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Annex A/Chapter 18

ANNEX A to the

Proposal for a

REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL

on the European System of national and regional accounts in the European Union

ANNEX A

Chapter 18: rest of the world accounts

Introduction

18.01 The accounts of resident institutional sectors show economic activity: production; generation, distribution and redistribution of income; consumption; and accumulation of assets and liabilities. These accounts capture transactions amongst resident units, and transactions of resident with non-resident units that make up the rest of the world.

18.02 The ESA is a closed system in that both sides to every transaction are recorded in the accounts as a use and a resource. For resident units, this enables a coherent articulated set of accounts to be drawn up, and all the economic activities of each institutional unit are included in the sequence of accounts. This is not true for non-resident units. Non-resident units can only be observed through their interaction with resident units of the economy being measured, and so only their transactions with resident units can be recorded. This is done through the creation of a sector called "the rest of the world" sector, and the compilation of a special set of accounts with limited entries which show for non-resident units, only the transactions with resident units.

18.03 The sequence of accounts for the rest of the world sector is as follows:

a) The external account of goods and services (V.I), covering imports and exports of goods and services.

b) The external account of primary and secondary incomes (V.II), covering compensation of employees, property and investment income, and current transfers such as personal transfers (including workers' remittances) and international aid.

c) The external accumulation accounts (V.III), consisting of

(1) The capital account (V.III.1), showing capital transfers and acquisitions less disposals of non-produced non-financial assets;

(2) The financial account (V.III.2), showing transactions in financial assets and liabilities;

(3) Other changes in volume of assets account (V.III.3.1), showing uncompensated seizures etc.;

(4) Revaluation account (V.III.3.2), showing nominal holding gains and losses.

d) The external assets and liabilities account (V.IV) presents the opening and closing balance sheets, and the changes in the value of those assets and liabilities between opening and closing balance sheets.

The full sequence is shown in Chapter 8, and the account numbers in brackets above refer to the account numbers in that chapter.

18.04 As the accounts are drawn up from the point of view of the rest of the world sector, imports to the domestic economy are shown as a resource, and exports from the domestic economy as a use of the external account of goods and services. A similar reversal occurs throughout the rest of the world accounts. If a balance is positive, it signifies a surplus for the rest of the world, and a deficit for the total domestic economy. Similarly, a negative balance shows a deficit for the rest of the world, and a surplus for the domestic economy. A financial asset held by the rest of the world is a liability for the domestic economy, and a liability held by the rest of the world is a domestic asset.

18.05 The standard framework for statistics on the transactions and positions between an economy and the rest of the world is set out in the Balance of Payments and International Investment Position Manual 2008 (sixth edition) (BPM6). This manual is harmonised with the System of National Accounts 2008, but sets out the interactions between the domestic economy and the rest of the world in a set of accounts and balance sheets which present the information in a different way. This chapter sets out the rest of the world sector accounts of ESA 2010, and how they relate to the BPM6 international accounts.

Economic territory

18.06 The most commonly used concept of economic territory is the area under the effective economic control of a single government. However, currency or economic unions, regions, or the world as a whole may be used, as they may also be a focus for macroeconomic policy or analysis. The full definition is given in chapter 2 (paragraphs 2.04 – 2.06)

18.07 The determination of whether an entity is a resident in a given economic territory is based on two steps:

(1) Does the entity qualify as an institutional unit, and, if this is the case;

(2) the criteria set out in chapter 2 to determine "residency" have to be met.

Residence

18.08 The residence of each institutional unit is the economic territory with which it has the strongest connection, expressed as its centre of predominant economic interest. The concepts are identical in the ESA, SNA and BPM6. The introduction of the terminology “centre of predominant economic interest” does not mean that entities with substantial operations in two or more territories no longer need to be split (see paragraph 18.12) or that institutional units without any significant physical presence can be disregarded (see paragraphs 18.10 and 18.15). The concept of residence in general, and for households, enterprises and other entities in particular, is described fully in Chapter 2.

Institutional units

18.09 The concept of "institutional unit" is the same in the ESA, SNA and BPM6. The general definition is given in Chapter 2, paragraphs 2.12 – 2.16. Because of the focus on the national economy, there are special treatments of units in cross-border situations. In some cases, legal entities are combined into a single institutional unit if they are resident in the same economy, but are not combined if they are resident in different economies. Similarly, a single legal entity may be split when it has substantial operations in two or more economies. As a result of these treatments, the residence of the resulting units concerned becomes more clear-cut and the concept of the economic territory is strengthened.

