transfers) (paragraphs 9.21-9.23; *BPM5* paragraphs 354-355).

The distinction between exchange rate and other revaluations is elaborated (paragraphs 9.26-9.28; *BPM5* paragraph 466).

## Chapter 10. Goods and Services Account

Exceptions to the change of ownership principle are eliminated (paragraphs 10.13, 10.22(b), 10.22(f), 10.24, 10.41-10.44; *BPM5* paragraphs 119-120).

Goods procured in ports by carriers are included under general merchandise rather than as a separate item under goods (paragraph 10.17(d); *BPM5* paragraphs 156 and 201).

Goods for own use or to give away acquired by travelers that are in excess of customs thresholds are included in general merchandise, rather than travel (paragraphs 10.20 and 10.90; *BPM5* paragraph 242).

Migrants' personal effects are not included in general merchandise or anywhere else in the international accounts (paragraph 10.22(b); *BPM5* paragraph 353).

The time of recording of transactions in high-value capital goods such as ships, heavy machinery, buildings, and other structures that take several months or years to complete is discussed (paragraph 10.28).

Re-exports are defined and introduced as a supplementary item (paragraphs 10.37-10.39).

Merchandising of goods is classified under goods, with both gross and net values shown, with net amounts included in the goods aggregates. Changes in inventories of goods under merchandising are no longer included under imports of general merchandise (paragraphs 10.41-10.49; *BPM5* paragraph 262).

A reconciliation table is introduced to show the relationship between international merchandise trade statistics and goods on a balance of payments basis (paragraphs 10.55-10.56, Table 10.2).

Manufacturing services on physical inputs owned by others are shown as a service in all cases. Previously, when the goods were supplied from the owner and returned to the owner, the value of the service was included in the value of goods. Previously, when the goods were not supplied by the owner or

not returned to the owner, they were shown under miscellaneous business, professional, and technical services (paragraphs 10.62-10.71; *BPM5* paragraphs 198-199).

Maintenance and repair services n.i.e. are renamed in line with the CPC and included under services, rather than goods, and the inclusion of maintenance of transport equipment is clarified (paragraphs 10.72-10.73; *BPM5* paragraphs 200 and 240).

Transport services are renamed (previously "transportation services") in line with the CPC (paragraph 10.74; *BPM5* paragraph 230).

Postal and courier services are included in transport (paragraphs 10.82-10.85; *BPM5* paragraph 253).

Treatments of alternative time-share arrangements are stated (paragraph 10.100 and Table 10.3).

The classification of acquisition of goods and services by nonresident construction enterprises in the economy in which they are working is changed to show separately construction abroad and construction in the compiling economy on a supplementary basis. Goods and services acquired locally are included under this heading, previously under other business services. The inclusion of buildings (excluding the land component) is clarified as being under construction. As a result of these changes, the title of the item is construction, rather than construction services (paragraphs 10.101—10.108, *BPM5* paragraph 254).

The estimate of insurance claims used to derive the value of insurance services is changed to adjust for claim volatility. Premium supplements are taken into account in deriving insurance services. Reinsurance and direct insurance are treated consistently (paragraph 10.111; *BPM5* paragraph 257).

Financial dealers' margins are discussed under services (previously only mentioned in the discussion of the financial account) (paragraphs 10.122-10.123; *BPM5* paragraph 106).

Services of asset-holding entities to their owners, where asset management costs are taken out of income, are recognized (paragraphs 10.124-10.125).

FISIM and other implicit financial services have been included in services, with a method for calculation based on the reference rate (paragraphs 10.126-10.136; footnote to *BPM5* paragraph 258).

"Charges for the use of intellectual property n.i.e." replaces the term "royalties and license fees." Also, its

content and borderlines with computing and audiovisual services have been clarified (paragraphs 10.137-10.140 and Table 10.4; *BPM5* paragraph 260).

A grouping of telecommunications, computer, and information services is introduced, involving a number of items that had previously been separated (paragraph 10.141; *BPM5* paragraphs 253 and 259).

The borderline between goods and services is elaborated for computer software (paragraph 10.143 and Table 10.4; *BPM5* paragraphs 259-260).

The results of research and development (such as patents, copyrights, and industrial processes) are treated as produced assets included in research and development services (previously treated as nonproduced assets and shown in the capital account) (paragraph 10.148; *BPM5* paragraph 358).

Environmental services such as carbon offsets and sequestration, waste treatment, and handling of scrap are discussed (paragraph 10.152, also 10.22(h)).

Merchanting of services is described and its treatment explained (paragraph 10.160).

Audiovisual services are delineated from goods, and the relationship between different kinds of licenses for intellectual property is explained (paragraphs 10.162-10.166 and Table 10.4; *BPM5* paragraph 265).

The treatment of gambling services is described (paragraph 10.171, also 12.25).

The coverage of government goods and services n.i.e. is clarified (paragraphs 10.173-10.181; *BPM5* paragraph 266).

A discussion of the treatment of government licenses, permits, and so forth is provided (paragraphs 10.180-10.181; *BPM5* paragraph 300).

Additional guidance on the treatment of technical assistance is provided (Box 10.6).

## **Chapter II. Primary Income Account**

The term "primary income" is introduced. Consistency between international accounts and national accounts is ensured. The meaning and relationship of primary income, property income, and investment income are clarified (paragraphs 11.1-11.3; *BPM5* paragraph 267).

A detailed breakdown of investment income is introduced to link with functional and instrument classi-

fications of financial instruments. Income on other investment and income on reserve assets are shown separately. Rent and taxes and subsidies on products and production are included explicitly as primary income items (Tables 11.1, 11.2, and 11.3; *BPM5* paragraph 281).

The employer-employee relationship is clarified to distinguish between compensation of employees and payments for services (paragraphs 11.11-11.13).

"Distributed income from quasi-corporations" as a term subsumes distributed branch profits (paragraph 11.26; *BPM5* paragraph 277).

Superdividends are defined and their treatment as withdrawals of equity extended (paragraph 11.27; limited to liquidating dividends in *BPM5* paragraph 290).

Dividends are recorded at the time the shares go ex dividend (paragraph 11.31, also paragraph 3.48; *BPM5* paragraph 282).

"Reinvested earnings" is used as a term for all direct investment enterprises, and thus includes undistributed branch profits (paragraph 11.35; *BPM5* paragraph 277).

Investment income attributable to the owners of investment fund shares also includes reinvested earnings (paragraphs 11.37-11.39; *BPM5* paragraphs 277-278).

If branches do not distribute profits, the retained earnings of the branch are considered to be reinvested earnings. In *BPM5*, if distributed branch profits were not identified, all branch profits were treated as being distributed, not reinvested earnings (paragraph 11.42; *BPM5* paragraph 278).

When a chain of direct investment relationships exists, it is clarified that reinvested earnings should be recorded between the direct investor and directly owned direct investment enterprises only (paragraph 11.47).

Debt instruments with both the amount to be paid at maturity and periodic payments indexed to a foreign currency are classified and treated as if they are denominated in foreign currency (paragraph 11.50(a)-(b); *BPM5* paragraph 397).

The treatment of index-linked debt instruments is clarified and modified (paragraphs 11.50(c) and 11.59-11.65; *BPM5* paragraph 397).

Fees on securities lending and gold loans are clarified and treated as interest (paragraphs 11.67-11.68).

Interest income is adjusted to remove the FISIM component, that is, "pure interest." "Actual interest" is continued as a memorandum item (paragraphs 11.74-11.75; footnote to *BPM5* paragraph 258).

Rent is identified as a component of primary income (paragraph 11.85; previously part of other investment income).

Taxes and subsidies on products and production are classed as primary income, not current transfers (paragraphs 11.91-11.92; *BPM5* paragraph 299).

Treatments of income on reverse investment and investment between fellow enterprises are included. Income arising from reverse investment is to be recorded on a gross, rather than net, basis. Possible breakdowns by type of direct investment relationship and associated investment income flows are distinguished (paragraphs 11.97-11.100; *BPM5* paragraph 276).

The treatment of transfer pricing is clarified (paragraphs 11.101-11.102; *BPM5* paragraph 97).

Income on reserve assets is identified separately (previously other investment) (paragraph 11.109; *BPM5* paragraph 281).

Consistent with the corresponding positions, interest on SDR allocations and holdings are shown on a gross basis (paragraph 11.110).

## Chapter 12. Secondary Income Account

The term "secondary income" is introduced (paragraph 12.1; *BPM5* paragraph 291).

More detailed classification of types of current transfers are introduced on a supplementary basis (paragraphs 12.20-12.58).

Refunds of taxes to taxpayers are treated as negative taxes, that is, the amount of taxes is reduced by tax refunds instead of positive transfers by government (paragraph 12.28; *BPM5* paragraph 299).

