# IV INSTITUTIONAL UNITS AND SECTORS

## A. Introduction

4.1 This chapter is concerned with the definition and description of institutional units and the way in which they are grouped to make up the sectors and sub-sectors of the System. Economic entities that are capable of owning assets, incurring liabilities and engaging in economic activities and in transactions with other entities are described in the System as institutional units. The various sectors and sub-sectors of an economy are composed of institutional units that are resident in the economy, the total economy consisting of the entire set of resident institutional units. The definition of residence is explained later.

### 1. Institutional units

4.2 An institutional unit may be defined as:

> An economic entity that is capable, in its own right, of owning assets, incurring liabilities and engaging in economic activities and in transactions with other entities.

The main attributes of institutional units may be described as follows:

(a) An institutional unit 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 of assets and liabilities, 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.

4.3 There are two main types of units in the real world that may qualify as institutional units, namely persons or groups of persons in the form of households, and 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.

4.132 For purposes of the System, a household may be defined as:

> a small 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.

4.4 The individual members of multi-person households are not treated as separate institutional units. Many assets are owned, or liabilities incurred, jointly by two or more members of the same household while some or all of the income received by individual members of the same household may be pooled for the benefit of all members. Moreover, many expenditure decisions, especially those relating to the consumption of food, or housing, may be made collectively for the household as a whole. It may be impossible, therefore, to draw up meaningful balance sheets or other accounts for members of the household on an individual basis. For these reasons, the household must be treated as the institutional unit. An unincorporated enterprise that is entirely owned by one or more members of the same household is treated as an integral part of that household and not as a separate institutional unit, except when the enterprise is treated as a quasi-corporation (see below).

4.5 The second type of institutional unit is a legal or social entity that engages in economic activities and transactions in its own right, such as a corporation, non-profit institution (NPI) or government unit. Such units are responsible and accountable for the economic decisions or actions they take, although their autonomy may be constrained to some extent by other institutional units; for example, corporations are ultimately controlled by their shareholders. Some unincorporated enterprises belonging to households or government units may behave in much the same way as corporations, and such enterprises are treated as quasi-corporations when they have complete sets of accounts.

4.23 Corporations may be described by different names: corporations, incorporated enterprises, public limited companies, public corporations, private companies, joint-stock companies, limited liability companies, limited liability partnerships, and so on. “Corporation” is the preferred term used in the System for all these kinds of entities. A typical corporation may be described as:

> a legal entity, created for the purpose of producing goods or services for the market, that may be a source of profit or other financial gain to its owner(s); it is collectively owned by shareholders who have the authority to appoint directors responsible for its general management.

4.54 Non-profit institutions are legal or social entities created for the purpose of producing goods and services whose status does not permit them to be a source of income, profit or other financial gain for the units that establish, control or finance them. In practice, their productive activities are bound to generate either surpluses or deficits but any surpluses they happen to make cannot be appropriated by other institutional units. The articles of association by which they are established are drawn up in such a way that the institutional units which control or manage them are not entitled to a share in any profits or other income which they receive. For this reason, they are frequently exempted from various kinds of taxes.

4.104 Government units may be described as unique kinds of legal entities established by political processes which 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 to 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 non-market production. In general terms:

(a) A government unit usually has the authority to raise funds by collecting taxes or compulsory transfers from other institutional units. In order to satisfy the basic requirements of an institutional unit in the System, a government unit - whether at the level of the nation, a region or a locality - must have funds of its own either raised by taxing other units or received as transfers from other government units and the authority to disburse some, or all, of such funds in the pursuit of its policy objectives. It must also be able to borrow funds on its own account;

(b) Government units typically make three different kinds of final outlays:

(i) The first group consists of actual or imputed expenditures on the free provision to the community of collective services such as public administration, defence, law enforcement, public health, etc. which, as a result of market failure, have to be organized collectively by government and financed out of general taxation or other income;

(ii) The second group consists of expenditures on the provision of goods or services free, or at prices that are not economically significant, to individual households. These expenditures are deliberately incurred and financed out of taxation or other income by government in the pursuit of its social or political objectives, even though individuals could be charged according to their usage;

(iii) The third group consists of transfers paid to other institutional units, mostly households, in order to redistribute income or wealth.

4.105 Within a single country there may be many separate government units when there are different levels of government - central, state or local government. In addition, social security funds also constitute government units. These different kinds of government units are described later when the sub-sectoring of the general government sector is explained.

## 2. Residence

4.15 The total economy is defined as the entire set of resident institutional units. It is divided into sectors that consist of groups of resident institutional units. An institutional unit is resident in a country when it has a centre of economic interest in the economic territory of that country. It is said to have a centre of economic interest when there exists some location - dwelling, place of production or other premises - within the economic territory on, or from, which it engages, and intends to continue to engage, in economic activities and transactions on a significant scale either indefinitely or over a finite but long period of time. In most cases, a long period of time may be interpreted as one year or more, although this is suggested only as a guideline and not as an inflexible rule (see paragraph 14.13 of chapter XIV).

4.16 Thus, residence is not based on nationality or legal criteria (although it may be similar to the concepts of residence used for exchange control, tax or other purposes in many countries). The concept of residence is explained in detail in chapter XIV; it is identical with that used in the fifth edition of the Balance of Payments Manual of the International Monetary Fund (IMF). It may nevertheless be useful to elaborate here on some aspects of residence:

(a) The residence of individual persons is determined by that of the household of which they form 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 long that they acquire a centre of 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;

(c) Corporations and NPIs may normally be expected to have a centre of economic interest in the country in which they are legally constituted and registered. Corporations may be resident in countries different from their shareholders and subsidiary corporations may be resident in different countries from their parent corporations. When a corporation, or unincorporated enterprise, maintains a branch, office or production site in another country in order to engage in a significant amount of production over a long period of time but without creating a subsidiary corporation for the purpose, the branch, office or site is considered to be a quasi-corporation (i.e., separate institutional unit) resident in the country in which it is located (see paragraphs 14.22 to 14.28 of chapter XIV);

(d) Owners of land and buildings in the economic territory of a country are deemed always to have a centre of economic interest in that country, even if they do not engage in other economic activities or transactions in the country. All land and buildings are therefore owned by residents (see paragraph 14.14 of chapter XIV).

## 3. Sectoring and economic behaviour

4.17 The sectors of the System group together similar kinds of institutional units. Corporations, NPIs, government units and households are intrinsically different from each other. Their economic objectives, functions and behaviour are also different.

4.18 Corporations are institutional units created for the purpose of producing goods or services for the market. They may be a source of profit to the units that own them. They are essentially producer units and do not themselves incur expenditures on final consumption. The functions of NPIs are similar in some respects to those of corporations but they can be broader in scope. NPIs are institutional units created for the purpose of producing or distributing goods or services but not for the purpose of generating any income or profit for the units that control or finance them. In contrast to corporations, NPIs may incur final consumption expenditures in respect of final goods or services that they provide to households.

4.19 The economic objectives, functions and behaviour of government units are quite distinct. They organize and finance the provision of non-market goods and services, including both individual and collective services, to households and the community and, therefore, incur expenditures on final consumption. They may also engage in non-market production themselves. They are also concerned with distribution and redistribution of income and wealth through taxation and other transfers. Government units include social security funds.

4.20 Finally, the economic objectives, functions and behaviour of households are different again. Although primarily consumer units, they can engage in any kind of economic activity. They not only supply labour to enterprises but may operate their own producer units in the form of unincorporated enterprises.

4.21 Thus, dividing the total economy into sectors enhances the usefulness of the accounts for purposes of economic analysis by grouping together institutional units with similar objectives and types of behaviour. However, sectors and sub-sectors are also needed in order to be able to target or monitor particular groups of institutional units for policy purposes. For example, the household sector has to be divided into sub-sectors in order to be able to observe how different sections of the community are affected by, or benefit from, the process of economic development or government economic and social policy measures. Similarly, it may be important to treat corporations subject to control by non-residents as sub-sectors of the financial and non-financial corporate sectors not only because they are liable to behave differently from domestically controlled corporations but because governments may wish to be able to identify and observe those parts of the economy that are subject to influence from abroad.

## 4. Institutional sectors and sub-sectors: summary

4.6 The resident institutional units that make up the total economy are grouped into the following five mutually exclusive institutional sectors:

- The non-financial corporations sector
- The financial corporations sector
- The general government sector
- The non-profit institutions serving households sector
- The households sector.

4.7 All resident non-financial corporations and quasi-corporations are included in the non-financial corporations sector and make up most of the sector in practice. In addition, it includes non-profit institutions (NPIs) engaged in the market production of goods and non-financial services: for example, hospitals, schools or colleges that charge fees that enable them to recover their current production costs, or trade associations financed by subscriptions from non-financial corporate or unincorporated enterprises whose role is to promote and serve the interests of those enterprises.

4.8 The financial corporations sector includes all resident corporations and quasi-corporations whose principal activity is financial intermediation or facilitating financial intermediation. In addition, it includes NPIs engaged in market production of a financial nature (e.g., insurance), including those financed by subscriptions from financial enterprises whose role is to promote and serve the interests of those enterprises.

4.9 The general government sector consists mainly of central, state and local government units together with social security funds imposed and controlled by those units. In addition, it includes NPIs engaged in non-market production that are controlled and mainly financed by government units or social security funds.

4.10 The non-profit institutions serving households sector consists of all resident NPIs, except those controlled and mainly financed by government, that provide non-market goods or services to households.

4.11 The households sector consists of all resident households. These include institutional households made up of persons staying in hospitals, retirement homes, convents, prisons, etc. for long periods of time. As already noted, an unincorporated enterprise owned by a household is treated as an integral part of the latter and not as a separate institutional unit, except when the enterprise qualifies as a quasi-corporation.

4.12 Each of the five institutional sectors listed above may be divided into sub-sectors as described in the later sections of this chapter. The division of sectors into sub-sectors depends upon the type of analysis to be undertaken, the needs of policy makers, the availability of data and the economic circumstances and institutional arrangements within a country. No single method of sub-sectoring may be optimal for all purposes or all countries, so that alternative methods of sub-sectoring are recommended below for certain sectors.

## 5. Relationship between sectors and types of institutional units

4.13 A cross-classification of institutional units by sector and type of unit is illustrated schematically in table 4.1. As financial corporations and quasi-corporations are essentially different kinds of institutional units from non-financial corporations and quasi-corporations, it can be seen that, with the exception of NPIs, all institutional units of a particular type are grouped together within the same sector. Thus:

- (a) All non-financial corporations and quasi-corporations are allocated to the non-financial corporations sector;

- (b) All financial corporations and quasi-corporations are allocated to the financial corporations sector;

- (c) All government units, including social security funds, are allocated to the general government sector;

- (d) All households are allocated to the households sector.

***Table 4.1. Institutional units cross-classified by sector and type***

4.14 However, NPIs may be classified as belonging to any of the five major sectors, except the households sector, depending upon the purposes they serve and the kinds of units that control and finance them. As explained below, NPIs are not necessarily non-market producers, the essential characteristic of an NPI is that it cannot be a source of income or profit to the units that control it. The way in which institutional units are grouped into sectors is, therefore, mostly self-evident except for NPIs. It is still necessary, however, to explain in more detail what are the characteristic features by which legal or social entities in the form of corporations, quasi-corporations or NPIs can be identified.