18.10 Corporations' and governments' use of Special Purpose Entities (SPEs) is normally to raise finance. Where the SPE is resident in the same economy as the parent, then the treatment is straightforward. The SPE will normally have none of the attributes that would make it a separate entity from the parent, and assets and liabilities incurred by the SPE will be shown in the accounts of the parent corporation. Where the SPE is non-resident, the residence criteria for the rest of the world sector demand that a separate entity is recognised. In this case, any assets and liabilities incurred by the SPE are shown in the rest of the world sector, and not in a sector of the domestic economy. The treatment of non-resident SPEs belonging to the general government is defined in paragraph 2.14.

18.11 Members of a household must all be resident in the same economy. If a person resides in a different economy from the other members of a household, that person is not regarded as a member of that household, even though they may share income and expenses, or hold assets together.

Branches as used in the international accounts of the balance of payments

18.12 A branch is an unincorporated enterprise that belongs to a non-resident unit, known as the parent. It is treated as a resident and a quasi-corporation in the territory where it is situated. The identification of branches as separate institutional units requires indications of substantial operations that can be separated from the rest of the entity. A branch is recognized in the following cases:

a) Either a complete set of accounts, including a balance sheet, exists for the branch, or

b) it is possible and meaningful, from both an economic and legal viewpoint, to compile these accounts if required. The availability of separate records indicates that an actual unit exists and makes it practical to prepare statistics.

In addition, one or more of the following factors tend to be present:

(1) The branch undertakes or intends to undertake production on a significant scale which 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;

ii) If the production does not involve physical presence, such as some cases of banking, insurance, other financial services, ownership of patents, trademarks or copyrights, merchanting and "virtual manufacturing," then the operations should be recognized as being in the territory by virtue of the registration or legal domicile of those operations in that territory;

(2) The branch is recognised 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.

18.13 The identification of branches has implications for the statistical reporting of both the parent and branch. The operations of the branch are excluded from the institutional unit of its head office and the delineation of parent and branch has to be made consistently in both of the affected economies. A branch may be identified for construction projects or mobile operations such as transport, fishing or consulting. However, if the operations are not substantial enough to identify a branch, they are treated as an export of goods or services from the head office.

18.14 In some cases, preliminary operations related to a future direct investment project prior to incorporation are sufficient evidence of establishing residence so that a quasi-corporation is established. For example, licenses and legal expenses for a project are shown as being incurred by a quasi-corporation, and are part of direct investment flows into that unit rather than sales of licenses to non-residents, or exports of services, respectively, to the head office.

Notional resident units

18.15 When land located in a territory is owned by a non-resident entity, a notional unit that is treated as resident is identified for statistical purposes as being the owner of the land. This notional resident unit is a quasi-corporation. The notional resident unit treatment is also applied to associated buildings, structures and other improvements on that land, leases of land for long periods, and ownership of natural resources other than land. As a result of this treatment, the non-resident is owner of the notional resident unit, rather than owning the land directly, so there is an equity liability to the non-resident, but the land and other natural resources are always assets of the economy in which they are located. The notional resident unit usually supplies services to its owner, for example accommodation in the case of vacation homes.

18.16 In general, if a non-resident unit has a long-term lease on an immovable asset such as a building, this is associated with it undertaking production in the economy where it is located. If for any reason there is no associated production activity, a notional resident unit is also created to cover such a lease. Therefore the non-resident unit is treated as owning the notional resident unit and not the building, which is the property of the economy where it is located.

Multi-territory enterprises

18.17 A few enterprises operate as a seamless operation over more than one economic territory, typically for cross-border activities such as airlines, shipping lines, hydroelectric schemes on border rivers, pipelines, bridges, tunnels and undersea cables. Separate branches need to be identified unless the entity is run as a single operation with no separate accounts or decision-making for each territory that it operates in. In such cases, because of the central focus on data for each national economy, it is necessary to split the operations between economies. The operations are then prorated according to an appropriate enterprise-specific indicator of the proportions of operations in each territory. The prorating treatment may also be adopted for enterprises in zones subject to joint administration by two or more governments.

Geographical breakdown

18.18 For the purpose of compiling the accounts of the European Union, the rest of the world accounts (S.2) is sub-divided into:

a) Member States and institutions and bodies of the European Union (S.21)

(1) Member States of the European Union (S.211)

(i) Member States of the euro area (S.2111)

(ii) Member States outside the euro area (S.2112)

(2) Institutions and bodies of the European Union (S.212)

(i) The European Central Bank (ECB) (S.2121)

(ii) European institutions and bodies, except the ECB (S.2122)

b) Non-member countries and international organisations non resident of EU (S.22)

18.19 For the purpose of compiling the accounts of the euro area, the above sub-sectors may be grouped as follows:

The Member States of the euro area and the European Central Bank (S.2I = S.2111 + S.2121)

Countries and international organisations that are not resident of the euro area (S.2X = S.2112 + S.2122 + S.22)

A description of the European Accounts is provided in Chapter 19.