The delineation between taxes and services is clarified. Business licenses to fish, hunt, and so forth are no longer automatically treated as taxes, but as services, rent, taxes, or acquisition of a license asset, depending on what is supplied in return (paragraph 12.30, also 10.180-10.181; *BPM5* paragraph 300).

The treatment of social contributions and benefits is specified (paragraphs 12.32-12.40).

The treatment of pension contributions and benefits is aligned with the *SMA* and the adjustment for change in pension entitlements is introduced (paragraph 12.39; *BPM5* paragraph 299).

The treatment of insurance claims and net premiums and of standardized guarantees is specified (paragraphs 12.41-12.46; *BPM5* paragraph 257).

Clarification is made on technical assistance as a part of investment projects to be classified as capital transfers (paragraph 12.50).

Concessional debt is discussed and introduced as a supplementary item. In *BPM5*, a transfer could be identified on government loans bearing lower interest rates than those consistent with grace and repayment periods, although the implementation of this principle was not elaborated (paragraph 12.51; *BPM5* paragraph 104).

The term "personal transfers," which is broader than workers' remittances, is introduced (paragraph 12.21; *BPM5* paragraph 302).

The concepts of (1) personal remittances, (2) total remittances, and (3) total remittances and transfers to NPISHs are introduced (paragraph 12.27).

The treatment of gambling transfers is described (paragraph 12.26).

## Chapter 13. Capital Account

Debits and credits for acquisitions and disposals of nonproduced nonfinancial assets are to be recorded separately, not netted (paragraph 13.7, also paragraph 3.113; *BPM5* paragraph 312).

The terminology for nonproduced assets is expanded, to include "natural resources," "contracts, leases, and licenses," and "marketing assets and goodwill" (paragraphs 13.8-13.18; *BPM5* paragraph 358).

Internet domain names are identified as possible economic assets (paragraph 13.18).

Insurance claims may be treated as capital transfers in the case of catastrophes (paragraph 13.24; *BPM5* paragraph 257).

The personal effects, financial assets, and liabilities of persons changing residence are no longer covered by a capital transfer (paragraph 13.30, also 9.21-9.22 and 10.22(b); *BPM5* paragraphs 352-353).

Inheritance is treated as a capital transfer instead of a current transfer (paragraph 13.31; *BPM5* paragraph 303).

Patents and copyrights are no longer treated as non-produced assets, so no longer appear in the capital account. (Patents and copyrights are classified as produced assets and appear under particular services, such as research and development services; see Table 10.4.) (*BPM5* paragraph 358).

#### **Chapter 14. Selected Issues in Balance of Payments and International Investment Position Analysis**

The "analytic" presentation (paragraphs 14.16-14.17), monetary presentation (paragraphs 14.20-14.22), implications of a current account surplus (paragraphs 14.48-14.56), and balance sheet approach (paragraphs 14.57-14.66) are incorporated (*BPM5* Appendix V).

## Standard Components and Selected Other Items

BPM6 codes are shown before the name of item. Codes used in the 2008 SNA are shown, where applicable, in brackets after the item: B—balancing items, P—products, D—distributive transactions, F—financial transactions, AF—financial positions, NP—transactions in nonproduced assets, and X—supplementary items. For details, see 2008 SNA, Annex 1, Classification and Coding Structure of Accounting Entries. Suffixes are added to SNA codes for the international

accounts functional categories: D—direct investment, P—portfolio investment, F—financial derivatives (other than reserves) and employee stock options, O—other investment; and R—reserve assets.

*Supplementary items are shown in italics.* Headings and aggregates are shown in bold type. For definitions of standard components, memorandum items, and supplementary items, see paragraph 1.15.

### A. Balance of Payments

Balance of payments	Credits	Debits
<b>I. Current account</b>		
Current account balance (+ surplus; - deficit) (BI2)		
<b>I.A Goods and services (P6/P7)</b>		
Balance on goods and services (+ surplus; - deficit) (BI 1)		
<b>I.A.a Goods (P61/P71)</b>		
Balance on trade in goods (+ surplus; - deficit)		
I.A.a.1 General merchandise on a BOP basis		
<i>Of which: I.A.a.1.1 Re-exports</i>		n.a.
I.A.a.2 Net exports of goods under merchandising		n.a.
I.A.a.2.1 Goods acquired under merchandising (negative credits)		n.a.
I.A.a.2.2 Goods sold under merchandising		n.a.
I.A.a.3 Nonmonetary gold		
<b>I.A.b Services (P72/P82)</b>		
Balance on trade in services (+ surplus; - deficit)		
I.A.b.1 Manufacturing services on physical inputs owned by others		
I.A.b.1.1 <i>Goods for processing in reporting economy—Goods returned (CR.), Goods received (DR.) (see paragraph 10.67)</i>		
I.A.b.1.2 <i>Goods for processing abroad—Goods sent (CR.), Goods returned (DR.) (see paragraph 10.67)</i>		
I.A.b.2 Maintenance and repair services n.i.e.		
I.A.b.3 Transport <sup>1</sup>		
I.A.b.3.1 Sea transport		
I.A.b.3.1.1 Passenger		
<i>Of which: I.A.b.3.1.1.1 Payable by border, seasonal and other short-term workers</i>		
I.A.b.3.1.2 Freight		
I.A.b.3.1.3 Other		
I.A.b.3.2 Air transport		
I.A.b.3.2.1 Passenger		
<i>Of which: I.A.b.3.2.1.1 Payable by border, seasonal and other short-term workers</i>		



A. Balance of Payments (continued)

Balance of payments	Credits	Debits
I.A.b.3.2.2 Freight		
I.A.b.3.2.3 Other		
I.A.b.3.3 Other modes of transport		
I.A.b.3.3.1 Passenger		
Of which: I.A.b.3.3.1.1 Payable by border, seasonal, and other short-term workers		
I.A.b.3.3.2 Freight		
I.A.b.3.3.3 Other		
I.A.b.3.4 Postal and courier services		
For all modes of transport <sup>2</sup>		
I.A.b.3.0.1 Passenger		
Of which: I.A.b.3.0.1.1 Payable by border, seasonal, and other short-term workers		
I.A.b.3.0.2 Freight		
I.A.b.3.0.3 Other		
I.A.b.4 Travel		
I.A.b.4.1 Business		
I.A.b.4.1.1 Acquisition of goods and services by border, seasonal, and other short-term workers		
I.A.b.4.1.2 Other		
I.A.b.4.2 Personal		
I.A.b.4.2.1 Health-related		
I.A.b.4.2.2 Education-related		
I.A.b.4.2.3 Other		
For both business and personal travel		
I.A.b.4.0.1 Goods		
I.A.b.4.0.2 Local transport services		
I.A.b.4.0.3 Accommodation services		
I.A.b.4.0.4 Food-serving services		
I.A.b.4.0.5 Other services		
Of which: I.A.b.4.0.5.1 Health services		
I.A.b.4.0.5.2 Education services		
I.A.b.5 Construction		
I.A.b.5.1 Construction abroad <sup>10</sup>		
I.A.b.5.2 Construction in the reporting economy <sup>10</sup>		
I.A.b.6 Insurance and pension services <sup>1</sup>		
I.A.b.6.1 Direct insurance		
I.A.b.6.2 Reinsurance		
I.A.b.6.3 Auxiliary insurance services		
I.A.b.6.4 Pension and standardized guarantee services		
I.A.b.7 Financial services		
I.A.b.7.1 Explicitly charged and other financial services		
I.A.b.7.2 Financial intermediation services indirectly measured (FISIM)		
I.A.b.8 Charges for the use of intellectual property n.i.e. <sup>1</sup>		
I.A.b.9 Telecommunications, computer, and information services <sup>1</sup>		
I.A.b.9.1 Telecommunications services		
I.A.b.9.2 Computer services		
I.A.b.9.3 Information services		
I.A.b.10 Other business services <sup>1</sup>		
I.A.b. 10.1 Research and development services		
I.A.b. 10.2 Professional and management consulting services		
I.A.b. 10.3 Technical, trade-related, and other business services		
I.A.b.11 Personal, cultural, and recreational services <sup>1</sup>		
I.A.b. 11.1 Audiovisual and related services		
I.A.b. 11.2 Other personal, cultural, and recreational services		
I.A.b. 12 Government goods and services n.i.e. <sup>1</sup>		
IAb.0.1 Tourism-related services in travel and passenger transport		