## B. Institutional units in the form of legal or social entities

4.22 This section is concerned with three main categories of legal or social entities that constitute institutional units, namely corporations, quasi-corporations and NPIs. Units of central, state or local government are considered in a separate section below.

### 1. Corporations

4.23 Corporations may be described by different names: corporations, incorporated enterprises, public limited companies, public corporations, private companies, joint-stock companies, limited liability companies, limited liability partnerships, and so on. "Corporation" is the preferred term used in the System for all these kinds of entities. A typical corporation may be described as:

> a legal entity, created for the purpose of producing goods or services for the market, that may be a source of profit or other financial gain to its owner(s); it is collectively owned by shareholders who have the authority to appoint directors responsible for its general management.

4.24 The laws governing the creation, management and operations of corporations may vary from country to country so that it is not feasible to provide a precise, legal definition of a corporation that would be universally valid. It is possible, however, to indicate in more detail the typical features of corporations that are most relevant from the point of view of the System. They may be summarized as follows:

(a) A corporation is an entity created by process of law whose existence is recognized independently of the other institutional units - i.e., households, corporations or government units - which may own shares in its equity. The existence, name and address of a corporation are usually recorded in a special register kept for this purpose. A corporation may normally be expected to have a centre of economic interest - i.e. to be resident - in the country in which it is created and registered. When it also has one or more branches engaged in significant amounts of production over long periods of time in other countries, such branches are treated as quasi-corporations that are separate institutional units resident in the countries in which they are located;

(b) A corporation is created for the purpose of producing goods or services for sale on the market at prices which are economically significant. Prices are said to be economically significant when they have a significant influence on the amounts the producers are willing to supply and on the amounts purchasers wish to buy. Any operating surplus accruing from a corporation's productive activities or holding gains or property income accruing on its assets, belong to the shareholders, but the amount of profits or income actually distributed to shareholders as dividends in any single accounting period depends on the directors of the corporation. Undistributed profits are often described as retained earnings;

(c) Ownership of a corporation is vested in the shareholders collectively. Profits are usually distributed to shareholders in proportion to the value, or amounts, of the shares or other capital participations which they own. There may be different kinds of shares in the same corporation carrying different entitlements. In the event of a corporation being wound up, or liquidated, the shareholders are similarly entitled to a share in the net worth of the corporation remaining after all assets have been sold and all liabilities paid. If a corporation is declared bankrupt because its liabilities exceed the value of its assets, the shareholders are not liable to repay the excess liabilities. The shareholders are different institutional units from the corporation itself and their liability is limited to the amounts of capital they have subscribed in shares;

(d) A corporation is fully responsible and accountable at law for its own actions, obligations and contracts, this being an essential attribute of an institutional unit in the System. A corporation is liable to pay taxes on its productive activities, income or assets;

(e) Control of a corporation is ultimately exercised by the shareholders collectively. A corporation has a board of directors that is responsible for the corporation's policy and appoints the senior management of the corporation. The board of directors is usually appointed by the collective vote of the shareholders;

(f) In practice, however, some shareholders may exert much more influence or control over the policies and operations of a corporation than others:

(i) The voting rights of shareholders may not be equal. Some types of shares may carry no voting rights, while others may carry exceptional rights, such as the right to make specific appointments to the board of directors or the right to veto other appointments made on a majority vote. Such exceptional rights may be held by the Government when it is a shareholder in a corporation;

(ii) Many shareholders with voting rights do not choose to exercise them. Voting usually requires attendance at general meetings of the shareholders or the nomination of another shareholder as a proxy with authority to vote on behalf of the original shareholder. In practice, many shareholders may not exercise their voting rights, so that a small, organized minority of active shareholders may be in a position to control the policy and operations of a corporation.

4.25 Two characteristics of a corporation are worth noting. The first is that a corporation cannot be a final consumer. In contrast to an NPI, it cannot incur final expenditures for the benefit of households. When a corporation provides goods or services to its employees, these must be either compensation of employees paid in kind or intermediate consumption, depending upon the reason for providing the goods and services. The second characteristic is that the whole of the profit or income accruing to a corporation ultimately benefits other institutional units, namely its shareholders. This again differentiates a corporation from an NPI, which, by definition, cannot generate an income that can be appropriated by other institutional units.

## 2. Cooperatives, limited liability partnerships, etc.

4.45 In addition to entities calling themselves corporations or companies, there are also other legal entities created for the purpose of engaging in market production for profit but which may be described differently because they have rather specialized functions. Such entities are classified as corporations in the System.

4.46 They include, for example, cooperatives set up by producers for purposes of marketing their collective output. The profits of such cooperatives are distributed in accordance with their agreed rules and not necessarily in proportion to shares held, but effectively they operate like corporations. Similarly, partnerships whose members enjoy limited liability are separate legal entities which behave like corporations. In effect, the partners are at the same time both shareholders and managers.

4.47 In general, all entities, however they may describe themselves or whatever they may be called, which are set up for purposes of engaging in market production, which are capable of generating a profit or other financial gain for their owners and which are recognized at law as separate legal entities from their owners who enjoy limited liability, are treated as corporations in the System.

4.48 Conversely, some legal entities that are NPIs may sometimes be described "corporations". The status of an institutional unit cannot always be inferred from its name, and it may be necessary to examine its objectives and functions.

### 3. Quasi-corporations

4.49 Quasi-corporations are unincorporated enterprises that function as if they were corporations. A quasi-corporation may be:

*either* an unincorporated enterprise owned by a resident institutional unit that is operated as if it were a separate corporation and whose de facto relationship to its owner is that of a corporation to its shareholders: such an enterprise must, of course, keep a complete set of accounts

*or* an unincorporated enterprise owned by a non-resident institutional unit that is deemed to be a resident institutional unit because it engages in a significant amount of production in the economic territory over a long or indefinite period of time.

4.50 For purposes of sectoring and sub-sectoring, quasi-corporations are treated as if they were corporations: that is, as separate institutional units from the units to which they legally belong. Thus, quasi-corporations owned by households or government units are grouped with corporations in the non-financial or financial corporate sectors. Three main kinds of quasi-corporations are recognized in the System:

(a) Unincorporated enterprises owned by government units which are engaged in market production and which are operated in a similar way to publicly owned corporations;

(b) Unincorporated enterprises, including unincorporated partnerships, owned by households which are operated as if they were privately owned corporations;

(c) Unincorporated enterprises which belong to institutional units resident abroad: these consist of the permanent branches, or offices of foreign corporate or unincorporated enterprises, or of production units belonging to foreign enterprises which engage in significant amounts of production within the economic territory over long, or indefinite, periods of time; e.g., units engaged in the construction of bridges, dams or other large structures.

4.51 The intent behind the concept of a quasi-corporation is clear: namely, to separate from their owners those unincorporated enterprises which are sufficiently self-contained and independent that they behave in the same way as corporations. If they function like corporations, they must keep complete sets of accounts. Indeed, the existence of a complete set of accounts, including balance sheets, for the enterprise is a necessary condition for it to be treated as quasi-corporation. Otherwise, it would not be feasible from an accounting point of view to distinguish the quasi-corporation from its owner.

4.52 As a quasi-corporation is treated as a separate institutional unit from its owner, it must have its own value added, saving, assets, liabilities, etc. It must be possible to identify and record any flows of income and capital that are deemed to take place between the quasi-corporation and its owner. The amount of income withdrawn from a quasi-corporation during a given accounting period is decided by the owner, such a withdrawal being equivalent to the payment of a dividend by a corporation to its shareholder(s). Given the amount of the income withdrawn, the saving of the quasi-corporation (i.e., the amount of earnings retained within the quasi-corporation) is determined. A balance sheet is also needed for the quasi-corporation showing the values of its fixed assets - land, buildings, machinery and equipment, inventories - used in production and also the financial assets and liabilities - owned or incurred in the name of the enterprise - bank deposits, overdrafts, trade credit and debits, other receivables or payables, etc. It is assumed that the owner's net equity in a quasi-corporation is equal to the difference between the value of its assets and the value of its other liabilities so that the net worth of the quasi-corporation is always zero in practice. The owner may invest more capital in the enterprise or withdraw capital from it by disposing of some of its assets, and such flows of capital must also be identifiable in the accounts whenever they occur.

4.53 Experience has shown that countries have difficulty distinguishing quasi-corporations owned by households. However, it is not useful to introduce additional criteria, such as size, into the definition of quasi-corporations owned by households as such criteria do not help in practice if the enterprise in question is not in fact operated like a corporation and does not have a complete set of accounts of its own, however large it may be.

*(c) Groups of corporations and holding corporations*

4.36 As described above, large groups of corporations, or conglomerates, may be created whereby a parent corporation controls several subsidiaries, some of which may control subsidiaries of their own, etc. Two different types of parent corporation may be distinguished. The first consists of a corporation with significant production of its own which acquires control over other corporations in order to strengthen its own position as a producer. It may, for example, acquire control of a corporation that supplies it with components, or it may acquire control of a competitor.

4.37 On the other hand, the principal function of a corporation may be to control and direct a group of subsidiaries, without having any other significant production of its own. Such a corporation is described as a "holding corporation" or "holding company".

4.38 For certain purposes, it may be desirable to have information relating to a group of corporations as a whole. However, with the exception of ancillary corporations described in the next section, each individual corporation should be treated as a separate institutional unit, whether or not it forms part of a group. Even subsidiaries which are wholly owned by other corporations are separate legal entities that are required by law and the tax authorities to produce complete sets of accounts, including balance sheets. Although the management of a subsidiary corporation may be subject to the control of another corporation, it remains responsible and accountable for the conduct of its own production activities.

## 4. Ancillary corporations

4.40 An ancillary corporation may be defined as:

> a subsidiary corporation, wholly owned by a parent corporation, whose productive activities are ancillary in nature: that is, are strictly confined to providing services to the parent corporation, or other ancillary corporations owned by the same parent corporation.

4.41 As described in chapter V, a productive activity is described as ancillary when its sole function is to produce one or more common types of services for intermediate consumption within the same enterprise. The kinds of services which may be produced by ancillary activities are transportation, purchasing, sales and marketing, various kinds of financial or business services, computing and communications, security, maintenance, and cleaning. These are typically services that are likely to be needed, to some extent or other, in most enterprises, whatever the nature of their principal activities. Neither the inputs into, nor the outputs from, ancillary activities are recorded separately from others consumed or produced by the principal or secondary productive activities.

4.42 A corporation may find it advantageous for tax or other reasons to create a subsidiary corporation purely in order to perform certain ancillary activities for its own benefit. For example, it may create a subsidiary to which ownership of its land, buildings or equipment is transferred and whose sole function is to lease them back again to the parent corporation; or it may create a subsidiary to keep its accounts and records on a separate computer installation; and so on. In some cases, corporations may create "dormant" subsidiaries which are not actually engaged in any production but which may be activated at the convenience of the parent corporation.