The international accounts of the Balance of Payments

18.20 The national accounts are different from the international accounts shown in the BPM6. The international accounts show the transactions between an economy and abroad from the point of view of the domestic economy. So imports are shown as a use (a debit) and exports as a resource (a credit).

A summarised form of the international accounts as presented in the BPM6 is given in Table 18.1.

18.21 A second major difference between the international accounts of the balance of payments, and the rest of the world sector accounts in the ESA, is the use of functional categories in the international accounts rather than instruments in the classifications of financial transactions in the ESA. This issue is further discussed in paragraphs18.60 and 18.61.

Balancing items in the current accounts of the international accounts

18.22 The structure of the balancing items in the balance of payments is somewhat different from that in the national accounts, in that each account in the international accounts has its own balancing item and another that carries down to the next account. To illustrate, the primary income account has its own balancing item (balance on primary income) and a cumulative balance (balance on goods, services and primary income). The external balance on primary income corresponds to balance of primary incomes and is the item feeding into GNI. The current external balance corresponds to saving by the rest of the world relative to the domestic economy. The balancing items in the BPM6 structure of accounts are shown in table 18.1.

Table 18.1 The international flow accounts of the Balance of Payments

Balance of Payments

Current accounts	Credits	Debits	Balance
Goods and services account			
Goods	462	392	70
Services	78	107	-29
Goods and services	540	499	41
Primary income account			
Compensation of employees	6	2	
Interest	13	21	
Distributed income of corporations	36	17	
Reinvested earnings	14	0	
Primary income	69	40	29
Goods, services and primary income	609	539	70
Secondary income account			
Taxes on income, wealth	1	0	
Net non-life insurance premiums	2	11	
Non-life insurance claims	12	3	
Current international transfers	1	31	
Miscellaneous current transfers	1	10	
Secondary income	17	55	-38
Current account balance			32
Capital account			
Acquisitions/disposals of non-produced assets	0		
Capital transfers	1	-4	
Capital account balance			-3
Net lending (+)/borrowing (-)			29
Financial account (by functional category)	Change in assets	Change in liabilities	Balance
Direct investment	-4	8	

Portfolio investment	17	7	
Financial derivatives etc.	3	0	
Other investment	42	22	
Reserve assets	8	-	
Total change in assets/liabilities	66	37	
Net lending (+)/net borrowing (-) (financial)			29
Net errors and omissions			0

The accounts for the rest of the world sector and their relationship with the international accounts of the balance of payments

The external account of goods and services

18.23 The goods and services account consists only of imports and exports of goods and services because these are the only transactions in goods and services with a cross-border dimension. Goods and services are recorded when there is a change of economic ownership from a unit in one economy to a unit in another country. Although there is usually a physical movement of goods when there is a change of ownership, this is not necessarily the case. In the case of merchanting, goods may change ownership and not change location until they are resold to a third party.

Tables 18.2 and 18.3 show an example of recording of primary and secondary income in the ESA and BPM6.

Table 18.2 External account of goods and services (ESA V.1)

Uses			Resources		
P6	Exports of goods and services	540	P7	Imports of goods and services	499
P61	Exports of goods	462	P71	Imports of goods	392
P62	Exports of services	78	P72	Imports of services	107
B11	External balance of goods and services	-41			

Table 18.3 Goods and services account of BPM6

Current accounts	Credits	Debits	Balance
Goods and services account			
Goods	462	392	70
Services	78	107	-29

Goods and services	540	499	41

18.24 Goods that change locations from one economy to another but do not change economic ownership do not appear in imports and exports. Thus goods sent abroad for processing, or returned after processing, do not appear as imports and exports of goods; only the fee agreed for processing appears as a service.

18.25 The balance of payments gives emphasis to the distinction between goods and services. This distinction reflects policy interests, in that there are separate international treaties covering goods and services. It also reflects data issues, in that data on goods are usually obtained from customs sources, while data on services are usually obtained from payments records or surveys.