## A. Balance of Payments (continued)

Balance of payments	Credits	Debits
<b>I.B Primary Income</b>		
Balance on primary income (+ surplus; – deficit)		
I.B.1 Compensation of employees (D1)		
I.B.2 Investment income		
I.B.2.1 Direct investment		
I.B.2.1.1 Income on equity and investment fund shares		
I.B.2.1.1.1 Dividends and withdrawals from income of quasi-corporations (D42D)		
I.B.2.1.1.1.1 Direct investor in direct investment enterprises		
I.B.2.1.1.1.2 Direct investment enterprises in direct investor (reverse investment)		
I.B.2.1.1.1.3 Between fellow enterprises		
I.B.2.1.1.1.3.1 if ultimate controlling parent is resident		
I.B.2.1.1.1.3.2 if ultimate controlling parent is nonresident		
I.B.2.1.1.1.3.3 if ultimate controlling parent is unknown		
I.B.2.1.1.2 Reinvested earnings (D43D)		
<i>Investment income attributable to policyholders in insurance, pension schemes, and standardized guarantees, and to investment fund shareholders (D44D)</i>		
<i>Of which: Investment income attributable to investment fund shareholders (D443D)</i>		
I.B.2.1.2 Interest (D41D)		
I.B.2.1.2.1 Direct investor in direct investment enterprises		
I.B.2.1.2.2 Direct investment enterprises in direct investor (reverse investment)		
I.B.2.1.2.3 Between fellow enterprises		
I.B.2.1.2.3.1 if ultimate controlling parent is resident		
I.B.2.1.2.3.2 if ultimate controlling parent is nonresident		
I.B.2.1.2.3.3 if ultimate controlling parent is unknown		
I.B.2.1.2M Memorandum: Interest before FISIM		
I.B.2.2 Portfolio investment		
I.B.2.2.1 Investment income on equity and investment fund shares		
I.B.2.2.1.1 Dividends on equity excluding investment fund shares (D42P)		
I.B.2.2.1.2 Investment income attributable to investment fund shareholders (D443P)		
I.B.2.2.1.2.1 Dividends		
I.B.2.2.1.2.2 Reinvested earnings		
I.B.2.2.2 Interest (D41P)		
I.B.2.2.2.1 Short-term		
I.B.2.2.2.2 Long-term		
I.B.2.3 Other investment		
I.B.2.3.1 Withdrawals from income of quasi-corporations (D420)		
I.B.2.3.2 Interest (D41O)		
I.B.2.3.2M Memorandum: Interest before FISIM		
I.B.2.3.3 Investment income attributable to policyholders in insurance, pension schemes, and standardized guarantee schemes		
I.B.2.4 Reserve assets <sup>3</sup>		
I.B.2.4.1 Income on equity and investment fund shares (D42R) <sup>3</sup>		
I.B.2.4.2 Interest (D41R) <sup>3</sup>		
I.B.2.4.2M Memorandum: Interest before FISIM <sup>3</sup>		
I.B.3 Other primary income		
I.B.3.1 Taxes on production and on imports (D2)		
I.B.3.2 Subsidies (D3)		
I.B.3.3 Rent (D45)		
Balance on goods, services, and primary income (+ surplus; – deficit)		
<b>I.C Secondary income</b>		
Balance on secondary income (+ surplus; – deficit)		
I.C.1 General government		
I.C.1.1 Current taxes on income, wealth, etc. (D5)		
Of which: I.C.1.1.1 payable by border, seasonal, and other short-term workers		
I.C.1.2 Social contributions (D61)		
Of which: I.C.1.2.1 payable by border, seasonal, and other short-term workers		
		n.a.
		n.a.
		n.a.
		n.a.

## BALANCE OF PAYMENTS AND INTERNATIONAL INVESTMENT POSITION MANUAL

### A. Balance of Payments (continued)

Balance of payments	Credits	Debits
<i>I.C. 1.3 Social benefits (D62+D63)</i>	<i>n.o.</i>	
<i>I.C.1.4 Current International cooperation (D74)</i>		
<i>I.C.1.5 Miscellaneous current transfers of general government (D7J)</i>		
<i>Of which: I.C.1.5.1 Current transfers to NPISHs</i>		
<b>I.C.2 Financial corporations, nonfinancial corporations, households, and NPISHs</b>		
<b>I.C.2.1 Personal transfers (Current transfers between resident and nonresident households)</b>		
<i>Of which: I.C.2.1.1 Workers' remittances</i>		
<b>I.C.2.2 Other current transfers</b>		
<i>I.C.2.0.1 Current taxes on income, wealth, etc. (D5)</i>	<i>n.a.</i>	
<i>I.C.2.0.2 Social contributions (D6I)</i>		
<i>I.C.2.0.3 Social benefits (D62+D63)</i>		
<i>I.C.2.0.4 Net nonlife insurance premiums (D7I)</i>		
<i>I.C.2.0.5 Nonlife insurance claims (D72)</i>		
<i>I.C.2.0.6 Current international cooperation (D74)</i>		
<i>I.C.2.0.7 Miscellaneous current transfers (D75)</i>		
<i>Of which: I.C.2.0.7.1 Current transfers to NPISHs</i>		
<b>I.C.3 Adjustment for change in pension entitlements (D8)</b>		
<b>2 Capital account</b>		
Capital account balance (+ surplus; - deficit)		
2.1 Gross acquisitions (DR.)/disposals (CR.) of nonproduced nonfinancial assets (N2)		
2.2 Capital transfers (D9)		
2.2.1 General government		
2.2.1.1 Debt forgiveness		
2.2.1.2 Other capital transfers		
<i>Of which: 2.2.1.2.1 Capital taxes (D9I)</i>		
2.2.2 Financial corporations, nonfinancial corporations, households, and NPISHs		
2.2.2.1 Debt forgiveness		
2.2.2.2 Other capital transfers		
<i>Of which: 2.2.2.2.1 Capital taxes (D91)</i>	<i>n.a.</i>	
<i>Of which: 2.2.2.0.1 Between households</i>		
<i>Of which:</i>		
<i>for each item in capital transfers:</i>		
<i>Transfers to NPISHs</i>		
Net lending (+) / net borrowing (-) (balance from current and capital accounts) (B9)		

Balance of payments	Net acquisition of financial assets	Net incurrence of liabilities
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### 3 Financial account

Net lending (+) / net borrowing (-) (from financial account) (B9)

<b>3.1 Direct investment (FD)</b>		
<b>3.1.1 Equity and investment fund shares (F5D)</b>		
3.1.1.1 Equity other than reinvestment of earnings		
3.1.1.1.1 Direct investor in direct investment enterprises		
3.1.1.1.2 Direct investment enterprises in direct investor (reverse investment)		
3.1.1.1.3 Between fellow enterprises		
3.1.1.1.3.1 if ultimate controlling parent is resident		
3.1.1.1.3.2 if ultimate controlling parent is nonresident		
3.1.1.1.3.3 if ultimate controlling parent is unknown		
3.1.1.2 Reinvestment of earnings		
<i>Of which: 3.1.1.0.1 Investment fund shares/units (F52D)</i>		
<i>Of which: 3.1.1.0.1.1 Money market fund shares/units (F52ID)</i>		
<b>3.1.2 Debt instruments</b>		
3.1.2.1 Direct investor in direct investment enterprises		
3.1.2.2 Direct investment enterprises in direct investor (reverse investment)		
3.1.2.3 Between fellow enterprises		
3.1.2.3.1 if ultimate controlling parent is resident		
3.1.2.3.2 if ultimate controlling parent is nonresident		
3.1.2.3.3 if ultimate controlling parent is unknown		