4.43 Ancillary corporations are not treated as separate institutional units in the System. When a parent corporation has created a single ancillary corporation, the ancillary corporation should be treated as an integral part of the parent and its accounts consolidated with those of the parent. When a parent corporation has created several ancillary corporations, they should all be combined with the parent corporation to form a single institutional unit.

4.44 Ancillary corporations are not treated as separate institutional units because they can be regarded as artificial units created 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 country.

### Ownership and control of corporations

4.26 The ownership of a corporation is diffused among the institutional units that own its shares in proportion to their shareholdings. It is possible for a single institutional unit, another corporation or a household or a government unit, to own all the equity or shares in a corporation but, in general, ownership is diffused among several, possibly very many, institutional units.

4.27 A single institutional unit owning more than a half of the shares, or equity, of a corporation is able to control its policy and operations by outvoting all other shareholders, if necessary. Similarly, a small, organized group of shareholders whose combined ownership of shares exceeds 50 per cent of the total is able to control the corporation by acting in concert. There may be exceptional cases in which certain shareholders enjoy privileged voting rights, such as a right of veto, but in general an individual institutional unit or group of units owning more than half the voting shares of a corporation can exercise complete control by appointing directors of its own choice. The degree of autonomy exercised by the directors and managers of a corporation is, therefore, likely to vary considerably, depending upon the extent to which the ownership of its shares is concentrated in the hands of a small number of other institutional units, whether these are other corporations, households or government units. In general, institutional units do not have to be autonomous but they do have to be responsible, and accountable, for the decisions and actions they take.

4.28 Because many shareholders do not exercise their voting rights, a single shareholder, or small number of shareholders acting together, may be able to secure control over a corporation, even though they may hold considerably less than half of the total shares. When ownership of shares is widely diffused among a large number of shareholders, control may be secured by owning 20 per cent or less of the total shares.

4.29 However, it is not possible to stipulate a minimum shareholding below 50 per cent which will guarantee control in all cases. The minimum must vary depending upon the total number of shareholders, the distribution of shares among them, and the extent to which small shareholders take an active interest, etc.

4.30 As explained later in this chapter, the sub-sectors of the System require private corporations to be separated from public corporations subject to control by government units, and also private corporations controlled by non-resident units to be separated from other private corporations. In both cases, control is defined as the ability to determine general corporate policy by appointing appropriate directors, if necessary. Owning more than half the shares of a corporation is evidently a sufficient, but not a necessary, condition for control. Nevertheless, because it may be difficult to identify those corporations in which control is exercised by a minority of shareholders, it is recommended that, in practice, corporations subject to public or foreign control should normally be confined to those in which governments or non-residents own a majority of the shares. This recommendation is intended only as a practical guideline, however, to which exceptions can be admitted if there is other evidence of control. For example, a corporation which a government is able to control as a result of special legislation should be treated as a public corporation even if the government does not own a majority of the shares.

*Subsidiary, associate and holding corporations*

4.31 It is common for corporations to own shares in other corporations, and certain inter-relationships between corporations need to be specified for purposes of the System.

*(a) Subsidiary corporations*

4.32 Corporation B is said to be a subsidiary of corporation A when:

(a) Either corporation A controls more than half of the shareholders' voting power in corporation B; or

(b) Corporation A is a shareholder in corporation B with the right to appoint or remove a majority of the directors of corporation B.

4.33 Corporation A may be described as the parent corporation in this situation. As the relationship of a parent corporation to a subsidiary is defined in terms of control rather than ownership, the relationship must be transitive: that is, if C is a subsidiary of B and B is a subsidiary of A, then C must also be a subsidiary of A. If A has a majority shareholding in B while B has a majority shareholding in C, A cannot also have a majority shareholding in C. Nevertheless, A must be able to control C if it controls B. By analogy with families of persons, corporation B can be described as a first generation subsidiary of corporation A, and corporation C as a second generation subsidiary of A. Evidently, large families of corporations may be built up with any number of subsidiaries at each level or generation and also any number of generations. Very large families of corporations, described as conglomerates, are encountered in some countries. Conglomerates may include corporations resident in different countries, in which case the parent corporation is usually described as a multinational corporation.

*(b) Associate corporations*

4.34 Corporation B is said to be an associate of corporation A when corporation A and its subsidiaries control between 10 per cent and 50 per cent of the shareholders' voting power in B so that A has some influence over the corporate policy and management of B.

4.35 By definition, a corporation is able to exert less influence over an associate corporation than over a subsidiary. Although some corporations may be able to exert considerable influence over their associates, this cannot be guaranteed. The relationship between associates is weaker than that between parent and subsidiary corporations, and groups of associates may not be well defined.

4.39 Another reason for not treating groups of corporations as single institutional units is that groups are not always well defined, stable or easily identified in practice. It may be difficult to obtain data for groups whose activities are not closely integrated. Moreover, many conglomerates are much too large and heterogeneous for them to be treated as single units, and their size and composition may be continually shifting over time as a result of mergers and takeovers.

## 5. Non-profit institutions

4.54 Non-profit institutions are legal or social entities created for the purpose of producing goods and services whose status does not permit them to be a source of income, profit or other financial gain for the units that establish, control or finance them. In practice, their productive activities are bound to generate either surpluses or deficits but any surpluses they happen to make cannot be appropriated by other institutional units. The articles of association by which they are established are drawn up in such a way that the institutional units which control or manage them are not entitled to a share in any profits or other income which they receive. For this reason, they are frequently exempted from various kinds of taxes.

4.55 The motives leading other institutional units - whether persons, corporations, or government - to create NPIs are varied. For example, NPIs may be created to provide services for the benefit of the persons or corporations who control or finance them; or they may be created for charitable, philanthropic or welfare reasons to provide goods or services to other persons in need; or they may be intended to provide health or education services for a fee, but not for profit; or they may be intended to promote the interests of pressure groups in business or politics; etc. Although they may provide services to groups of persons or institutional units, by convention they are deemed to produce only individual services and not collective services.

### The characteristics of NPIs

4.56 The main features of NPIs may be summarized as follows:

(a) Most NPIs are legal entities created by process of law whose existence is recognized independently of the persons, corporations or government units that establish, finance, control or manage them. The purpose of the NPI is usually stated in the articles of association or similar document drawn up at the time of its establishment. In some countries, especially developing countries, an NPI may be an informal entity whose existence is recognized by the society but which does not have any formal legal status; such NPI may be created for the purpose of producing non-market goods or services for the benefit of individual households or groups of households;

(b) Many NPIs are controlled by associations whose members have equal rights, including equal votes on all major decisions affecting the affairs of the NPI. Members enjoy limited liability with respect to the NPIs operations;

(c) There are no shareholders with a claim on the profits or equity of the NPI. The members are not entitled to a share in any profits, or surplus, generated by the productive activities of the NPI, such profits being retained within the NPI;

(d) The direction of an NPI is usually vested in a group of officers, executive committee or similar body elected by a simple majority vote of all the members. These officers are the counterpart of the board of directors of a corporation and are responsible for appointing any paid managers;

(e) The term “non-profit institution” derives from the fact that the members of the association controlling the NPI are not permitted to gain financially from its operations and cannot appropriate any surplus which it may make. It does not imply that an NPI cannot make an operating surplus on its production.

## NPIs as market and non-market producers

4.57 As in the case of producer units owned by government units, it is important to distinguish between NPIs engaged in market and non-market production as this affects the sector of the economy to which NPI is allocated. NPIs do not necessarily engage in non-market production.

*NPIs engaged in market production*

4.58 Market producers are producers that sell most or all of their output at prices that are economically significant - i.e., at prices which have a significant influence on the amounts the producers are willing to supply and on the amounts purchasers wish to buy. Schools, colleges, universities, clinics, hospitals, etc. constituted as NPIs are market producers when they charge fees which are based on their production costs and which are sufficiently high to have a significant influence on the demand for their services. Their production activities must generate an operating surplus or loss. Any surpluses they make must be retained within the institutions as their status prevents them from distributing them to others. On the other hand, because of their status as “non-profit institutions” they are also able to raise additional funds by appealing for donations from persons, corporations or government. In this way, they may be able to acquire assets which generate significant property income in addition to their revenues from fees, thereby enabling them to charge fees below average costs. However, they must continue to be treated as market producers so long as their fees are determined mainly by their costs of production and are high enough to have a significant impact on demand. Such NPIs are not charities, their real objective often being to provide educational, health or other services of a very high quality using their incomes from endowments merely to keep down somewhat the high fees they have to charge.

*Market NPIs serving businesses*

4.59 Most market NPIs serving businesses are created by associations of the businesses whose interests they are designed to promote. They consist of chambers of commerce, agricultural, manufacturing or trade associations, employers’ organizations, research or testing laboratories or other organizations or institutes which engage in activities which are of mutual interest or benefit to the group of businesses that control and finance them. The NPIs often engage in publicity on behalf of the group, lobby politicians or provide advice or assistance to individual members in difficulty for one reason or another. The NPIs are usually financed by contributions or subscriptions from the group of businesses concerned. The subscriptions are treated not as transfers but as payments for services rendered and these NPIs are, therefore, classed as market producers. However, as explained below, when chambers of commerce or similar organizations for the benefit of businesses are controlled and mainly financed by government units, they are classified as non-market NPIs and allocated to the general government sector.

*NPIs engaged in non-market production*

4.60 The majority of NPIs in most countries are non-market rather than market producers. Non-market producers are producers that provide most of their output to others free or at prices which are not economically significant: that is, at prices which do not have a significant influence on the amounts the producers are willing to supply or on the amounts purchasers wish to buy. Thus, NPIs engaged mainly in non-market production may be distinguished not only by the fact that they are incapable of providing financial gain to the units which control or manage them, but also by the fact that they must rely principally on funds other than receipts from sales to cover their costs of production or other activities. Their principal source of finance may be regular subscriptions paid by the members of the association that controls them or transfers or donations from third parties, including government.

4.61 NPIs engaged mainly in non-market production may be divided into two main groups: those NPIs controlled and mainly financed by government and those NPIs providing non-market goods and services to households financed mainly by transfers from non-governmental sources - households, corporations or non-residents. The second group are described as "NPIs serving households" (NPISHs) and constitute a separate sector in the System.

*NPIs controlled and mainly financed by government*

4.62 NPIs controlled and mainly financed by government must be properly constituted legal entities which exist separately from government. In this context, control is to be understood as the ability to determine the general policy or programme of the NPI by having the right to appoint the officers managing the NPI. Such NPIs may be engaged in research or development, for example, for the benefit of certain groups of producers, such as farmers. They may also be concerned with the setting or maintenance of standards in fields such as health, safety, the environment, accounting, finance, education, etc., for the benefit of both enterprises and households. Governments find it appropriate to create NPIs for this purpose, rather than using agencies of government to carry out the same functions, because NPIs concerned with public standards may need to be seen as detached and objective, and not subject to political pressures. NPIs controlled and financed by government are allocated to the general government sector, irrespectively of the types of institutional units that mainly benefit from their activities.