18.26 The main source of data for goods is international merchandise trade statistics. International standards are given in International Merchandise Trade Statistics: Concepts and Definitions Rev. 2 (IMTS). BPM6 identifies some possible sources of difference between the value of goods recorded in merchandise trade statistics and in balance of payments. It also recommends a standard reconciliation table to assist users in understanding these differences. One major source of difference is that the standards for IMTS use a CIF-type (cost, insurance and freight) valuation for imports, while the balance of payments use a uniform FOB (the value at the customs frontier of the exporting economy, that is, free on board) valuation for both exports and imports. It is therefore necessary to exclude freight and insurance costs incurred between the customs frontier of the exporter and the customs frontier of the importer. Because of variations between the FOB-type valuation and actual contractual arrangements, some freight and insurance costs need to be rerouted.

The valuation principles are the same in ESA and the balance of payments. FOB valuation is therefore to be followed for recording exports and imports of goods (see paragraph18.32).

18.27 The change of ownership basis used for the balance of payments means that goods entries will have a time of reporting consistent with the corresponding financial flows. In BPM6, there are no longer exceptions to the change of ownership principle. In contrast, IMTS follow the timing of customs processing. While this timing is often an acceptable approximation, adjustments may be needed in some cases, such as goods sent on consignment. In the case of goods sent abroad for processing with no change of ownership, the values of goods movements are included in IMTS, but changes in ownership are the primary presentation in the balance of payments, and therefore the balance of payments will only show the fees related to "manufacturing services on physical inputs owned by others". (However, the values of goods movements are recommended as supplementary items to understand the nature of these arrangements.) Further details of the recording of these processing arrangements are given later in this chapter. Other adjustments to IMTS may be needed to bring estimates into line with the change of economic ownership of goods, either generally or because of the particular coverage of each country. Possible examples include merchanting, non-monetary gold, goods entering or leaving the territory illegally, and goods procured in ports by carriers.

18.28 Re-exports are foreign goods (goods produced in other economies and previously imported with a change of economic ownership) that are exported with no substantial transformation from the state in which they were previously imported. Because re-exported goods are not produced in the economy concerned, they have less connection to the economy than other exports. Economies that are major trans-shipment points and locations of wholesalers often have large values of re-exports. Re-exports increase the figures for both imports and exports and when re-exporting is significant, the proportions of imports and exports to economic aggregates are increased also. It is therefore useful to show re-exports separately. Goods that have been imported and are waiting to be re-exported are recorded in inventories of the resident economic owner.

Transit trade is where goods cross a country on their way to their final destination, and for the country crossed, are generally excluded from foreign trade statistics, Balance of Payments statistics and the national accounts.

Quasi transit trade are goods imported into a country, cleared through Customs for free circulation within the EU, and then dispatched to a third country in the EU. The entity used for Customs clearance is usually not an institutional unit as defined in Chapter 2, and so does not acquire ownership of the goods. In this case, the import is shown in the national accounts as a direct import to the final destination, as in the case of simple transit trade. The appropriate value is that recorded as the goods enter the final destination country.

18.29 Goods are presented at an aggregate level in the balance of payments. More detailed commodity breakdowns can be obtained from IMTS data.

18.30 In the balance of payments, detail is produced for the following twelve standard components of services:

a) Manufacturing services on physical inputs owned by others;

b) Maintenance and repair services n.i.e.;

c) Transport;

d) Travel;

e) Construction;

f) Insurance and pension services;

g) Financial services;

h) Charges for the use of intellectual property n.i.e.;

i) Telecommunications, computer and information services;

j) Other business services;

k) Personal, cultural and recreational services; and

l) Government goods and services n.i.e.

18.31 Three of the balance of payments' standard components above are transactor-based items, that is, they relate to the acquirer or provider, rather than the product itself. These categories are travel, construction and government goods and services n.i.e.

a) Travel covers all goods or services acquired by non-residents during visits whether for own use or to give away. Travel includes goods, local transport, accommodation, meals and other services.

b) Construction covers the total value of the product delivered by the contractor, including any materials sourced locally and therefore not recorded in imports and exports of goods.

c) Government goods and services n.i.e. cover a range of items that cannot be allocated to more specific headings.

Besides these three transactor-based items, the remaining components are product-based, built from the more detailed classes of CPA Rev. 2. Additional standards for services trade are shown in the Manual on Statistics of International Trade in Services (MSITS), which is harmonised with the international accounts.

Valuation

18.32 Valuation principles are the same in the ESA and the international accounts. In both cases, market values are used, with nominal values used for some positions in instruments where market prices are not observable. In the international accounts, the valuation of exports and imports of goods is a special case where a uniform valuation point is used, namely the value at the customs frontier of the exporting economy, that is, the FOB-type valuation (free on board). This treatment brings about consistent valuation between exporter and importer and provides for a consistent basis for measurement in circumstances where the parties may have a wide range of different contractual arrangements, from “ex-works” at one extreme (where the importer is responsible for arranging all transport and insurance) to “delivered duty paid” at the other (where the exporter is responsible for arranging all transport, insurance and any import duties).