## A. Balance of Payments (continued)

Balance of payments	Net acquisition of financial assets	Net incurrence of liabilities
<i>Of which: 3.1.2.0 Debt securities (F3D):</i>		
3.1.2.0.1 Direct investor in direct investment enterprises		
3.1.2.0.2 Direct investment enterprises in direct investor (reverse investment)		
3.1.2.0.3 Between fellow enterprises		
3.1.2.0.3.1 if ultimate controlling parent is resident		
3.1.2.0.3.2 if ultimate controlling parent is nonresident		
3.1.2.0.3.3 if ultimate controlling parent is unknown		
3.2 Portfolio investment (FP)		
3.2.1 Equity and investment fund shares (F5P)		
3.2.1.1 Central bank	n.a.	
3.2.1.1.9 Monetary authorities (where relevant)	n.a.	
3.2.1.2 Deposit-taking corporations, except the central bank		
3.2.1.3 General government	n.a.	
3.2.1.4 Other sectors		
3.2.1.4.1 Other financial corporations		
3.2.1.4.2 Nonfinancial corporations, households, and NPISHs		
3.2.1.0.1 Equity securities other than investment fund shares (F51P)		
3.2.1.0.1.1 Listed (F51 IP)		
3.2.1.0.1.2 Unlisted (F512P)		
3.2.1.0.2 Investment fund shares/units (F52P)		
Of which: 3.2.1.0.2.1 Reinvestment of earnings		
Of which: 3.2.1.0.2.0.1 Money market fund shares/units (F52IP)		
3.2.2 Debt securities (F3P)		
3.2.2.1 Central bank		
3.2.2.1.1 Short-term		
3.2.2.1.2 Long-term		
3.2.2.1.9 Monetary authorities (where relevant)		
3.2.2.1.9.1 Short-term		
3.2.2.1.9.2 Long-term		
3.2.2.2 Deposit-taking corporations, except the central bank		
3.2.2.2.1 Short-term		
3.2.2.2.2 Long-term		
3.2.2.3 General government		
3.2.2.3.1 Short-term		
3.2.2.3.2 Long-term		
3.2.2.4 Other sectors		
3.2.2.4.0.1 Short-term		
3.2.2.4.0.2 Long-term		
3.2.2.4.1 Other financial corporations		
3.2.2.4.1.1 Short-term		
3.2.2.4.1.2 Long-term		
3.2.2.4.2 Nonfinancial corporations, households, and NPISHs		
3.2.2.4.2.1 Short-term		
3.2.2.4.2.2 Long-term		
3.3 Financial derivatives (other than reserves) and employee stock options (F7F) <sup>5</sup>	5	5
3.3.1 Central bank	5	5
3.3.1.9 Monetary authorities (where relevant)	5	5
3.3.2 Deposit-taking corporations, except the central bank	5	5
3.3.3 General government	5	5
3.3.4 Other sectors	5	5
3.3.4.1 Other financial corporations	5	5
3.3.4.2 Nonfinancial corporations, households, and NPISHs	5	5
3.3.0.1 Financial derivatives (other than reserves) (F7IF)	5	5
3.3.0.1.1 Options (F71 IF)	5	5
3.3.0.1.2 Forward-type contracts (F712F)	5	5
3.3.0.2 Employee stock options (F72)	5	5
3.4 Other investment (FO)		
3.4.1 Other equity (FS190)		
3.4.2 Currency and deposits (F20)		
3.4.2.1 Central bank		
3.4.2.1.1 Short-term		
3.4.2.1.2 Long-term		

## BALANCE OF PAYMENTS AND INTERNATIONAL INVESTMENT POSITION MANUAL

### A. Balance of Payments (continued)

Balance of payments	Net acquisition of financial assets	Net incurrence of liabilities
3.4.2.1.9 <i>Monetary authorities (where relevant)</i>		
3.4.2.1.9.1 <i>Short-term</i>		
3.4.2.1.9.2 <i>Long-term</i>		
3.4.2.2 <i>Deposit-taking corporations, except the central bank</i>		
3.4.2.2.0.1 <i>Of which: Interbank positions</i>		
3.4.2.2.1 <i>Short-term</i>		
3.4.2.2.2 <i>Long-term</i>		
3.4.2.3 <i>General government</i>		
3.4.2.3.1 <i>Short-term</i>		
3.4.2.3.2 <i>Long-term</i>		
3.4.2.4 <i>Other sectors</i>		
3.4.2.4.0.1 <i>Short-term</i>		
3.4.2.4.0.2 <i>Long-term</i>		
3.4.2.4.1 <i>Other financial corporations</i>		
3.4.2.4.1.1 <i>Short-term</i>		
3.4.2.4.1.2 <i>Long-term</i>		
3.4.2.4.2 <i>Nonfinancial corporations, households, and NPISHs</i>		n.a.
3.4.2.4.2.1 <i>Short-term</i>		n.a.
3.4.2.4.2.2 <i>Long-term</i>		n.a.
3.4.3 <i>Loans (F40)</i>		
3.4.3.1 <i>Central bank</i>		
3.4.3.1.1 <i>Credit and loans with the IMF (other than reserves)</i>		
3.4.3.1.2 <i>Other short-term</i>		
3.4.3.1.3 <i>Other long-term</i>		
3.4.3.1.9 <i>Monetary authorities (where relevant)</i>		
3.4.3.1.9.1 <i>Credit and loans with the IMF (other than reserves)</i>		
3.4.3.1.9.2 <i>Other short-term</i>		
3.4.3.1.9.3 <i>Other long-term</i>		
3.4.3.2 <i>Deposit-taking corporations, except the central bank</i>		
3.4.3.2.1 <i>Short-term</i>		
3.4.3.2.2 <i>Long-term</i>		
3.4.3.3 <i>General government</i>		
3.4.3.3.1 <i>Credit and loans with the IMF (other than reserves)</i>		
3.4.3.3.2 <i>Other short-term</i>		
3.4.3.3.3 <i>Other long-term</i>		
3.4.3.4 <i>Other sectors</i>		
3.4.3.4.0.1 <i>Short-term</i>		
3.4.3.4.0.2 <i>Long-term</i>		
3.4.3.4.1 <i>Other financial corporations</i>		
3.4.2.4.1.1 <i>Short-term</i>		
3.4.2.4.1.2 <i>Long-term</i>		
3.4.3.4.2 <i>Nonfinancial corporations, households, and NPISHs</i>		
3.4.3.4.2.1 <i>Short-term</i>		
3.4.3.4.2.2 <i>Long-term</i>		
3.4.4 <i>Insurance, pension, and standardized guarantee schemes (F60)</i>		
3.4.4.1 <i>Central bank</i>		
3.4.4.1.9 <i>Monetary authorities (where relevant)</i>		
3.4.4.2 <i>Deposit-taking corporations, except the central bank</i>		
3.4.4.3 <i>General government</i>		
3.4.4.4 <i>Other sectors</i>		
3.4.4.4.1 <i>Other financial corporations</i>		
3.4.4.4.2 <i>Nonfinancial corporations, households, and NPISHs</i>		
3.4.4.0.1 <i>Nonlife insurance technical reserves (F610)</i>		
3.4.4.0.2 <i>Life insurance and annuity entitlements (F620)</i>		
3.4.4.0.3 <i>Pension entitlements (F630)</i>		
3.4.4.0.4 <i>Claims of pension funds on pension managers (F640)</i>		
3.4.4.0.5 <i>Entitlements to nonpension benefits (F650)</i>		
3.4.4.0.6 <i>Provisions for calls under standardized guarantees (F660)</i>		
3.4.5 <i>Trade credit and advances (F810)</i>		
3.4.5.1 <i>Central bank</i>		
3.4.5.1.1 <i>Short-term</i>		
3.4.5.1.2 <i>Long-term</i>		
3.4.5.1.9 <i>Monetary authorities (where relevant)</i>		
3.4.5.1.9.1 <i>Short-term</i>		
3.4.5.1.9.2 <i>Long-term</i>		

## A. Balance of Payments (continued)

Balance of payments	Net acquisition of financial assets	Net incurrence of liabilities
3.4.5.2 General government		
3.4.5.2.1 Short-term		
3.4.5.2.2 Long-term		
3.4.5.3 Deposit-taking corporations		
3.4.5.3.1 Short-term		
3.4.5.3.2 Long-term		
3.4.5.4 Other sectors		
3.4.5.4.0.1 Short-term		
3.4.5.4.0.2 Long-term		
3.4.5.4.1 Other financial corporations		
3.4.5.4.1.1 Short-term		
3.4.5.4.1.2 Long-term		
3.4.5.4.2 Nonfinancial corporations, households, and NPISHs		
3.4.5.4.2.1 Short-term		
3.4.5.4.2.2 Long-term		
3.4.6 Other accounts receivable/payable—other (F890)		
3.4.6.1 Central bank		
3.4.6.1.1 Short-term		
3.4.6.1.2 Long-term		
3.4.6.1.9 Monetary authorities (where relevant)		
3.4.6.1.9.1 Short-term		
3.4.6.1.9.2 Long-term		
3.4.6.2 Deposit-taking corporations, except the central bank		
3.4.6.2.1 Short-term		
3.4.6.2.2 Long-term		
3.4.6.3 General government		
3.4.6.3.1 Short-term		
3.4.6.3.2 Long-term		
3.4.6.4 Other sectors		
3.4.6.4.0.1 Short-term		
3.4.6.4.0.2 Long-term		
3.4.6.4.1 Other financial corporations		
3.4.6.4.1.1 Short-term		
3.4.6.4.1.2 Long-term		
3.4.6.4.2 Nonfinancial corporations, households, and NPISHs		
3.4.6.4.2.1 Short-term		
3.4.6.4.2.2 Long-term		
3.4.7 Special drawing rights (F12)	n.a.	
3.5 Reserve assets (FR)		
3.5.1 Monetary gold (F1 I)		n.a.
3.5.1.1 Gold bullion <sup>6</sup>		n.a.
3.5.1.2 Unallocated gold accounts <sup>6</sup>		n.a.
3.5.2 Special drawing rights (F12)		n.a.
3.5.3 Reserve position in the IMF		n.a.
3.5.4 Other reserve assets		n.a.
3.5.4.1 Currency and deposits		n.a.
3.5.4.1.1 Claims on monetary authorities		n.a.
3.5.4.1.2 Claims on other entities		n.a.
3.5.4.2 Securities		n.a.
3.5.4.2.1 Debt securities (F3R)		n.a.
3.5.4.2.1.1 Short-term (F31R)		n.a.
3.5.4.2.1.2 Long-term (F32R)		n.a.
3.5.4.2.2 Equity and investment fund shares (F5R)		n.a.
3.5.4.3 Financial derivatives (F7R) <sup>4</sup>		n.a.
3.5.4.4 Other claims		n.a.
3 Total assets/liabilities (F)		
Of which: (by instrument):		
3.0.1 Equity and investment fund shares (F5)		
3.0.1.1 Equity (F5 I)		
3.0.1.2 Investment fund shares (F52)		
3.0.2 Debt instruments		
3.0.2.1 Special drawing rights (F12)		
3.0.2.2 Currency and deposits (F2)		