4.63 In some countries, certain legal entities created by government units may have the characteristics of, and behave like, NPIs controlled and mainly financed by government units and yet be formally described as "corporations". Such entities must be treated as NPIs whatever their names. In general, the status of a legal entity cannot be automatically ascertained from its name and it is necessary to take account of its functions and purpose.

*NPIs serving households (NPISHs)*

4.64 Non-profit institutions serving households (NPISHs) consist of NPIs which provide goods or services to households free or at prices that are not economically significant. Two main types of NPISHs may be distinguished.

4.65 The first type consists of NPISHs which are created by associations of persons to provide goods or, more often, services primarily for the benefit of the members themselves. The services are usually provided free, being financed by regular membership subscriptions or dues. They include NPISHs such as professional or learned societies, political parties, trade unions, consumers' associations, churches or religious societies, and social, cultural, recreational or sports clubs. They do not include bodies serving similar functions that are controlled and mainly financed by government units, except that churches are always treated as serving households even when mainly financed by government units. Political parties in countries with one-party political systems that are controlled and financed by government units are always included in the general government sector.

4.66 In some communities, NPISHs may be found which do not possess any legal status or formal articles of association. They should be treated as NPISHs when they perform the same kinds of functions as the societies, parties, unions, etc., described above, even if they are not legally constituted as NPISHs. However, when groups of households collaborate on communal construction projects (such as construction of buildings, roads, bridges, ditches, dykes, etc.), they should be treated as informal partnerships engaged on own-account construction rather than NPISHs. NPISHs should normally have a continuing role to play and not be deemed to be created for single projects of limited duration.

4.67 The second type of NPISH consists of charities, relief or aid agencies that are created for philanthropic purposes and not to serve the interests of the members of the association controlling the NPISH. Such NPISHs provide goods or services on a non-market basis to households in need, including households affected by natural disasters or war. The resources of such NPISHs are provided mainly by donations in cash or in kind from the general public, corporations or governments. They may also be provided by transfers from non- residents, including similar kinds of NPISHs resident in other countries.

## C. The non-financial corporations sector and its sub-sectors (S.11)

4.68 Non-financial corporations or quasi-corporations are corporations or quasi-corporations whose principal activity is the production of market goods or non-financial services. The non-financial corporations sector is composed of the following set of resident institutional units:

(a) All resident non-financial corporations, irrespectively of the residence of their shareholders;

(b) All resident non-financial quasi-corporations including the branches or agencies of foreign-owned non-financial enterprises that are engaged in significant amounts of production on the economic territory on a long-term basis;

(c) All resident NPIs that are market producers of goods or non-financial services.

4.69 Some non-financial corporations or quasi-corporations may have secondary financial activities: for example, producers or retailers of goods may provide consumer credit directly to their own customers. As explained more fully below, such corporations or quasi-corporations are nevertheless classified as belonging in their entirety to the non-financial corporate sector provided their principal activity is non-financial. Sectors are groups of institutional units, and the whole of each institutional unit must be classified to one or other sector of the System even though that unit may be engaged in more than one type of economic activity.

4.70 The non-financial corporate sector is divided into three sub-sectors on the basis of the types of institutional units that exercise control over the corporations, quasi-corporations or market NPIs. While control over corporations may be guaranteed by owning or controlling a majority of voting shares, it is usually possible to secure control by owning or controlling considerably less than half the voting shares, depending upon the distribution of voting shares among shareholders as explained earlier. However, as the minimum shareholding that is sufficient to secure control may vary from corporation to corporation, it is not possible to specify a figure below 50 per cent that is guaranteed to secure control. As a practical guideline, therefore, it is recommended that control should normally be attributed to an institutional unit, or organized group of units, only when they own or control (e.g., through a subsidiary) more than 50 per cent of the voting shares of a corporation unless there is other evidence that control is exercised.

### 1. The sub-sectors of the non-financial corporations sector

4.71 Three sub-sectors are distinguished:

(a) Public non-financial corporations;

(b) National private non-financial corporations;

(c) Foreign controlled non-financial corporations.

### Public non-financial corporations (S.11001)

4.72 These consist of resident non-financial corporations and quasi-corporations that are subject to control by government units, control over a corporation being defined as the ability to determine general corporate policy by choosing appropriate directors, if necessary. The government may secure control over a corporation:

(a) By owning more than half the voting shares or otherwise controlling more than half the shareholders' voting power; or

(b) As a result of special legislation, decree or regulation which empowers the government to determine corporate policy or to appoint the directors.

4.73 In order to control more than half the shareholders' voting power, a government unit need not own any of the voting shares itself. For example, a public corporation could be a subsidiary of another public corporation in which the government owns a majority of the voting shares. Public quasi-corporations are quasi-corporations owned directly by government units.

4.74 Public corporations do not include any non-market NPIs controlled and financed by government units, such NPIs being included in the general government sector.

### National private non-financial corporations (S.11002)

4.75 These include all resident non-financial corporations and quasi-corporations that are not controlled by government or by non-resident institutional units. Such corporations may, or may not, be controlled by other resident institutional units. They are simply characterised by the fact that they are not subject to control by the government or from abroad. The sub-sector also includes market NPIs producing goods or non-financial services: for example, market NPIs engaged in providing education or health services on a fee-paying basis, or trade associations serving enterprises.

### Foreign controlled non-financial corporations (S.11003)

4.76 These consist of all resident non-financial corporations and quasi-corporations that are controlled by non-resident institutional units. The sub-sector includes:

(a) All subsidiaries of non-resident corporations (but not associates of non-resident corporations);

(b) All corporations controlled by a non-resident institutional unit that is not itself a corporation: for example, a corporation which is controlled by a foreign government; it also includes corporations controlled by a group of non-resident units acting in concert;

(c) All branches or other unincorporated agencies of non-resident corporate or unincorporated enterprises that are engaged in significant amounts of production on the economic territory on a long-term basis and that are, therefore, treated as resident quasi-corporations.

## D. The financial corporations sector and its sub-sectors (S.12)

4.77 The financial corporations sector consists of all resident corporations or quasi-corporations principally engaged in financial intermediation or in auxiliary financial activities which are closely related to financial intermediation. Because financial intermediation is inherently different from most other types of productive activity and because of the importance of financial intermediation in the economy, financial corporations are distinguished from non-financial corporations at the first level of sectoring in the System.

## 1. Financial intermediation

4.78 Financial intermediation may be defined as 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. The role of financial intermediaries is to channel funds from lenders to borrowers by intermediating between them. They collect funds from lenders and transform, or repackage, them in ways which suit the requirements of borrowers. They obtain funds by incurring liabilities on their own account, not only by taking deposits but also by issuing bills, bonds or other securities. They use these funds to acquire financial assets, principally by making advances or loans to others but also by purchasing bills, bonds or other securities. A financial intermediary does not simply act as an agent for other institutional units but places itself at risk by incurring liabilities on its own account.

## 2. Financial enterprises

4.79 Financial enterprises are defined in the System as enterprises that are principally engaged in financial intermediation or in auxiliary financial activities which are closely related to financial intermediation. They thus include enterprises whose principal function is to facilitate financial intermediation without necessarily engaging in financial intermediation themselves. Financial enterprises consist of all those enterprises (i.e., institutional units as distinct from establishments) whose principal activity is classified under Divisions 65, 66 and 67 of the International Standard Industrial Classification of All Economic Activities (ISIC) Rev.3.

4.80 The provision of services that are auxiliary to financial intermediation may be carried out as secondary activities of financial intermediaries or they may be provided by specialist agencies or brokers. The latter consist of agencies such as securities brokers, flotation companies, loan brokers, etc. There are also other agencies whose principal function is to guarantee, by endorsement, bills or similar instruments intended for discounting or refinancing by financial enterprises and also institutions that arrange hedging instruments, such as swaps, options and futures which have evolved as a result of wide-ranging financial innovation. These enterprises provide services which border very closely on financial intermediation, but they may not constitute true financial intermediation as the enterprises may not acquire financial assets and put themselves at risk by incurring liabilities on their own account. However, it is becoming increasingly difficult to draw a clear distinction between true intermediation and certain other financial activities. The boundary between financial intermediation and many of the services which are auxiliary to financial intermediation has become rather blurred as a result of continuous evolution and innovation in financial markets.

4.81 However, this is not the only reason for classifying financial auxiliaries as financial enterprises in the System. As already mentioned, corporations whose principal function is financial intermediation also tend to provide a wide range of auxiliary services themselves as secondary activities. As a corporation as a whole has to be allocated to a sector, the auxiliary activities of financial corporations would fall within the financial corporate sector of the System anyway, even if financial auxiliaries themselves were to be excluded.

## 3. Unincorporated financial enterprises

4.82 Individuals or households may engage in financial activities such as money lending or buying and selling foreign currency. Unincorporated financial enterprises of this kind are included in the financial corporations sector only if they qualify as proper financial intermediaries or auxiliaries and as quasi-corporations. In particular, they must have complete sets of accounts that are separable from those of their owners in their personal capacities. As large unincorporated financial enterprises may be subject to government regulation and control, they may well be obliged to keep such accounts.

However, money lenders, currency changers and similar individuals engaged in financial activities on a small scale are unlikely to qualify, in which case they cannot be treated as quasi-corporations and are not included in the financial corporations sector.

## 4. The sub-sectors of the financial corporations sector

4.83 Financial corporations and quasi-corporations are grouped into the following sub-sectors:

(a) The central bank;

(b) Other depository corporations, of which:

(i) Deposit money corporations;

(ii) Other;

(c) Other financial intermediaries, except insurance corporations and pension funds;

(d) Financial auxiliaries;

(e) Insurance corporations and pension funds.

4.84 In addition, financial corporations and quasi-corporations may also be sub-divided according to whether they are subject to public, private or foreign control as follows:

(a) Public financial corporations;

(b) National private financial corporations;

(c) Foreign controlled financial corporations.

The criteria for determining control are exactly the same as for non-financial corporations.

4.85 The first level of sub-sectoring the financial corporations sector is the breakdown into the five categories of financial corporation listed above (central bank, other depository corporations, etc.), the division between public, private and foreign controlled corporations being made at the second level of sub-sectoring. The second breakdown is not relevant to the central bank. The corporations and quasi-corporations which make up the five sub-sectors at the first level are described below.

### The central bank (S.121)

4.86 This sub-sector consists of the central bank together with any other agencies or bodies which regulate or supervise financial corporations and which are themselves separate institutional units. The central bank is the public financial corporation which is a monetary authority: that is, which issues banknotes and sometimes coins and may hold all or part of the international reserves of the country. The central bank also has liabilities in the form of demand or reserve deposits of other depository corporations and often government deposits.

4.87 In some countries, some monetary authority-type functions, such as the maintenance of the international reserves or the issue of currency, may be carried out by an agency, or agencies, of central government which remain financially integrated with central government and are directly controlled and managed by government itself as a matter of policy. Such agencies are not separate institutional units from government and must, therefore, remain in the general government sector.