Goods for Processing

18.33 Between ESA 95 and ESA 2010, there has been a fundamental change in the treatment of goods sent abroad for processing without change of ownership. In ESA 95, such goods were shown as exports on being sent abroad, and then recorded as imports on return from abroad, at a higher value as a result of the processing. This was known as the gross recording method, and effectively imputes a change of ownership so that international trade figures represent an estimate of the value of the goods being traded. The 2008 SNA, BPM6 and the ESA 2010 do not impute a change of ownership, but rather show only one entry – an import of the processing service. This would be an export of the service for the country in which the processing takes place. This recording is more consistent with the institutional records and associated financial transactions. It does however cause an inconsistency with the international merchandise trade statistics (IMTS). This will continue to show the gross value of the exports for process and returning imported processed goods.

18.34 In order to avoid such an inconsistency in the national accounts, the value of the exported goods can be recorded alongside that of the imported goods as supplementary items, the values being those recorded in the IMTS. This will enable the net processing service to be derived as the value of the processed goods exported less the value of the unprocessed goods which are imported. It is this service which is recorded in the national accounts. So for the country having the goods processed abroad, the exports will be scored alongside the imported processed goods, as supplementary items in the external goods and services account. This will reconcile the IMTS entries with the net import services figure reflecting the processing costs.

18.35 An example related to the treatment of goods for processing in the supply and use tables will demonstrate the change. Consider the case where a food manufacturing firm harvests and processes vegetables, then out-sources the actual canning of the vegetables to a wholly owned subsidiary abroad, and then takes them back canned and sells the canned food on.

18.36 In Table 18.4 for the ESA 95, the imports and exports figures should match the entries in the international merchandise trade statistics (IMTS). The exports of goods to the canning subsidiary abroad is 50, and then the canned vegetables are returned as imports of 90.

Table 18.4 The 1995 ESA treatment of goods for processing as international trade

	Purchases	Final demand		Total
Sales	Food manufacturing	Household expenditure	Exports	
Food		90	50	140
Canned food imports	90			90
Value added	50		GDP(E) =	50
Total output	140			

Table 18.5 ESA 2010 treatment of goods for processing as international trade

	Purchases	Final demand		Total
Sales	Food manufacturing	Household expenditure	Exports	
Food		90	0	90
Canning services imports	40			40
Value added	50			50
Total output	90			

18.37 Table 18.5 shows the ESA 2010 treatment of goods for processing on a net basis: only the trade in services is shown and there will be no match with the movement in goods recorded in the IMTS. The net position, of exports less imports, will be shown in the balance of payments international accounts and the corresponding rest of the world sector accounts. BPM6 recommends that where it is known that imports and exports in the IMTS statistics reflect a situation where there is no change in ownership, then the two are recorded side by side in the balance of payments figures, so that the services element can be immediately calculated. So for the food manufacturing industry, the vegetables sent abroad for canning would be shown as an export of 50, and the re-imported canned vegetables would be shown as an import of 90. These figures can be set beside each other in the international accounts statistics as supplementary items, with the exports recorded as negative imports, so enabling a net import of canning services of 40 to be derived.

The recording of this example in BPM6 is shown in Table 18.6

Table 18.6 Recording of processing in BPM6

Current accounts	Credits	Debits	Balance
Goods and services account			-40
Services (standard components)			
"Manufacturing services on physical inputs owned by others"		40	-40
Supplementary items			
Goods for processing abroad	*50*	*90*	-40

Merchanting

Goods under merchanting

18.38 Merchanting is defined as the purchase of goods by a resident (of the compiling economy) from a non-resident combined with the subsequent resale of the same goods to another non-resident 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. These and the following clarifications related to merchanting follow the corresponding paragraphs in BPM6 (§ 10.41-10.48).

18.39 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. 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 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.

18.40 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 detailed specifically in the 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.

The treatment of merchanting is that:

a) The acquisition of goods by merchants is shown under goods as a negative export of the economy of the merchant;

b) 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.

18.41 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.

18.42 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).

18.43 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. (While 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.)

Imports and exports of FISIM

18.44 Actual interest on loans paid and received includes an income element and a charge for a service. Credit institutions 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. ESA prescribes the imputation of a service charge for these "Financial Intermediation Services Indirectly Measured" (FISIM). The concept of FISIM and the guidelines for estimating FISIM value are given in Chapter 14.