## BALANCE OF PAYMENTS AND INTERNATIONAL INVESTMENT POSITION MANUAL

### A. Balance of Payments *(continued)*

Balance of payments	Net acquisition of financial assets	Net incurrence of liabilities
3.0.2.3 Debt securities (F3)		
3.0.2.4 Loans (F4)		
3.0.2.5 Insurance, pension, and standardized guarantee schemes (F6)		
3.0.2.6 Other accounts receivable/payable (F8)		
3.03 Other financial assets and liabilities		
3.0.3.1 Monetary gold (FI 1)		n.a.
3.0.3.2 Financial derivatives and ESOs (FI)		
	Credits	Debits
<i>Net errors and omissions</i>		
Memorandum Items—Exceptional Financing		
1. Current and/or capital transfers		
1.1 Debt forgiveness		
1.2 Other intergovernmental grants		
1.3 Grants received from IMF subsidy accounts		
2. Direct investment		
2.1 Equity investment associated with debt reduction		
2.2 Debt instruments		
3. Portfolio investment—liabilities <sup>7</sup>		
4. Other investment—liabilities <sup>7</sup>		
4.1 Drawings on new loans by authorities or by other sectors on behalf of authorities		
4.2 Rescheduling of existing debt		
5. Arrears <sup>7,8</sup>		
5.1 Accumulation of arrears		
5.1.1 Principal on short-term debt		
5.1.2 Principal on long-term debt		
5.1.3 Original interest		
5.1.4 Penalty interest		
5.2 Repayment of arrears		
5.2.1 Principal		
5.2.2 Interest		
5.3 Rescheduling of arrears		
5.3.1 Principal		
5.3.2 Interest		
5.4 Cancellation of arrears		
5.4.1 Principal		
5.4.2 Interest		

**(See end of IIP listing for footnotes.)**

**Short-term and long-term are defined on an original maturity basis in the standard components.**

**Additional items for balance of payments:**

*Direct investment*

*Direct investment by instrument, maturity, and institutional sector for reconciliation with national accounts, monetary and financial statistics, and government finance statistics (see paragraphs 2.32, 2.34, and 14.59)*

*Direct investment involving resident SPEs (SPEs according to national definitions) (see paragraphs 4.50 and 4.87)*

*Direct investment in the reporting economy and direct investment abroad (see Box 6.4)*

*Real estate investment (see paragraph 6.31)*

*Pass-through funds (see paragraphs 6.33-6.34)*

*Data by kind of economic activity (industry) (see paragraph 6.50)*

*Mergers and acquisitions (see paragraph 8.18)*

*Data for the money-issuing sector, i.e., the central bank plus other deposit-taking corporations plus other institutions covered in the definition of broad money (e.g., money market funds in some cases; see paragraph 4.72)*

*Financial account items for public corporations (see paragraph 4.108)*

*Data by partner economy (see paragraphs 4.146-4.148)*

*Detail for investment income to match the IIP, to facilitate rate of return calculations (see paragraphs 7.13 and 11.6)*

*Gross flows for financial account items (see paragraph 8.9)*

*Reconciliation table between merchandise source data and goods on a balance of payments basis (see Table 10.2)*

*Gross insurance premiums earned and unadjusted insurance claims (see paragraph 10.112)*

*Transfers implied by loans at concessional interest (see paragraph 12.51)*

*Personal remittances (XD5452PR) (see paragraph 12.27(a))*

*Total remittances (XD5452TR) (see paragraph 12.27(b))*

*Total remittances and transfers to nonprofit institutions serving households (see paragraph 12.27(c))*

*Insurance claims included in other capital transfers (see paragraph 13.24)*

## B. International Investment Position

International Investment Position	Assets	Liabilities
<b>Net International Investment Position (B90)</b>		
<b>1 Direct investment (AFD)</b>		
1.1 Equity and investment fund shares (AF5D)		
1.1.1 Direct investor in direct investment enterprises		
1.1.2 Direct investment enterprises in direct investor (reverse investment)		
1.1.3 Between fellow enterprises		
1.1.3.1 if ultimate controlling parent is resident		
1.1.3.2 if ultimate controlling parent is nonresident		
1.1.3.3 if ultimate controlling parent is unknown		
<i>Of which: 1.1.0.1 Investment fund shares/units (AF52D)</i>		
<i>Of which: 1.1.0.1.1 Money market fund shares/units (AF52ID)</i>		
1.2 Debt instruments		
1.2.1 Direct investor in direct investment enterprises		
1.2.2 Direct investment enterprises in direct investor (reverse investment)		
1.2.3 Between fellow enterprises		
1.2.3.1 if ultimate controlling parent is resident		
1.2.3.2 if ultimate controlling parent is nonresident		
1.2.3.3 if ultimate controlling parent is unknown		
<i>Of which: 1.2.0.1 Debt securities (AF3D):</i>		
1.2.0.1.1 Direct investor in direct investment enterprises		
1.2.0.1.2 Direct investment enterprises in direct investor (reverse investment)		
1.2.0.1.3 Between fellow enterprises		
1.2.0.1.3.1 if ultimate controlling parent is resident		
1.2.0.1.3.2 if ultimate controlling parent is nonresident		
1.2.0.1.3.3 if ultimate controlling parent is unknown		
<b>2 Portfolio investment (AFP)</b>		
2.1 Equity and investment fund shares (AF5P)		
2.1.1 Central bank		
2.1.1.9 Monetary authorities (where relevant)		
2.1.2 Deposit-taking corporations, except the central bank		
2.1.3 General government		
2.1.4 Other sectors		
2.1.4.1 Other financial corporations		
2.1.4.2 Nonfinancial corporations, households, and NPISHs		
2.1.0.1 Equity securities other than investment fund shares/units (AF51P)		
2.1.0.1.1 Listed (AF51 IP)		
2.1.0.1.2 Unlisted (AF512P)		
2.1.0.2 Investment fund shares/units (AF52P)		
<i>Of which: 2.1.0.2.1 Money market fund shares/units (AF521P)</i>		
2.2 Debt securities (AF3P)		
2.2.1 Central bank		
2.2.1.1 Short-term		
2.2.1.2 Long-term		
2.2.1.9 Monetary authorities (where relevant)		
2.2.1.9.1 Short-term		
2.2.1.9.2 Long-term		
2.2.2 Deposit-taking corporations, except the central bank		
2.2.2.1 Short-term		
2.2.2.2 Long-term		
2.2.3 General government		
2.2.3.1 Short-term		
2.2.3.2 Long-term		
2.2.4 Other sectors		
2.2.4.0.1 Short-term		
2.2.4.0.2 Long-term		
2.2.4.1 Other financial corporations		
2.2.4.1.1 Short-term		
2.2.4.1.2 Long-term		
2.2.4.2 Nonfinancial corporations, households, and NPISHs		
2.2.4.2.1 Short-term		
2.2.4.2.2 Long-term		