## Other depository corporations (S.122)

4.88 This sub-sector consists of all resident financial corporations and quasi-corporations, except the central bank, whose principal activity is financial intermediation and which have liabilities in the form of deposits or financial instruments such as short-term certificates of deposit which are close substitutes for deposits in mobilizing financial resources and which are included in measures of money broadly defined.

4.89 Traditionally, money has been interpreted as a financial instrument which may be used as a unit of account, a medium of exchange, and a store of value. A narrow concept of money is one which focuses on money as an asset which is immediately, universally and legally accepted as a means of payment. Narrow money therefore consists of currency (including coin) plus deposits which are repayable on demand and immediately transferable by cheque, standing order or other means of transferring deposits for the purpose of making payments. In the past, only deposits with certain types of financial corporations, typically called "banks", were universally acceptable for this purpose. However, two developments have led to the use of a more broadly based concept of money. The first is that, as a result of increasing competition and financial innovation, banks have been able to offer other kinds of deposits or facilities which are very close substitutes for narrow money and which can be used for payment purposes with little or no delay or financial penalty, without being technically transferable deposits payable on demand. The second is that deposits with other kinds of financial corporations (not necessarily describing themselves as "banks") which in the past may not have been repayable on demand or used as a means of payment, have become increasingly transferable, again as a result of financial innovation. They have also become increasingly close substitutes for narrow money on deposit with banks. A broad concept of money is one which embraces all these new kinds of deposits and quasi-deposit liabilities of depository corporations. The need for broader measures of money has been generally accepted for purposes of economic analysis and policy-making, as relationships previously observed to hold between narrow measures of money and levels of economic activity have tended to break down.

4.90 Given the wide variation in institutional arrangements between countries whose financial systems and markets are at different stages of development and also the continuous innovation in financial markets and instruments over time, it is not possible to provide precise, operational definitions of narrow or broad money which would be appropriate and analytically useful across a range of different countries and which would continue to be valid over any long period of time. The System does not, therefore, attempt to provide such definitions even though it recognizes the usefulness and importance of the concepts of narrow and broad money themselves.

4.91 As stated above, the sub-sector "other depository corporations" covers those corporations which have liabilities in the form of deposits or close substitutes for deposits which are included in measures of broad money. "Other depository corporations" cannot be simply described as "banks", however, because they may possibly include some corporations which may not call themselves banks, and which may not be permitted to do so in some countries, while some other corporations describing themselves as "banks" may not in fact be depository corporations as defined above. In general, there is no one-to-one correspondence between "depository corporations" and "banks".

4.92 When the financial instruments and arrangements within a country are such that it is meaningful and analytically useful to identify a sub-set of depository corporations whose deposits correspond to money in the narrow sense, it is recommended that they should be separately identified. This sub-set is described as "deposit money corporations". It may not always be feasible, however, to subdivide "other depository corporations" in this way, as explained further in paragraph 4.94 below.

### *Deposit money corporations (S.1221)*

4.93 These consist of resident depository corporations and quasi-corporations which have any liabilities in the form of deposits payable on demand, transferable by cheque or otherwise usable for making payments. Such deposits are included in the concept of money in a narrow sense. These corporations include so-called “clearing banks” which participate in a common clearing system organized to facilitate the transfer of deposits between them by cheques or other means.

*Other (S.1222)*

4.94 These consist of all other resident depository corporations and quasi-corporations which have liabilities in the form of deposits that may not be readily transferable or in the form of financial instruments such as short-term certificates of deposit which are close substitutes for deposits and included in measures of money broadly defined. These corporations compete for funds with deposit money corporations in financial markets even if they unable, or unwilling, to incur liabilities in the form of transferable deposits. They may include corporations described as savings banks (including trustee savings banks and savings banks and loan associations), credit cooperatives and mortgage banks or building societies. It must be emphasized that such corporations are described in different ways in different countries and they can only be identified by examining their functions rather than their names. They may also include post office savings banks or other savings banks controlled by the government, provided these are separate institutional units from government. As a result of financial innovation, improved technology in the field of computers and communications, and also financial deregulation in many countries, some of the corporations included under this heading take deposits which, although not readily transferable by traditional methods, may increasingly be used for payments purposes and be gradually transformed into deposits which are partially or even wholly transferable without much delay, difficulty or cost. This simply underlines the difficulty of drawing a clear distinction between narrow and broad money, and the fact that the distinction between “deposit money corporations” and “other” depository corporations may be too blurred to be operational in some countries.

### Other financial intermediaries except insurance corporations and pension funds (S.123)

4.95 This sub-sector consists of all resident corporations and quasi-corporations primarily engaged in financial intermediation except depository corporations, insurance corporations and pension funds. Financial corporations included under the present heading are those which raise funds on financial markets, but not in the form of deposits, and use them to acquire other kinds of financial assets. The types of corporations which may be included under this heading are those engaged in financing investment or capital formation; for example, investment corporations, corporations engaged in financial leasing, hire purchase corporations and other corporations engaged in the provision of personal finance or consumer credit.

### Financial auxiliaries (S.124)

4.96 This sub-sector consists of all resident corporations and quasi-corporations engaged primarily in activities closely related to financial intermediation but which do not themselves perform an intermediation role. They consist of corporations such as securities brokers, loan brokers, flotation corporations, insurance brokers, etc. They also include corporations whose principal function is to guarantee, by endorsement, bills or similar instruments intended for discounting or refinancing by financial corporations, and also corporations which arrange hedging instruments such as swaps, options, and futures or other instruments which are continually being developed as a result of wide-ranging financial innovation.

### Insurance corporations and pension funds (S.125)

4.97 This sub-sector consists of resident insurance corporations and quasi-corporations and autonomous pension funds. Insurance corporations consist of incorporated, mutual and other entities whose principal function is to provide life, accident, sickness, fire or other forms of insurance to individual institutional units or groups of units.

4.98 The pension funds included here are those which are constituted in such a way that they are separate institutional units from the units which create them. They are established for purposes of providing benefits on retirement for specific groups of employees. They have their own assets and liabilities and they engage in financial transactions in the market on their own account. These funds are organized, and directed, by individual private or government employers, or jointly by individual employers and their employees; and the employees and/or employers make regular contributions. They do not cover pension arrangements for the employees of private or government entities which do not include a separately organized fund nor an arrangement organized by a non-government employer in which the reserves of the fund are simply added to that employer's own reserves or invested in securities issued by that employer.

## 5. The sub-sectoring of some special cases

4.99 It is useful to specify the treatment of a number of special cases including corporations which lie close to the boundary between the financial and non-financial corporations sectors.

### Holding corporations

4.100 As explained earlier in the chapter, holding corporations are corporations that control a group of subsidiary corporations and whose principal activity is owning and directing the group. Holding corporations are classified as financial if the preponderant type of activity of the group of corporations as a whole is financial. In the absence of suitable information about the relative sizes of the subsidiaries, a holding corporation may be classified as financial if a simple majority of the corporations it controls are financial. Similarly, financial holding corporations may be allocated to sub-sectors according to the type of financial activity mainly carried out by the group it controls. For example, if the group of corporations is mainly concerned with insurance, the holding corporation will itself be classified in the sub-sector, insurance corporations and pension funds. If there is no single type of financial activity which is clearly predominant within the group, the holding corporation should be classified in the sub-sector, other financial intermediaries except insurance corporations and pension funds.

### Regulatory bodies

4.101 Bodies which regulate or supervise financial corporations may be classified as financial or non-financial according to their status. Such bodies which form part of government and cannot be treated as separate institutional units - i.e., cannot be treated as quasi-corporations - must remain in the general government sector and cannot be allocated to the financial corporate sector. When such bodies are separate institutional units they are to be included with the central bank.

### Secondary financial activities

4.102 One form of financial innovation has been a substantial growth in activity of a kind traditionally carried out by, or through, financial corporations but which may also be done directly by non-financial enterprises themselves. For example, there is a tendency in some countries for producers or retailers of goods to provide consumer credit directly to their customers. Another example is the tendency for non-financial enterprises in some countries to raise funds themselves by selling their own obligations directly on the money or capital markets. However, provided that:

(a) A non-financial enterprise does not create a new institutional unit, such as a subsidiary corporation, to carry out the financial activity; and

(b) The financial activity remains secondary to the principal activity of the enterprise;

the enterprise as a whole must continue to be classified as non-financial.

4.103 The same principle applies to the sub-sectoring of financial corporations. For example, many central banks also engage in some commercial banking. However, as a single institutional unit, the central bank as a whole, including its commercial banking activities, is classified in the sub-sector “central banks”. For the same reason, central bank or monetary authority-type functions carried out by agencies within the central government which are not separate institutional units from government are not allocated to the central bank sub-sector.

## E. The general government sector and its sub-sectors

### 1. Introduction: governments as institutional units

4.104 Government units may be described as unique kinds of legal entities established by political processes which 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 to 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 non-market production. In general terms:

(a) A government unit usually has the authority to raise funds by collecting taxes or compulsory transfers from other institutional units. In order to satisfy the basic requirements of an institutional unit in the System, a government unit - whether at the level of the nation, a region or a locality - must have funds of its own either raised by taxing other units or received as transfers from other government units and the authority to disburse some, or all, of such funds in the pursuit of its policy objectives. It must also be able to borrow funds on its own account;

(b) Government units typically make three different kinds of final outlays:

(i) The first group consists of actual or imputed expenditures on the free provision to the community of collective services such as public administration, defence, law enforcement, public health, etc. which, as a result of market failure, have to be organized collectively by government and financed out of general taxation or other income;

(ii) The second group consists of expenditures on the provision of goods or services free, or at prices that are not economically significant, to individual households. These expenditures are deliberately incurred and financed out of taxation or other income by government in the pursuit of its social or political objectives, even though individuals could be charged according to their usage;

(iii) The third group consists of transfers paid to other institutional units, mostly households, in order to redistribute income or wealth.

4.105 Within a single country there may be many separate government units when there are different levels of government - central, state or local government. In addition, social security funds also constitute government units. These different kinds of government units are described later when the sub-sectoring of the general government sector is explained.

#### Government units as producers

4.106 Government units, like households, may own and operate unincorporated enterprises that are engaged in the production of goods or services. The extent to which government units decide to engage in production themselves rather than purchase the goods or services from market producers is largely a matter of political choice. The fact that governments choose to supply not only collective services but also many goods and individual services free, or at prices that are not economically significant, to households or other units does not require that they produce them themselves. Even in the case of most collective services, or so-called "public goods", for which there is market failure, governments are obliged only to assume responsibility for organizing and financing their production. They are not obliged to produce them. However, government units do usually engage in a wide range of productive activities in practice, covering not only collective services but also many other goods and individual services. Because it is largely a matter of political choice, the range of goods and services produced by government units varies greatly from one country to another. Apart from some collective services such as public administration and defence, it is therefore difficult to categorize certain types of production, such as the production of education or health services, as intrinsically governmental, even though they are often produced by government units.