18.45 The financial institutions that are implicitly charging FISIM are not necessarily resident, nor need the clients of these institutions to be resident. Therefore imports and exports of this type of financial service are possible. Guidelines for compiling FISIM imports and exports are in paragraph 14.10.

The external account of primary and secondary income

Tables 18.7 and 18.8 show an example of recording of primary and secondary income in the ESA and BPM6.

Table 18.7 External account of primary and secondary incomes (ESA V.II)

Uses			Resources		
			B11	External balance of goods and services	-41
D1	Compensation of employees	6	D1	Compensation of employees	2
D2	Taxes on production and imports	0	D2	Taxes on production and imports	0
D3	Subsidies	0	D3	Subsidies	0
D4	Property income	63	D4	Property income	38
D5	Current taxes on income, wealth	1	D5	Current taxes on income, wealth	0
D6	Social contributions and benefits	0	D6	Social contributions and benefits	0
D7	Other current transfers	16	D7	Other current transfers	55
D8	Adjustment for the change in pension entitlements	0	D8	Adjustment for the change in pension entitlements	0
B12	Current external balance	-32			

Table 18.8 The primary income account and secondary income account of BPM6

	ESA code	Credits	Debits	Balance
From goods and services				41
Primary income account				

Compensation of employees	D1	6	2	
Interest	D4	13	21	
Distributed income of corporations		36	17	
Reinvested earnings		14	0	
Taxes on production and imports	D2	0	0	
Subsidies	D3	0	0	
Primary income		69	40	29
Goods, services and primary income		609	539	70
Secondary income account				
taxes on income, wealth	D5	1	0	
Net non-life insurance premiums	D6, D7, D8	2	11	
Non-life insurance claims		12	3	
Current international transfers		1	31	
Miscellaneous current transfers		1	10	
Secondary income		17	55	-38
Current account balance				32

The primary income account

18.46 In the balance of payments, the entries in the primary income account include compensation of employees and property income, exactly as in the allocation of primary income account in the ESA. Payments of taxes on production by residents and receipts of subsidies by residents from the domestic government are recorded in the generation of income account, an account that does not form part of the balance of payments. Any payments of taxes on production payable by a resident to another government as well as any subsidy receivable by a resident from another government are recorded in the primary income account of the balance of payments. The matching entries for the domestic government are shown in the allocation of primary income account and for foreign governments in the rest of the world column of that account and in the primary income account of the balance of payments.

18.47 Rent may arise in cross-border situations, but rarely, because all land is deemed to be owned by residents, if necessary by creating a notional resident unit. If those notional resident units are owned by non-residents then any income earned by these units is classified as direct investment income and not as rent. An example where rent is recorded in the international accounts, is short-term fishing rights in territorial waters provided to foreign fishing fleets. It is common in the international accounts to use the term investment income meaning property income excluding rent. Investment income reflects income arising from the ownership of financial assets, and the disaggregation of investment income matches that of financial assets and liabilities so that rates of return can be calculated.

Direct investment income

18.48 The role of direct investment is particularly important and reflected in both the flows and positions in the international accounts. In the case of a direct investment, it is assumed that a proportion of the enterprise's retained earnings is distributed to the direct investor as a form of investment income. The proportion corresponds to the direct investor's holding in the enterprise.

18.49 Retained earnings are equal to the net operating surplus of the enterprise plus all property income earned less all property income payable (before calculating reinvested earnings) plus current transfers receivable less current transfers payable and less the item for the adjustment for the change in pension entitlements. Reinvested earnings accrued from any immediate subsidiaries are included in the property income receivable by the direct investment enterprise.

18.50 Reinvested earnings may be negative, for example where the enterprise makes a loss or where dividends are distributed from holding gains, or in a quarter when an annual dividend is paid. 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.

For a direct investment enterprise that is 100 per cent owned by a non-resident, reinvested earnings are equal to retained earnings and the balance of primary incomes of the enterprise is exactly zero.

The secondary income (current transfers) account of BPM 6

18.51 The secondary income account shows current transfers between residents and non-residents. The range of entries of current transfers corresponds exactly to those in the secondary distribution of income account. Several of these are particularly important in the international accounts, especially current international cooperation and remittances sent to their home countries by individuals working abroad.

18.52 Cross-border personal transfers are household-to-household transfers and are of interest because they are an important source of international funding for some countries that provide large numbers of long-term workers abroad. Personal transfers include remittances by long-term workers, that is, those who change their economy of residence.

18.53 Other workers, such as border and seasonal workers do not change their economy of residence from the home economy. Instead of transfers, the international transactions of these workers include compensation of employees, taxes and travel costs. In balance of payments, a supplementary presentation of personal remittances brings together personal transfers with these related items. Personal remittances include personal transfers, compensation of employees less taxes and travel, and capital transfers between households.