## BALANCE OF PAYMENTS AND INTERNATIONAL INVESTMENT POSITION MANUAL

### B. International Investment Position *(continued)*

International Investment Position	Assets	Liabilities
3 Financial derivatives (other than reserves) and employee stock options (AF7F)	5	5
3.1 Central bank	5	5
3.1.9 Monetary authorities (where relevant)	5	5
3.2 Deposit-taking corporations, except the central bank	5	5
3.3 General government	5	5
3.4 Other sectors	5	5
3.4.1 Other financial corporations	5	5
3.4.2 Nonfinancial corporations, households, and NPISHs	5	5
3.0.1 Financial derivatives (other than reserves) (AF7IF)	5	5
3.0.1.1 Options (AF7IIF)	5	5
3.0.1.2 Forward-type contracts (AF7I2F)	5	5
3.0.2 Employee stock options (AF72)	5	5
4 Other investment (AFO)		
4.1 Other equity (AF5110)		
4.2 Currency and deposits (AF20)		
4.2.1 Central bank		
4.2.1.0.1 Short-term		
4.2.1.0.2 Long-term		
4.2.1.9 Monetary authorities (where relevant)		
4.2.1.9.1 Short-term		
4.2.1.9.2 Long-term		
4.2.2 Deposit-taking corporations, except the central bank		
4.2.2.1 Short-term		
4.2.2.2 Long-term		
Of which: 4.2.2.0.1 Interbank positions (AF2210)		
4.2.3 General government		
4.2.3.1 Short-term		
4.2.3.2 Long-term		
4.2.4 Other sectors		
4.2.4.0.1 Short-term		
4.2.4.0.2 Long-term		
4.2.4.1 Other financial corporations		
4.2.4.1.1 Short-term		
4.2.4.1.2 Long-term		
4.2.4.2 Nonfinancial corporations, households, and NPISHs		n.a.
4.2.4.2.1 Short-term		n.a.
4.2.4.2.2 Long-term		n.a.
4.3 Loans (AF40)		
4.3.1 Central bank		
4.3.1.1 Credit and loans with the IMF (other than reserves)		
4.3.1.2 Other short-term		
4.3.1.3 Other long-term		
4.3.1.9 Monetary authorities (where relevant)		
4.3.1.9.1 Credit and loans with the IMF (other than reserves)		
4.3.1.9.2 Other short-term		
4.3.1.9.3 Other long-term		
4.3.2 Deposit-taking corporations, except the central bank		
4.3.2.1 Short-term		
4.3.2.2 Long-term		
4.3.3 General government		
4.3.3.1 Credit and loans with the IMF		
4.3.3.2 Other short-term		
4.3.3.3 Other long-term		
4.3.4 Other sectors		
4.3.4.0.1 Short-term		
4.3.4.0.2 Long-term		
4.3.4.1 Other financial corporations		
4.3.4.1.1 Short-term		
4.3.4.1.2 Long-term		
4.3.4.2 Nonfinancial corporations, households, and NPISHs		
4.3.4.2.1 Short-term		
4.3.4.2.2 Long-term		
4.4 Insurance, pension, and standardized guarantee schemes (AF60)		
4.4.1 Central bank		
4.4.1.9 Monetary authorities (where relevant)		

## B. International Investment Position (continued)

International Investment Position	Assets	Liabilities
4.4.2 Deposit-taking corporations, except the central bank		
4.4.3 General government		
4.4.4 Other sectors		
4.4.4.1 Other financial corporations		
4.4.4.2 Nonfinancial corporations, households, and NPISHs		
4.4.0.1 <i>Nonlife insurance technical reserves (AF610)</i>		
4.4.0.2 <i>Life insurance and annuity entitlements (AF620)</i>		
4.4.0.3 <i>Pension entitlements (AF630)</i>		
4.4.0.4 <i>Claims of pension funds on pension managers (AF640)</i>		
4.4.0.5 <i>Entitlements to nonpension benefits (AF650)</i>		
4.4.0.6 <i>Provisions for calls under standardized guarantees (AF660)</i>		
4.5 Trade credit and advances (AF810)		
4.5.1 Central bank		
4.5.1.1 Short-term		
4.5.1.2 Long-term		
4.5.1.9 <i>Monetary authorities (where relevant)</i>		
4.5.1.9.1 <i>Short-term</i>		
4.5.1.9.2 <i>Long-term</i>		
4.5.2 General government		
4.5.2.1 Short-term		
4.5.2.2 Long-term		
4.5.3 Deposit-taking corporations, except the central bank		
4.5.3.1 Short-term		
4.5.3.2 Long-term		
4.5.4 Other sectors		
4.5.4.0.1 Short-term		
4.5.4.0.2 Long-term		
4.5.4.1 Other financial corporations		
4.5.4.1.1 Short-term		
4.5.4.1.2 Long-term		
4.5.4.2 Nonfinancial corporations, households, and NPISHs		
4.5.4.2.1 Short-term		
4.5.4.2.2 Long-term		
4.6 Other accounts receivable/payable—other (AF890)		
4.6.1 Central bank		
4.6.1.1 Short-term		
4.6.1.2 Long-term		
4.6.1.9 <i>Monetary authorities (where relevant)</i>		
4.6.1.9.1 <i>Short-term</i>		
4.6.1.9.2 <i>Long-term</i>		
4.6.2 Deposit-taking corporations, except the central bank		
4.6.2.1 Short-term		
4.6.2.2 Long-term		
4.6.3 General government		
4.6.3.1 Short-term		
4.6.3.2 Long-term		
4.6.4 Other sectors		
4.6.4.0.1 Short-term		
4.6.4.0.2 Long-term		
4.6.4.1 Other financial corporations		
4.6.4.1.1 Short-term		
4.6.4.1.2 Long-term		
4.6.4.2 Nonfinancial corporations, households, and NPISHs		
4.6.4.2.1 Short-term		
4.6.4.2.2 Long-term		
4.7 Special drawing rights (AF12)	n.a.	
5 Reserve assets (AFR)		n.a.
5.1 Monetary gold (AF11)		n.a.
5.1.1 Gold bullion <sup>1</sup>		n.a.
5.1.2 Unallocated gold accounts <sup>6</sup>		n.a.
Of which: 5.1.0.1 Monetary gold under swap for cash collateral		n.a.
5.2 Special drawing rights (AF12)		n.a.
5.3 Reserve position in the IMF		n.a.
5.4 Other reserve assets		n.a.
5.4.1 Currency and deposits		n.a.

## BALANCE OF PAYMENTS AND INTERNATIONAL INVESTMENT POSITION MANUAL

### B. International Investment Position (concluded)

International Investment Position	Assets	Liabilities
5.4.1.1 Claims on monetary authorities		n.a.
5.4.1.2 Claims on other entities		n.a.
5.4.2 Securities		n.a.
5.4.2.1 Debt securities (AF3R)		n.a.
5.4.2.1.1 Short-term (AF31R)		n.a.
5.4.2.1.2 Long-term (AF32R)		n.a.
5.4.2.2 Equity and investment fund shares (AF5R)		n.a.
Of which: 5.4.2.0.1 Securities under repo for cash collateral		n.a.
5.4.3 Financial derivatives (AF7R) <sup>4</sup>		n.a.
5.4.4 Other claims		n.a.
<b>Total assets/liabilities (AF)</b>		

**Of which: (by instrument):**

0.1 Equity and investment fund shares (AF5)		
0.1.1 Equity (AF5 I)		
0.1.2 Investment fund shares (AF52)		
0.2 Debt instruments		
0.2.1 Special drawing rights (AF12)		
0.2.2 Currency and deposits (AF2)		
0.2.3 Debt securities (AF3)		
0.2.4 Loans (AF4)		
0.2.5 Insurance, pension, and standardized guarantee schemes (AF6)		
0.2.6 Other accounts receivable/payable (AF8)		
0.3 Other financial assets and liabilities		
0.3.1 Monetary gold (AF11)		n.a.
<u>0.3.1 Financial derivatives and ESOs (AF7)</u>		

As well as the additional items for the financial account (listed above for the balance of payments standard components) that are also applicable to the MR the following are further additional items for the IIP:

Reserve-related liabilities (see Table A9-V below; includes memorandum and supplementary items)	n.a.	
Loans—measures of impairment (see paragraphs 7.45–7.56): fair value, nonperforming loans (XAF4_NNP) <sup>9</sup> loan loss (bad debt) provisions, arrears for assets; for each institutional sector and maturity		n.a.
Currency composition of assets and liabilities and institutional sector See Table A9-I (memorandum) and Tables A9-II and A9-III (supplementary) below		
Foreign currency assets of the monetary authorities:		n.a.
Foreign currency deposits with deposit-taking corporations resident in the reporting economy (see paragraph 6.65)		n.a.
Foreign currency claims on neighboring economies (see paragraph 6.73)		n.a.
Foreign assets of special purpose government funds not included in reserve assets (see paragraphs 6.93–6.98)		n.a.
Pooled assets included in reserve assets (see paragraphs 6.99–6.101)		n.a.
Pledged assets excluded from reserve assets (see paragraphs 6.107–6.109)		n.a.
Debt securities at nominal values (see paragraph 7.30)		
Remaining maturity split for debt liabilities (see Table A9-IV below)	n.a.	
For each instrument and sector	n.a.	
Integrated IIP statement with positions, transactions and other changes in volume, exchange rate changes, and other revaluations (as shown in Table 7. ) by asset and liability category changes in positions due to transactions by other parties (see paragraph 9.16)		
Contingent assets/ liabilities (XAF11_CP) (see paragraph 5.10)		

n.a. not applicable—no entries in this cell

Other sectors—other financial corporations, nonfinancial corporations, households, and NPISHs

<sup>1</sup>Further detail in EBOPS, see MSITS Annex II, Extended Balance of Payments Services Classification.