4.107 When a government unit wishes to intervene in the sphere of production it has three options:

(a) it may create a public corporation whose corporate policy, including pricing and investment, it is able to control;

(b) it may create a NPI that it controls and mainly, or entirely, finances;

(c) it may produce the goods or services itself in an establishment which it owns and which does not exist as a separate legal entity from the government unit itself.

However, if a government establishment, or group of establishments engaged on the same kind of production under common management,

(a) charges prices for its outputs that are economically significant;

(b) is operated and managed in a similar way to a corporation; and

(c) has a complete set of accounts that enable its operating surpluses, savings, assets and liabilities to be separately identified and measured;

it should be treated as a quasi-corporation. Such quasi-corporations are market producers that are treated as separate institutional units from the government units that own them. They are classified, sectored and sub-sectored in the same way as public corporations.

4.108 In order to be treated as a quasi-corporation the government must allow the management of the enterprise considerable discretion not only with respect to the management of the production process but also the use of funds. Government quasi-corporations must be able to maintain their own working balances and business credit and be able to finance some or all of their capital formation out of their own savings, depreciation reserves or borrowing. The ability to distinguish flows of income and capital between quasi-corporations and government implies that their operating and financing activities cannot be fully integrated with government revenue or finance statistics in practice, despite the fact that they are not separate legal entities. The net operating surplus of a government quasi-corporation is not a component of government revenue, and the accounts for government record only the actual or imputed flows of income and capital between the quasi-corporation and government.

4.109 Thus, the producer units that remain integrated with the government units that own them are those that cannot be treated as quasi-corporations. Such units remain within the general government sector. They are likely to consist largely, or entirely, of non-market producers: that is, producers most or all of whose output is supplied to other units free, or at prices that are not economically significant. In addition to providing non-market goods or services to the general public, such units may include government producers supplying non-market goods or services to other government units for purposes of intermediate consumption or gross fixed capital formation: for example, munitions factories, government printing offices, transport agencies, computer or communications agencies, etc. In principle, government units can also be market producers.

4.110 In contrast to output produced for own consumption or own gross capital formation by market producers, there are usually no suitable markets whose prices can be used to value government non-market output. By convention, therefore, such output is valued by its production costs.

## 2. Social security funds

4.111 Social security funds constitute special kinds of institutional units which may be found at any level of government - central, state or local. Before defining social security funds, it is necessary to give a brief description of social insurance schemes in general. Social insurance schemes are intended to provide social benefits to members of the community, or to groups of individuals such as the employees of an enterprise and their dependants, out of funds derived mainly from social contributions. Social security schemes are social insurance schemes covering the community as a whole or large sections of the community that are imposed and controlled by government units. They generally involve compulsory contributions by employees or employers or both, and the terms on which benefits are paid to recipients are determined by government units. The schemes cover a wide variety of programmes, providing benefits in cash or in kind for old age, invalidity or death, survivors, sickness and maternity, work injury, unemployment, family allowance, health care, etc. There is usually no direct link between the amount of the contribution paid by an individual and the risk to which that individual is exposed. Social security schemes have to be distinguished from pension schemes or other social insurance schemes which are determined by mutual agreement between individual employers and their employees, the benefits being linked to contributions.

4.112 Social security funds may be distinguished by the fact that they are separately organized from the other activities of government units and hold their assets and liabilities separately from the latter. They are separate institutional units because they are autonomous funds, they have their own assets and liabilities and engage in financial transactions on their own account. However, institutional arrangements in respect of social security differ from country to country and in some countries they may become so closely integrated with the other finances of government as to bring into question whether they should be treated as a separate sub-sector. The amounts raised, and paid out, in social security contributions and benefits may be deliberately varied in order to achieve objectives of government policy that have no direct connection with the concept of social security as a scheme to provide social benefits to members of the community. They may be raised or lowered in order to influence the level of aggregate demand in the economy, for example. Nevertheless, so long as they remain separately constituted funds they must be treated as separate institutional units in the System.

## 3. The general government sector (S.13)

4.113 The general government sector consists of the following group of resident institutional units:

(a) All units of central, state or local government;

(b) All social security funds at each level of government;

(c) All non-market NPIs that are controlled and mainly financed by government units.

The sector does not include public corporations, even when all the equity of such corporations is owned by government units. It also does not include quasi-corporations that are owned and controlled by government units. However, unincorporated enterprises owned by government units that are not quasi-corporations remain integral parts of those units and, therefore, must be included in the general government sector.

## 4. Sub-sectors of the general government sector

4.114 Two alternative methods of sub-sectoring the general government sector are proposed in the System. One method is as follows:

(a) Central government (S.1311);

(b) State government (S.1312);

(c) Local government (S.1313);

(d) Social security funds (S.1314).

4.115 The alternative method is as follows:

(a) Central government plus social security funds operating at the central government level (S.1321);

(b) State government plus social security funds operating at the state government level (S.1322);

(c) Local government plus social security funds operating at the local government level (S.1323).

4.116 As explained more fully later, the choice between the two methods of sub-sectoring depends mainly on the size, or importance, of social security funds within a country and on the way in which they are managed. In some countries there may not exist a proper intermediate level of government between central and local government, in which case the sub-sector "state government" is not distinguished.

### Central government (S.1311)

4.117 The central government sub-sector consists of the institutional unit or units making up the central government plus those NPIs that are controlled and mainly financed by central government.

4.118 The political authority of central government extends over the entire territory of the country. Central government has therefore the authority to impose taxes on all resident and non-resident units engaged in economic activities within the country. Its political responsibilities include national defence and relations with foreign governments and it also seeks to ensure the efficient working of the social and economic system by means of appropriate legislation and regulation and also the maintenance of law and order. It is responsible for providing collective services for the benefit of the community as a whole, and for this purpose incurs expenditures on defence and public administration. In addition it may incur expenditures on the provision of services, such as education or health, primarily for the benefit of individual households. Finally, it may make transfers to other institutional units - households, NPIs, corporations and other levels of government.

4.119 Central government is a large and complex sub-sector in most countries. It is generally composed of a central group of departments or ministries that make up a single institutional unit plus, in many countries, other institutional units. The departments may be responsible for considerable amounts of expenditure within the framework of the government's overall budget, but they are nevertheless not separate institutional units. Each department is not capable of owning assets, incurring liabilities, engaging in transactions, etc., in its own right, i.e., independently of central government as a whole. It would not be possible to compile meaningful, or analytically useful, income and accumulation accounts or balance sheets for each separate department as if it were a single legal entity. In addition, there may be agencies of central government with separate legal identity and substantial autonomy; they may have discretion over the volume and composition of their expenditures and may have a direct source of revenue such as earmarked taxes. Such agencies are often established to carry out specific functions such as road construction or the non-market production of health or education services. These should be treated as separate institutional units if they maintain full sets of accounts but are part of the central government sub-sector if they meet the criteria described in paragraph 4.104.

4.120 The departments of central government are often deliberately dispersed geographically and located in different parts of the country, but they nevertheless remain parts of a single institutional unit. Similarly, if the central government maintains branch offices or agencies in different parts of the country to meet local needs, including military bases or installations which serve national defence purposes, these must also be counted as parts of a single institutional unit for central government. However, for purposes of production accounts by type of productive activity, the establishment is used as the statistical unit, and producer units located in different regions are to be treated as different establishments, even though part of a single institutional unit.

4.121 In some countries, the central government may include units which engage in financial transactions which in other countries would be performed by central banks. In particular, units of central government may be responsible for the issue of currency, the maintenance of international reserves and the operation of exchange stabilization funds, and also transactions with the International Monetary Fund (IMF). When the units in question remain financially integrated with central government and under the direct control and supervision of central government, they cannot be treated as separate institutional units. Moreover, whatever monetary authority functions are carried out by central government are recorded in the government sector and not the corporate financial sector. However, because of the analytical importance which is attached to obtaining accounts covering the monetary authorities as a whole, and in order to provide links with other statistical systems, such as the Balance of Payments Manual, Government Finance Statistics and Money and Banking Statistics of the IMF, it is recommended that the transactions of central government agencies carrying out monetary authority and deposit-taking functions should be separately identified, so that they can be combined with those of the central bank and other depository corporations in special tabulations if desired.

4.122 Finally, it may be noted that social security funds are treated in the System as separate institutional units at each level of government, even though in some countries their finances may be partially integrated with government. Social security funds are described below. However, treating social security funds as separate institutional units does not, of course, preclude them from being included in the same sub-sector as the government units with which they are associated, and they are so included in the alternative method of sub-sectoring the general government sector.

### State government (S.1312)

4.123 The state government sub-sector consists of state governments which are separate institutional units plus those NPIs that are controlled and mainly financed by state governments.

4.124 State governments are institutional units exercising some of the functions of government at a level below that of central government and above that of the governmental institutional units existing at a local level. They are institutional units whose fiscal, legislative and executive authority extends only over the individual “states” into which the country as a whole may be divided. Such “states” may be described by different terms in different countries. In some countries, especially small countries, individual states and state governments may not exist. However, in large countries, especially those which have federal constitutions, considerable powers and responsibilities may be assigned to state governments.

4.125 A state government usually has the fiscal authority to levy taxes on institutional units which are resident in, or engage in economic activities or transactions within, its area of competence (but not other areas). In any case, in order to be recognized as an institutional unit it must be able to own assets, raise funds and incur liabilities on its own account. It must also be entitled to spend or allocate some, or possibly all, of the taxes or other income that it receives according to its own policies, within the general rules of law of the country, although some of the transfers it receives from central government may be tied to certain specified purposes. It should also be able to appoint its own officers, independently of external administrative control. On the other hand, if a regional unit is entirely dependent on funds from central government, and if the central government also dictates the ways in which those funds are to be spent at the regional level, it should be treated as an agency of central government rather than as a separate institutional unit.

4.126 State governments, when they exist, are distinguished by the fact that their fiscal authority extends over the largest geographical areas into which the country as a whole may be divided for political or administrative purposes. In a few countries more than one level of government exists between the central government and the smallest governmental institutional units at a local level; in such cases, these intermediate levels of government are grouped together with the level of government, either state or local, with which they are most closely associated for purposes of sectoring in the System.

4.127 State governments may own, or control, corporations in the same way as central government. Similarly, they may have units which engage in market production, in which case the relevant producer units should be treated as quasi-corporations whenever their operations and accounting records justify this. Social security schemes may also exist at a state level and are treated as separate institutional units.

### Local government (S.1313)

4.128 The local government sub-sector consists of local governments that are separate institutional units plus those NPIs which are controlled and mainly financed by local governments. In principle, local government units are institutional units whose fiscal, legislative and executive authority extends over the smallest geographical areas distinguished for administrative and political purposes. The scope of their authority is generally much less than that of central government or regional governments, and they may, or may not, be entitled to levy taxes on institutional units resident in their areas. They are often heavily dependent on grants or transfers from higher levels of government, and they may also act as agents of central or regional governments to some extent. However, in order to be treated as institutional units they must be entitled to own assets, raise funds and incur liabilities by borrowing on their own account; similarly, they must have some discretion over how such funds are spent. They should also be able to appoint their own officers, independently of external administrative control. The fact that they may also act as agents of central or state governments to some extent does not prevent them from being treated as separate institutional units provided they are also able to raise and spend some funds on their own initiative and own responsibility.