18.54 Insurance flows, especially flows relating to reinsurance, can be important internationally. The transactions between the direct insurer and the re-insurer 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 re-insurer on the other.

The external capital account

18.55 The elements of the capital account subject to international transactions are more restricted than those covered in the domestic sectors. The entries in the capital account only cover acquisitions and disposals of non-produced non-financial assets and capital transfers. There are no transactions recorded as capital formation of produced assets because the ultimate use of exports and imports of goods is not known at the time of recording. Neither are land acquisitions and disposals included.

18.56 Net lending or net borrowing is the balancing item for the sum of the current and capital accounts and for the financial account. It covers all instruments used for providing or acquiring funding, not just lending and borrowing. Conceptually, BPM6 net lending or net borrowing has the same value as the corresponding national accounts item for the total economy, and the same as the national accounts item for the rest of the world but with the sign reversed. Tables 18.9, 18.10 and 18.11 show the recording of the current and capital account elements and the resulting balance both in ESA and BPM6.

Table 18.9 Change in net worth due to saving and capital transfers (ESA V.III.1.1)

Change in assets			Change in liabilities and net worth		
			B12	Current external balance	-32
			D9	Capital transfers, receivable	4
			D9	Capital transfers, payable	-1
B101	Changes in net worth due to saving and capital transfers	-29			

Table 18.10 Acquisition of non-financial assets account (ESA V.III.1.2)

Changes in assets			Changes in liabilities and net worth		
			B101	Changes in net worth due to saving and capital transfers	-29
NP	Acquisitions less disposals of non-produced assets	0			
B9	Net lending(+)/net borrowing(-)	-29			

Table 18.11 Capital account of BPM6

	Credits	Debits	Balance
Current account balance			32
Capital account			
Acquisitions/disposals of non-produced assets	0		
Capital transfers	1	4	
Capital account balance			-3
Net lending (+)/borrowing (-)			29

The external financial account and international investment position (IIP)

18.57 The financial account of the balance of payments and the IIP are of particular importance because they provide an understanding of international financing as well as of international liquidity and vulnerability. Compared to the classification of financial instruments used in ESA, in balance of payments the classification of the financial instruments is based on functional categories (see paragraph 18.21), with additional data on instruments and institutional sectors. Tables 18.12 and 18.13 show the financial account in ESA and in BPM6 respectively.

Table 18.12 Financial account (ESA V.III.2)

Changes in assets	Changes in liabilities and net worth

F	Net acquisition of financial assets	37	F	Net incurrence of liabilities	66
F1	Monetary gold and SDRs	1	F1	Monetary gold and SDRs	0
F2	Currency and deposits	11	F2	Currency and deposits	-2
F3	Debt securities	9	F3	Debt securities	20
F4	Loans	4	F4	Loans	45
F5	Equity and investment fund shares	2	F5	Equity and investment fund shares	14
F6	Insurance, pension and standardised guarantee schemes	0	F6	Insurance, pension and standardised guarantee schemes	0
F7	Financial derivatives and employee stock options	0	F7	Financial derivatives and employee stock options	3
F8	Other accounts receivable/payable	10	F8	Other accounts receivable/payable	-14
			B9	Net lending (+)/net borrowing (-)	-29

Table 18.13 Financial account of BPM6

Net lending (+)/borrowing (-) (curr&cap)			29
Financial account (by functional category)	Change in assets	Change in liabilities	Balance
Direct investment	-4	8	
Portfolio investment	17	7	
Financial derivatives etc.	3	0	
Other investment	42	22	
Reserve assets	8	-	
Total change in assets/liabilities	66	37	
Net lending (+)/net borrowing (-) (Financial account)			29
Net errors and omissions			0

18.58 The functional categories of BPM6 convey information about the motivation and relationship between the parties, which are of particular interest to international economic analysis. Data by functional category are further subdivided by instrument and institutional sector, which makes it possible to link them to the corresponding ESA and monetary and financial statistics items. The institutional sector classification in BPM6 is the same as in the ESA, although it is usually abbreviated (to five sectors in the standard components). In addition, a supplementary sub-sector is used for monetary authorities, which is a functional sub-sector linked to reserve assets. It covers the central bank and any parts of general government or financial corporations other than the central bank that hold reserve assets, so is relevant for countries where some or all reserves are held outside the central bank.

18.59 The main links between the financial instrument categories of the national accounts and the functional categories of the international accounts are shown in table 18.14. The functional categories are used both on the asset side and the liabilities side of the financial account of BPM6. Relatively uncommon links are not shown.