Standard components for those countries that are unable (for example, for reasons of confidentiality) to provide the full breakdown by mode of transport; otherwise supplementary, but can be derived by summing the standard components for each mode of transport.

<sup>3</sup>If available for publication. If not available for publication, include in other investment-interest.

<sup>4</sup>Assets and liabilities combined and reported as a net figure for assets less liabilities, included under assets.

<sup>5</sup>Preferably assets and liabilities reported separately, but otherwise a net figure for liabilities less assets, included, by convention, under assets.

<sup>6</sup>If available for publication.

<sup>7</sup>Specify sector involved and standard component in which the item is included.

<sup>8</sup>Arrears related to exceptional financing. Not a transaction, but included in the "analytic" presentation (see paragraphs 14.17 and A1.21).

<sup>9</sup>Loans at fair value as a memorandum item, if feasible. Nonperforming loans at nominal value as a supplementary item (or memorandum if fair value of loans is unavailable).

<sup>10</sup>Construction abroad—Construction (CR.); Goods and services acquired (DR.). Construction in the reporting economy—(Goods and services acquired (CR.); (Construction (DR.).

## C. Additional Analytical Position Data

### (a) Currency Composition

**Table A9-1. Currency Composition of Assets and Liabilities (at a reference date)<sup>1</sup>**

**Table A9-1-1a. Debt Claims on Nonresidents**

Year... (latest year under review)

	Central bank	General government	Deposit-taking corporations, except the central bank	Other sectors <sup>3</sup>			Inter-company lending <sup>6</sup>	Total
				Total	OFC	Other		
<b>Total<sup>2</sup></b>								
Domestic currency								
Foreign currency								
U.S. dollar								
Euro								
Yen								
Other currencies								
Unallocated <sup>3</sup>								
<b>Of which one year or less<sup>4</sup></b>								
Domestic currency								
Foreign currency								
U.S. dollar								
Euro								
Yen								
Other currencies								
Unallocated <sup>3</sup>								
<b>Reserve assets<sup>7</sup></b>								
In SDR basket								
Not in SDR basket								

**Table A9-1-1b. Financial Derivative Positions with Nonresidents**  
**Foreign Currency Derivatives: Notional Value of Contracts with Nonresidents<sup>8</sup>**

	Central bank	General government	Deposit-taking corporations, except the central bank	Other sectors <sup>3</sup>			Inter-company lending	Total
				Total	OFC	Other		
Receive foreign currency							n.a.	
U.S. dollar							n.a.	
Euro							n.a.	
Yen							n.a.	
Other currencies							n.a.	

<sup>1</sup>Tsblc A9-1 is 3. memorandum item.

<sup>2</sup>Excluding reserve assets.

<sup>3</sup>See paragraph 5.107 on when currency data is shown as unallocated.

<sup>4</sup>Original maturity.

<sup>5</sup>OFC = other financial corporations, Other = nonfinancial corporations (except intercompany lending), households, and NPISHs.

<sup>6</sup>Data on debt instruments from the direct investment category. Intercompany lending (as defined in paragraph 6.26) is classified as long-term by convention. Intercompany lending is excluded from data for the other sectors.

<sup>7</sup>Total reserve assets.

<sup>8</sup>Data on notional value of derivatives in this table should include those derivatives that swap foreign currency liabilities into domestic currency (e.g., if the monetary authority issues a foreign currency bond and uses a foreign currency swap contract with a nonresident to swap the proceeds into domestic currency, the notional value of the swap contract to receive foreign currency when the swap contract matures should be reported in the Table I-1 b). For similar foreign currency derivative transactions with residents, similar data on notional positions with other residents could be considered.

**Table A9-1-2a. Debt Liabilities to Nonresidents**

Year... (latest year under review)

	Central bank	General government	Deposit-taking corporations, except the central bank	Other sectors <sup>4</sup>			Inter-company lending <sup>3</sup>	Total
				Total	OFC	Other		
<b>Total</b>								
Domestic currency								
Foreign currency								
U.S. dollar								
Euro								
Yen								
Other currencies								
Unallocated								
<b>Of which one year or less<sup>1</sup></b>								
Domestic currency								
Foreign currency								
U.S. dollar								
Euro								
Yen								
Other currencies								
Unallocated								

**Table A9-1-2b. Financial Derivative Positions with Nonresidents**
**Foreign Currency Derivatives: Notional Value of Contracts with Nonresidents**

	Central bank	General government	Deposit-taking corporations, except the central bank	Other sectors <sup>2</sup>			Inter-company lending	Total
				Total	OFC	Other		
Pay foreign currency							n.a.	
U.S. dollar							n.a.	
Euro							n.a.	
Yen							n.a.	
Other currencies							n.a.	

<sup>1</sup>Original maturity.

<sup>2</sup>FC = other financial corporations, Other = nonfinancial corporations (except intercompany lending), households, and NPISHs.

<sup>3</sup>Data on debt instruments from the direct investment category. There is no original maturity breakdown for intercompany lending (as defined in paragraph 6.26); see also paragraph 5.103 on maturity for direct investment). Intercompany lending is excluded from data for the other sectors.

Table A9-II. Currency Composition of Assets and Liabilities (time series data)<sup>1</sup>

## Table A9-II-1a. Debt Claims on Nonresidents

All Sectors	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8
<b>Total<sup>1</sup></b>								
Domestic currency								
Foreign currency								
U.S. dollar								
Euro								
Yen								
Other currencies								
Unallocated								
<b>Of which one year or less<sup>3</sup></b>								
Domestic currency								
Foreign currency								
U.S. dollar								
Euro								
Yen								
Other currencies								
Unallocated								
<b>Reserve assets</b>								
In SDR basket								
Not in SDR basket								

## Table A9-II-1b. Financial Derivative Positions with Nonresidents

## Financial Derivatives: Notional Value of Foreign Currency Contracts with Nonresidents

Receive foreign currency								
U.S. dollar								
Euro								
Yen								
Other currencies								

<sup>1</sup>Table A9-II is supplementary and covers time series data, not projections.<sup>2</sup>Excluding reserve assets.<sup>3</sup>Original maturity.

**Table A9-II-2a. Debt Liabilities to Nonresidents**

All Sectors	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8
<b>Total</b>								
Domestic currency								
Foreign currency								
U.S. dollar								
Euro								
Yen								
Other currencies								
Unallocated								
<b>Of which one year or less<sup>1</sup></b>								
Domestic currency								
Foreign currency								
U.S. dollar								
Euro								
Yen								
Other currencies								
Unallocated								

<sup>1</sup>Original maturity.

**Table A9-II-2b. Financial Derivative Positions with Nonresidents**  
**Financial Derivatives: Notional Value of Foreign Currency Contracts with Nonresidents**

Pay foreign currency							
U.S. dollar							
Euro							
Yen							
Other currencies							

**Table A9-III. Currency Composition by Sector and Instrument (at a reference date)**

**Table III-1 a. Debt Claims on Nonresidents**

	Foreign currency	Domestic currency	Unallocated	Total
<b>LONG-TERM</b>				
<b>Central bank<sup>1</sup></b>				
Debt securities				
Trade credit and advances				
Loans				
Currency and deposits				
Other debt claims				
<b>General government</b>				
Debt securities				
Trade credit and advances				
Loans				
Currency and deposits				
Other debt claims				
<b>Deposit-taking corporations, except the central bank</b>				
Debt securities				
Trade credit and advances				
Loans				
Currency and deposits				
Other debt claims				

Table A9–III–1 a (concluded)

	Foreign currency	Domestic currency	Unallocated	Total
<b>Other sectors<sup>3</sup></b>				
Debt securities				
Trade credit and advances				
Loans				
Currency and deposits				
Other debt claims				
<b>SHORT-TERM</b>				
<b>Central bank<sup>2</sup></b>				
Debt securities				
Trade credit and advances				
Loans				
Currency and deposits				
Other debt claims				
<b>General government</b>				
Debt securities				
Trade credit and advances				
Loans				
Currency and deposits				
Other debt claims				
<b>Deposit-taking corporations, except the central bank</b>				
Debt securities				
Trade credit and advances				
Loans				
Currency and deposits				
Other debt claims				
<b>Other sectors<sup>3</sup></b>				
Debt securities				
Trade credit and advances				
Loans				
Currency and deposits				
Other debt claims				
<b>DIRECT INVESTMENT<sup>4</sup></b>				
<b>Intercompany lending</b>				
Debt claims on direct investors				
Debt claims on direct investment enterprises				
Debt claims on fellow enterprises				
<b>TOTAL</b>				

<sup>1</sup>Table A9–III is supplementary.