4.129 As they are the government units which are in closest contact with the institutional units resident in their localities, they typically provide a wide range of services to local residents, some of which may be financed out of transfers from higher levels of government. The same rules govern the treatment of the production of goods and services by local government units as are applied to central and state governments. Units such as municipal theatres, museums, swimming pools, etc., which supply goods or services on a market basis should be treated as quasi-corporations whenever appropriate. Units supplying services such as education or health on a non-market basis remain an integral part of the local government unit to which they belong.

### Social security funds (S.1314)

4.130 The social security funds sub-sector consists of the social security funds operating at all levels of government. As explained in paragraph 111 above, social security funds are social insurance schemes covering the community as a whole or large sections of the community that are imposed and controlled by government units.

### 5. The alternative method of sub-sectoring

4.131 The alternative method of sub-sectoring the general government sector is to group the social security funds operating at each level of government with the corresponding government units and government controlled and financed NPIs at that level of government. The two alternative methods of sub-sectoring are designed to accommodate different analytical needs. The decision as to which method is more appropriate in a given country cannot be made a priori. It depends on how well organized and important social security funds are and on the extent to which they are managed independently of the government units with which they are associated. If the management of social security funds is so closely integrated with the short- or medium-term requirements of the government's general economic policy that contributions and benefits are deliberately adjusted in the interests of overall economic policy, it becomes difficult, at a conceptual level, to draw any clear distinction between the management of social security and the other economic functions of government. Alternatively, in some countries, social security funds may exist in only a very rudimentary form. In either of these circumstances it is difficult to justify treating social security funds as a separate sub-sector on a par with central, state and local government, and it is more appropriate to use the alternative method of sub-sectoring in which they are grouped with the corresponding government units at each level of government.

## F. The households sectors and its sub-sectors

### 1. Introduction: households as institutional units

4.132 For purposes of the System, a household may be defined as:

> a small 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.

4.133 In general, each member of a household should have some claim upon the collective resources of the household. At least some decisions affecting consumption or other economic activities must be taken for the household as a whole.

4.134 Households often coincide with families, but members of the same household do not necessarily have to belong to the same family so long as there is some sharing of resources and consumption. 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 socio-economic factors. The definition of a household which is adopted by survey statisticians familiar with the socio-economic conditions within a given country is likely to approximate closely to the concept of a household as defined in the System, although survey statisticians may add more precise, or operational, criteria within a particular country.

4.135 Servants or other paid domestic employees who live on the same premises as their employer do not form part of their employer's household even though they may be provided with accommodation and meals as remuneration in kind. Paid domestic employees have no claim upon the collective resources of their employers' households and the accommodation and food they consume are not included with their employer's consumption. They should therefore be treated as belonging to separate households from their employers.

4.136 Persons living permanently in an institution, or who may be expected to reside in an institution for a very long, or indefinite, period of time are treated as belonging to a single institutional household when they have little or no autonomy of action or decision in economic matters. Some examples of persons belonging to institutional households are the following:

(a) Members of religious orders living in monasteries, convents or similar institutions;

(b) Long-term patients in hospitals, including mental hospitals;

(c) Prisoners serving long sentences;

(d) Old persons living permanently in retirement homes.

4.137 On the other hand, persons who enter hospitals, clinics, convalescent homes, religious retreats, or similar institutions for short periods, who attend residential schools, colleges or universities, or who serve short prison sentences should be treated as members of the individual households to which they normally belong.

4.138 Households may engage in any kind of economic activity and not merely consumption. In this respect, their economic behaviour may be more varied than that of legal entities whose activities may be restricted to the purposes for which they are created. In particular, members of households play a major role in production either by operating their own unincorporated enterprises or by supplying labour to other unincorporated or corporate enterprises by working as employees. They lend and borrow funds, and so on. When individual members of households engage in economic activities, they are treated as acting on behalf of the households to which they belong and not as separate entities. Thus, when a member of a household owns his or her own enterprise, which is not a corporation or quasi-corporation, that enterprise forms an integral part of the household itself.

## 2. Households as producers

4.139 Production within the household sector takes place within enterprises that are directly owned and controlled by members of households, either individually or in partnership with others. When members of households work as employees for corporations, quasi-corporations or government, the production to which they contribute takes place outside the household sector.

4.140 Producer units within the household sector are all “unincorporated enterprises”, even though this terminology is admittedly cumbersome when applied to some of the smaller, or highly specialized, producer units. Nevertheless, the term “unincorporated enterprise” emphasizes the fact that the producer unit is not incorporated as a separate legal entity from the household itself.

4.141 The fixed and other assets used in unincorporated enterprises do not belong to the enterprises but to their owners. The enterprises as such cannot engage in transactions with other economic units. They cannot enter into contractual relationships with other units nor incur liabilities on their own behalf. Their owners are personally liable, without limit, for any debts or obligations incurred in the course of production.

4.142 The owner of a household unincorporated enterprise usually has a dual role to play: first as the entrepreneur who is responsible for the creation and management of the enterprise and second as a worker who contributes labour inputs of a kind which could be provided by paid employees. The establishment of an unincorporated enterprise requires initiative, enterprise and capital equipment. Owners, in their capacity as entrepreneurs, have to raise the necessary finance at their own risk and on their own personal security; they have to find suitable premises and purchase, or lease, whatever capital equipment or materials are needed; and they may also have to engage and supervise paid employees. In some cases, the principal role of an owner is to act in this way as entrepreneur, innovator and risk-taker, in which case the surplus from production which eventually accrues to the owner represents primarily a return to entrepreneurship. In other cases, the principal function of an owner may be to provide labour, often highly skilled professional labour, in which case most of the surplus may, in effect, represent remuneration for work done.

4.143 Thus, the surplus arising from the productive activities of a household unincorporated enterprise usually represents a mixture of two very different kinds of income, and is, therefore, described as “mixed income” instead of “operating surplus” (except for the surplus arising from the production of own-account housing services). The balance between the return to entrepreneurship and remuneration for work done may vary greatly between different kinds of household unincorporated enterprises but it can be very difficult to make a clear separation even conceptually in many cases.

### Household unincorporated market enterprises

4.144 Household unincorporated market enterprises are created for the purpose of producing goods or services for sale or barter on the market. They can be engaged in virtually any kind of productive activity - agriculture, mining, manufacturing, construction, retail distribution or the production of other kinds of services. They can range from single persons working as street traders or shoe cleaners with virtually no capital or premises of their own through to large manufacturing, construction or service enterprises with many employees.

4.145 Household unincorporated market enterprises also include unincorporated partnerships that are engaged in producing goods or services for sale or barter on the market. The partners may belong to different households. The liability of the partners for the debts of the businesses must be unlimited for the partnerships to be treated as unincorporated enterprises. However, unincorporated partnerships with many partners, such as some large legal, accounting or architectural firms, are likely to behave like corporations and should be treated as quasi-corporations assuming complete sets of accounts are available for the partnerships. Partnerships whose partners enjoy limited liability are effectively separate legal entities and should be treated as corporations.

4.146 Some of the outputs of these market producers may be retained for consumption by members of the household to which the owner belongs. Such goods or services are included in the outputs of the enterprises and in the final consumption of the households, although it may be difficult to obtain the requisite data especially if taxes are being evaded in the process. Similarly, buildings or capital equipment may be used partly for production and partly for consumption. This underlines the extreme difficulty of separating unincorporated enterprises from their owners who are perfectly entitled to use such assets in any way they choose.

### Household enterprises producing for own final use

4.147 These are household enterprises operated primarily for the purpose of producing goods or certain services for own final consumption or own gross fixed capital formation. The value of their output has to be imputed on the basis of the prices of similar goods or services sold on the market.

*Producers of goods for own final use*

4.148 Household unincorporated enterprises engaged in the production of goods for own final use may consist of:

(a) Subsistence farmers or others engaged in the production of agricultural goods for their own final consumption;

(b) Households engaged in the construction of their own dwellings or other structures for their own use, or on structural improvements or extensions to existing dwellings or structures;

(c) Households engaged in the production of other goods for their own consumption such as cloth, clothing, furniture, other household goods, foodstuffs (other than meals for immediate consumption), etc.

Such enterprises may sell any output that is surplus to their own requirements, but if they regularly sell most of their output they should be treated as market enterprises. Groups of households that engage in the communal construction of buildings, roads, bridges, etc., for their own individual or community use should be treated as informal partnerships engaged in non-market production.

*Producers of services for own final use*

4.149 As explained in chapter VI, section 2, only two categories of services produced by households for own final consumption are included within the production boundary of the System:

(a) Services of owner-occupied dwellings: owner-occupiers are deemed to own household unincorporated enterprises that produce housing services for their own consumption;

(b) Domestic services produced by employing paid staff: households are deemed to own household unincorporated enterprises in which they employ paid staff - servants, cooks, gardeners, etc. - to produce services for their own consumption.

4.150 The production of these services does not generate mixed income. There is no labour input into the production of the services of owner-occupied dwellings so that any surplus arising is operating surplus. There is no surplus generated by employing paid staff as, by convention, the value of the output produced is assumed to be equal to the value of the compensation of employees paid to the domestic staff, no other inputs being recognized.

## 3. The household sector and its sub-sectors (S.14)

4.151 The household sector consists of all resident households. Defined as institutional units, households include unincorporated enterprises owned by households, whether market producers or producing for own final use, as integral parts of those households. Only those household unincorporated market enterprises that constitute quasi-corporations are treated as separate institutional units.

4.152 The households sector may be divided into sub-sectors on the basis of the type of income that is the largest source of income for each household or, alternatively, on the basis of other criteria of an economic, socio-economic or geographical nature. Different methods of sub-sectoring may be appropriate for different economies and may be needed for different kinds of analysis and policy-making. While one method of sub-sectoring is recommended here that is considered to be useful for many purposes, statistical authorities are not necessarily expected always to choose this particular method and are advised to implement the System flexibly with respect to sub-sectoring the households sector.

4.153 Households may be grouped into sub-sectors according to the nature of their largest source of income. For this purpose, the following types of household income need to be distinguished:

(a) Employers' mixed incomes: these consist of the mixed incomes accruing to the owners of household unincorporated enterprises with paid employees;

(b) Own-account workers' mixed incomes: these consist of mixed incomes accruing to the owners of household unincorporated enterprises without paid employees;

(c) Compensation of employees;

(d) Property and transfer incomes.

Households are allocated to sub-sectors according to which of the four categories of income listed above is the largest for the household as a whole, even if it does not always account for more than half of total household income. When more than one income of a given category is received within the same household - for example, because more than one member of the household earns compensation of employees or because more than one property or transfer income is received - the classification must be based on the total household income within each category. The four sub-sectors are described as follows:

(a) Employers (S.141);

(b) Own-account workers (S.142);

(c) Employees (S.143);

(d) Recipients of property and transfer incomes (S.144).