Table 18.14 Links between the functional categories of BPM6 and the financial instrument categories of the ESA

	International account functional categories				
ESA instruments	Direct invest -ment	Port-folio invest-ment	Financial derivatives	Other invest-ment	Reserve assets
Monetary gold					X
Special Drawing Rights (SDRs)				X	X

Currency and deposits					
Currency				X	X
Transferable deposits				X	X
Other deposits				X	X
Debt securities	X	X			X
Loans	X			X	X
Equity and investment fund shares					
Equity:					
Listed shares	X	X			X
Unlisted shares	X	X		X	
Other equity	X				
Investment fund shares/units:					
Money market fund shares/units		X			X
Non-MMF investment fund shares/units		X			X
Insurance, pensions, and standardised guarantee schemes					
Non-life insurance technical reserves				X	
Life insurance and annuity entitlements				X	
Pension entitlements				X	
Claims of pension funds on pension managers	X			X	
Entitlements to non-pension benefits				X	
Provisions for calls under standardised guarantees	X			X	
Financial derivatives and employee stock options					
Financial derivatives			X		X
Employee stock options			X		
Other accounts receivable/payable					

Trade credits and advances	X			X	
Other accounts receivable/payable, excluding trade credits and advances	X			X	

Balance sheets for the Rest of the World Sector

18.60 The part of the balance sheets covered in the international accounts is called the International Investment Position (IIP). The terminology highlights the specific components of the national balance sheet which are included. The IIP covers only financial assets and liabilities. In the case of directly owned real estate in a country by a non-resident unit, a notional resident unit is regarded as the owner of the real estate, and in turn subject to ownership by the non-resident unit in terms of a financial asset (see also paragraph 18.16). In the case of financial claims, the cross-border element arises when one party is a resident and the other party is a non-resident. In addition, while gold bullion is an asset that has no counterpart liability, it is included in the IIP when held as a reserve asset, because of its role in international payments. However, non-financial assets are excluded, as they do not have a counterpart liability or other international aspect.

18.61 The balancing item on the IIP is the net IIP. The net IIP plus non-financial assets in the national balance sheet equal national net worth, because resident-to-resident financial claims net to zero in the national balance sheet. Table 18.15 shows an example of balance sheet for the rest of the world sector, and Table 18.16 provides an example of IIP.

18.62 The same broad categories are used for investment income and the IIP. As a result, average rates of return can be calculated. Rates of return can be compared over time and for different instruments and maturities. For example, the trends in return on direct investment can be analysed, or the return can be compared with other instruments.

Table 18.15 Balance sheets for the Rest of the World Sector (ESA)

		Opening balance	Changes due to trans-actions	Other changes in volume	Revalu-ation	Closing balance
Assets						
Non-financial assets						
Financial assets		805	37	0	7	849
F1	Monetary gold and SDRs	0	1	0	0	1
F2	Currency and deposits	105	11	0	0	116
F3	Debt securities	125	9	0	4	138
F4	Loans	70	4	0	0	74
F5	Equity and investment fund shares	345	2	0	3	350
F6	Insurance, pension and standardised guarantee schemes	26	0	0	0	26
F7	Financial derivatives and employee stock options	0	0	0	0	0
F8	Other accounts receivable/payable	134	10	0	0	144
Liabilities		1074	66	0	3	1143
F1	Monetary gold and SDRs	770	0	0	0	770
F2	Currency and deposits	116	-2	0	0	114
F3	Debt securities	77	20	0	2	99
F4	Loans	17	45	0	0	62
F5	Equity and investment fund shares	3	14	0	1	18
F6	Insurance, pension and standardised guarantee schemes	25	0	0	0	25
F7	Financial derivatives and employee stock options	7	3	0	0	10
F8	Other accounts receivable/payable	59	-14	0	0	45

	Net worth	269				265

Table 18.16 The integrated International Investment Position statement of BPM6

International investment position (IIP)	Opening position	Trans-actions	Other changes in volume	Revalu-ation	Closing position
Assets					
Direct investment	42	-4	0	1	39
Portfolio investment	40	17	0	2	59
Financial derivatives	0	3	0	0	3
Other investment	152	42	0	0	194
Reserve assets	63	8	0	0	71
Total assets	297	66	0	3	366
Liabilities					
Direct investment	132	8	0	2	142
Portfolio investment	180	7	0	5	192
Financial derivatives	0	0	0	0	0
Other investment	261	22	0	0	283
Total liabilities	573	37	0	7	617
Net international investment position (net IIP)	-276	29	0	-4	-251