<sup>2</sup>Excluding reserve assets.

<sup>3</sup>A further breakdown for (i) other financial corporations, and (ii) nonfinancial corporations (except intercompany lending), households, and NPISHs is encouraged.

<sup>4</sup>There is no original maturity breakdown for intercompany lending (as defined in paragraph 6.26). Intercompany lending is excluded from data for the other sectors.



Table A9-III-1b. Financial Derivative Positions with Nonresidents

**Financial Derivatives: Notional Value of Foreign Currency and Foreign-Currency-Linked Contracts with Nonresidents**

<b>To Receive Foreign Currency</b>
<b>Central bank</b>
Forwards
Options
<b>General government</b>
Forwards
Options
<b>Deposit-taking corporations, except the central bank</b>
Forwards
Options
<b>Other sectors<sup>1</sup></b>
Forwards
Options
<b>Total</b>
Forwards
Options

<sup>1</sup>A further breakdown for (1) other financial corporations and (2) nonfinancial corporations (except intercompany lending), households, and NPISHs is encouraged.

Table A9-III-2a. Debt Liabilities to Nonresidents

	Foreign currency	Domestic currency	Unallocated	Total
<b>LONG-TERM</b>				
<b>Central bank</b>				
Debt securities				
Trade credit and advances				
Loans				
Currency and deposits				
Other debt liabilities				
<b>General government</b>				
Debt securities				
Trade credit and advances				
Loans				
Currency and deposits				
Other debt liabilities				
<b>Deposit-taking corporations, except the central bank</b>				
Debt securities				
Trade credit and advances				
Loans				
Currency and deposits				
Other debt liabilities				
<b>Other sectors<sup>1</sup></b>				
Bond and notes				
Trade credit and advances				
Loans				
Currency and deposits				
Other debt liabilities				
<b>SHORT-TERM</b>				
<b>Central bank</b>				
Debt securities				
Trade credit and advances				
Loans				
Currency and deposits				
Other debt liabilities				

Table A9-III-2a (concluded)

	Foreign currency	Domestic currency	Unallocated	Total
<b>General government</b>				
Debt securities				
Trade credit and advances				
Loans				
Currency and deposits				
Other debt liabilities				
<b>Deposit-taking corporations, except the central bank</b>				
Debt securities				
Trade credit and advances				
Loans				
Currency and deposits				
Other debt liabilities				
<b>Other sectors<sup>1</sup></b>				
Debt securities				
Trade credit and advances				
Loans				
Currency and deposits				
Other debt liabilities				
<b>DIRECT INVESTMENT<sup>1</sup></b>				
<b>Intercompany lending</b>				
Debt liabilities to direct investors				
Debt liabilities to direct investment enterprises				
Debt liabilities to fellow enterprises				
<b>TOTAL</b>				

<sup>1</sup>A further breakdown for (i) Other financial corporations, and (ii) Nonfinancial corporations (except intercompany lending), households, and NPISHs is encouraged.

<sup>2</sup>There is no original maturity breakdown for intercompany lending (as defined in paragraph 6.26). Intercompany lending is excluded from data for the other sectors.

Table A9-III-2b. Financial Derivative Positions with Nonresidents

### Financial Derivatives: Notional Value of Foreign-Currency and Foreign Currency-Linked Contracts with Nonresidents

To pay foreign currency

#### Central bank

Forwards  
Options

#### General government

Forwards  
Options

#### Deposit-taking corporations, except the central bank

Forwards  
Options

#### Other sectors<sup>1</sup>

Forwards  
Options

#### Total

Forwards  
Options

<sup>1</sup>A further breakdown for (i) Other financial corporations, and (ii) Nonfinancial corporations (except intercompany lending), households, and NPISHs is encouraged.

**(b) Remaining Maturity****Table A9-IV. Remaining Maturity of Debt Liabilities to Nonresidents (at a reference date)<sup>1</sup>****Specific Financial Instruments: Remaining Maturity of One Year or Less of Long-Term Debt Instruments by Sector**

	Central bank	General government	Deposit-taking corporations, except the central bank	Other sectors <sup>1</sup>			Total
				Total	OFC	Other	Total
Deb securities							
Trade credit and advances							
Loans							
Currency and deposits							
Other debt liabilities							
Total							

<sup>1</sup>Table A9-IV is supplementary.

<sup>2</sup>A further breakdown for (i) Other financial corporations, and (ii) Nonfinancial corporations (except intercompany lending), households, and NPISHs is encouraged.

**(c) Reserve-Related Liabilities:****Table A9-V. Memorandum/Supplementary Items: Position Data (at a reference date)****Reserve-Related Liabilities****Memorandum Items**

Reserve-related liabilities (RRL) to nonresidents<sup>1</sup>

## 2.2. Short-term

2.2.1. Credit and loans from the IMF

2.2.2. Debt securities

2.2.3. Deposits

2.2.4. Loans

2.2.4.1. Repo loans<sup>2</sup>

2.2.4.2. Other loans

2.2.5. Other short-term foreign currency liabilities to nonresidents

**Supplementary Items<sup>3</sup>**

1. Reserve assets (Section I.A of Reserve Template)

2. Reserve-related liabilities (RRL) to nonresidents<sup>4</sup>

## 2.1. Long-term

2.1.1. Credit and loans from the IMF

2.1.2. Debt securities

2.1.3. Deposits

2.1.4. Loans

2.1.4.1. Repo loans<sup>5</sup>

2.1.4.2. Other loans

2.1.5. Other foreign currency liabilities to nonresidents

2.1.5.1. SDR allocation

2.1.5.2. Other long-term foreign currency liabilities

Table A9-V (concluded)

---

2.2. Short-term
2.2.1. Credit and loans from the IMF
2.2.2. Debt securities
2.2.3. Deposits
2.2.4. Loans
2.2.4.1. Repo loans
2.2.4.2. Other loans
2.2.5. Other foreign currency liabilities to nonresidents
2.2.5.2. Other short-term foreign currency liabilities
3. Reserve assets (1.) less short-term RRL to nonresidents (2.2.)
4. Other foreign currency assets <sup>6</sup>
4.1. Long-term
4.2.1. Debt securities
4.2.2. Deposits
4.2.3. Loans
4.2.3.1. Repo loans
4.2.3.2. Other loans
4.2.4. Other foreign currency assets
4.2. Short-term
4.2.1. Debt securities
4.2.2. Deposits
4.2.3. Loans
4.2.3.1. Repo loans
4.2.3.2. Other loans
4.2.4. Other foreign currency assets <sup>7</sup>
5. Other foreign currency liabilities
5.2.1. Long-term
5.2.1.1. Debt securities
5.2.1.2. Deposits
5.2.1.3. Loans
5.2.1.3.1. Repo loans
5.2.1.3.2. Other loans
5.2.1.4. Other foreign currency liabilities
5.2.2. Short-term
5.2.2.1. Debt securities
5.2.2.2. Deposits
5.2.2.3. Loans
5.2.2.3.1. Repo loans
5.2.2.3.2. Other loans
5.2.2.4. Other foreign currency liabilities
6. Foreign currency resources: 1 + 4
7. Foreign currency liabilities: 2 + 5
8. Net foreign currency resources: 6 – 7

---

<sup>1</sup>Data for RRL are to be presented on a remaining maturity basis.

<sup>2</sup>The inclusion of a repo loan within RRL depends on the treatment of repo transactions within reserves. If the security stays in reserve assets, the repo loan is recorded as a liability within RRL. Otherwise the repo loan is excluded from RRL.

<sup>3</sup>For comprehensiveness, this listing of supplementary items incorporates the memorandum items for short-term liabilities (2.2.). See paragraph 6.115 for further information.

<sup>4</sup>Data for RRL, other foreign currency assets and liabilities are to be presented on a remaining maturity basis.

<sup>5</sup>The inclusion of a repo loan within RRL depends on the treatment of repo transactions within reserves. If the security stays in reserve assets, the repo loan is recorded as a liability within RRL. If the security is reclassified to portfolio investment, the asset and the repo loan liability are included under other foreign currency asset and other foreign currency liabilities respectively.

<sup>\*</sup>Other foreign currency assets and liabilities includes claims and liabilities of the monetary authorities and central government to both residents and non-residents, other than those covered in reserve assets and RRL to nonresidents. This approach for other foreign currency assets and liabilities is consistent with the approach in Sections 1.B and 2 of the Reserves Template. To support reconciliation with government finance statistics, a subsector split between central government and the central bank could be included.

<sup>†</sup>This item would include any net financial derivative positions of the central government and of the monetary authorities not included in reserve assets nor RRL.

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