The employers' sub-sector consists of the group of households for which employers' mixed incomes are the largest source of income for the household. Each of the other three sub-sectors is defined similarly using the income categories listed earlier. The distinction between own-account workers and employees is explained in detail in chapter VII.

4.154 The fourth sub-sector, households for which property and transfer incomes make up the largest source of income, constitutes a heterogeneous group and it is recommended that it should be divided into three further sub-sectors when possible. These sub-sectors are defined as follows:

(4.1) Recipients of property incomes (S.1441)

(4.2) Recipients of pensions (S.1442)

(4.3) Recipients of other transfer incomes (S.1443)

Pension households are households whose largest income consists of retirement or other pensions, including pensions from previous employers.

4.155 Other methods of sub-sectoring usually require a reference person to be identified for each household. The reference person is not necessarily the person that other members of the household regard as the "head of the household", as the reference person should be decided on grounds of economic importance rather than age or seniority. The reference person should normally be the person with the largest income although the reference person could also be the person who makes the major decisions with regard to the consumption of the household.

4.156 Once a reference person has been identified, it is possible to group households into sub-sectors on the basis of the reference person's characteristics. For example, sub-sectors may be defined according to:

(a) Occupation of the reference person;

(b) Industry, if any, in which the reference person works;

(c) Educational attainment of the reference person;

(d) Qualifications or skills possessed by the reference person.

Each of the criteria listed above provides its own possible scheme of sub-sectoring. It would also be possible to group households into sub-sectors according to the main income of the reference person if, for some reason, it was not possible to group on the basis of the largest income received by the household. For this purpose, the same income categories may be used as those recommended for the household's largest income.

4.157 Finally, it may be noted that households may be sub-sectored using criteria that apply to the household as a whole. For example, sub-sectors may be defined according to:

(a) Size of the total income of the household;

(b) Size of the household as measured by number of persons;

(c) Type of area in which the household is located.

The last criterion enables households living in agricultural, urban or metropolitan areas to be distinguished from each other, or households located in different geographical regions.

4.158 There are thus many useful ways in which the households sector may be sub-sectored and statistical agencies are advised to give due consideration to the various possibilities. More than one method may be adopted if there is a demand for different breakdowns of the households sector from different users, analysts or policy-makers.

4.159 It is particularly important for many developing countries to be able to distinguish between the formal and informal sectors of the economy. The fifteenth International Conference of Labour Statisticians (Geneva, January 1993) adopted Resolution II concerning statistics of employment in the informal sector. The resolution provides, among other guidelines, an international statistical standard definition of the informal sector. The relevant paragraphs of the International Conference of Labour Statisticians' resolution are reproduced in the annex of this chapter for the benefit of those countries that wish to introduce the distinction between formal and informal sectors into their sub-sectoring of the households sector.

4.160 The System has to be applied flexibly, and not rigidly, and the adaptation of the System to countries in different circumstance is the subject of a special chapter. In order to implement any of the possible methods of sub-sectoring the households sector suggested above, individual countries are obliged to make their own decisions about what they consider to be the most relevant classification - for example, with regard to location or levels of skill - for which international guidelines may not be helpful. Thus, the fact that specific classifications may not be proposed here should not be interpreted as implying that the characteristics in question are less important for purposes of economic analysis and policy-making.

## G. The non-profit institutions serving households sector (S.15)

4.161 Non-profit institutions are legal or social entities created for the purpose of producing goods or services whose status does not permit them to be a source of income, profit or other financial gain to the units that establish, control or finance them. Although they may not be a source of profit to other institutional units, NPIs may nevertheless be market producers if they provide services for which they charge prices or fees that are economically significant - that is, prices which have a significant influence both on the amounts the producers are willing to supply and on the amounts purchasers wish to buy. NPIs that are market producers are classified as belonging to one or another of the corporate sectors. Market NPIs include all NPIs serving enterprises, except those controlled and mainly financed by government units. The majority of NPIs, however, are likely to be non-market producers that provide goods or services to other institutional units either free or at prices or fees that are not economically significant.

4.162 Non-market NPIs may be divided into those controlled and mainly, or entirely, financed by government units and the remainder. The latter are described as "NPIs serving households" (NPISHs) and constitute a separate sector within the System. NPIs serving enterprises belong to the corporate or general government sectors depending upon whether they are controlled and mainly financed by government units. To summarize, therefore, the sector NPISHs is defined as the set of all resident NPIs except:

(a) NPIs that are market producers; and

(b) Non-market NPIs that are controlled and mainly financed by government units.

The NPIs serving households sector includes the following two main kinds of NPISHs that provide goods or services to their members or to other households without charge or at prices that are not economically significant:

(a) Trade unions, professional or learned societies, consumers' associations, political parties (except in single party states), churches or religious societies (including those financed by governments), and social, cultural, recreational and sports clubs;

(b) Charities, relief and aid organizations financed by voluntary transfers in cash or in kind from other institutional units.

## H. The rest of the world (S.2)

4.163 For purposes of the System, the rest of the world consists of all non-resident institutional units that enter into transactions with resident units, or have other economic links with resident units. It is not a sector for which complete sets of accounts have to be compiled, although it is often convenient to describe the rest of the world as if it were a sector. The accounts, or tables, for the rest of the world are confined to those which record transactions between residents and non-residents or other economic relationships, such as claims by residents on non-residents, and vice versa. The rest of the world includes certain institutional units that may be physically located within the geographic boundary of a country; for example, foreign enclaves such as embassies, consulates or military bases, and also international organizations.

### 1. International organizations

4.164 Certain international organizations have all the essential attributes of institutional units. The special characteristics of an "international organization" as this term is used in the System may be summarized as follows:

(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 which 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) Because they are established by international agreement, they are accorded sovereign status; that is, international organizations are not subject to the laws or regulations of the country, or countries, in which they are located; they are not treated as resident institutional units of the countries in which they are located;

(d) International organizations are created for various purposes including, among others, the following types of activities:

(i) The provision of non-market services of a collective nature for the benefit of their members;

(ii) Financial intermediation at an international level - that is, channelling funds between lenders and borrowers in different countries; an international organization may also act as a central bank to a group of countries.

4.165 Formal agreements concluded by all the member countries of an international organization may sometimes carry the force of law within those countries. Most international organizations are financed wholly or partly by contributions (transfers) from their member countries, but some organizations may raise funds in other ways such as borrowing on financial markets. For purposes of the System, international organizations are treated as units that are resident in the rest of the world.

## ANNEX:

# Extract from the resolution of the fifteenth international conference of labour statisticians, January 1993, concerning statistics of employment in the informal sector

**Concept**

5.(1) The informal sector may be broadly characterized as consisting of units engaged in the production of goods or services with the primary objective of generating employment and incomes to the persons concerned. These units typically operate at a low level of organization, with little or no division between labour and capital as factors of production and on a small scale. Labour relations - where they exist - are based mostly on casual employment, kinship or personal and social relations rather than contractual arrangements with formal guarantees.

5.(2) Production units of the informal sector have the characteristic features of household enterprises. The fixed and other assets used do not belong to the production units as such but to their owners. The units as such cannot engage in transactions or enter into contracts with other units, nor incur liabilities, on their own behalf. The owners have to raise the necessary finance at their own risk and are personally liable, without limit, for any debts or obligations incurred in the production process. Expenditure for production is often indistinguishable from household expenditure. Similarly, capital goods such as buildings or vehicles may be used indistinguishably for business and household purposes.

5.(3) Activities performed by production units of the informal sector are not necessarily performed with the deliberate intention of evading the payment of taxes or social security contributions, or infringing labour or other legislations or administrative provisions. Accordingly, the concept of informal sector activities should be distinguished from the concept of activities of the hidden or underground economy.

**Operational definitions**

Informal sector

6.(1) For statistical purposes, the informal sector is regarded as a group of production units which, according to the definitions and classifications provided in the United Nations System of National Accounts (Rev.4), form part of the household sector as household enterprises or, equivalently, unincorporated enterprises owned by households.

6.(2) Within the household sector, the informal sector comprises (i) “informal own-account enterprises” as defined in paragraph 8; and (ii) the additional component consisting of “enterprises of informal employers” as defined in paragraph 9.

6.(3) The informal sector is defined irrespective of the kind of workplace where the productive activities are carried out, the extent of fixed capital assets used, the duration of the operation of the enterprise (perennial, seasonal or casual), and its operation as a main or secondary activity of the owner.

### Informal own-account enterprises

8.(1) Informal own-account enterprises are household enterprises (in the sense of the System of National Accounts) owned and operated by own-account workers, either alone or in partnership with members of the same or other households, which may employ contributing family workers and employees on an occasional basis, but do not employ employees on a continuous basis and which have the characteristics described in subparagraphs 5(1) and (2).

8.(2) For operational purposes, informal own-account enterprises may comprise, depending on national circumstances, either all own-account enterprises or only those which are not registered under specific forms of national legislation.

8.(3) Registration may refer to registration under factories or commercial acts, tax or social security laws, professional groups' regulatory acts, or similar acts, laws, or regulations established by national legislative bodies.

8.(4) Own-account workers, contributing family workers, employees and the employment of employees on a continuous basis are defined in accordance with the most recently adopted version of the International Classification of Status in Employment (ICSE).

### Enterprises of informal employers

9.(1) Enterprises of informal employers are household enterprises (in the sense of the System of National Accounts) owned and operated by employers, either alone or in partnership with members of the same or other households, which employ one or more employees on a continuous basis and which have the characteristics described in subparagraphs 5(1) and (2).

9.(2) For operational purposes, enterprises of informal employers may be defined, depending on national circumstances, in terms of one or more of the following criteria:

(i) Size of the unit below a specified level of employment;

(ii) Non-registration of the enterprise or its employees.

8.(3) While the size criterion should preferably refer to the number of employees employed on a continuous basis, in practice, it may also be specified in terms of the total number of employees or the number of persons engaged during the reference period.

8.(4) The upper size limit in the definition of enterprises of informal employers may vary between countries and branches of economic activity. It may be determined on the basis of minimum size requirements as embodied in relevant national legislations, where they exist, or in terms of empirically determined norms. The choice of the upper size limit should take account of the coverage of statistical inquiries of larger units in the corresponding branches of economic activity, where they exist, in order to avoid an overlap.

8.(5) In the case of enterprises which carry out their activities in more than one establishment, the size criterion should, in principle, refer to each of the establishments separately rather than to the enterprise as a whole. Accordingly, an enterprise should be considered to satisfy the size criterion if none of its establishments exceeds the specified upper size limit.

8.(6) Registration of the enterprise may refer to registration under specific forms of national legislation as specified in subparagraph 8(3). Employees may be considered registered if they are employed on the basis of an employment or apprenticeship contract which commits the employer to pay relevant taxes and social security contributions on behalf of the employee or which makes the employment relationship subject to standard labour legislation.

8.(7) Employers, employees and the employment of employees on a continuous basis are defined in accordance with the most recently adopted version of the International Classification of Status in Employment (ICSE).

10 For particular analytical purposes, more specific definitions of the informal sector may be developed at the national level by introducing further criteria on the basis of the data collected. Such definitions may vary according to the needs of different users of the statistics.