

Chapter 22: The general government and public sectors

A. Introduction

- 22.1 A major strength of the SNA is the ability to compile accounts for whole sectors, individual units, at chosen intermediate levels and to aggregate the accounts in different ways. Disaggregating the economy into various sectors and sub-sectors makes it possible to observe and analyse the interactions between the different parts of the economy for purposes of policy-making. Particular interest is given to the general government sector, as defined in chapter 4 and the public sector, as defined in this chapter.
- 22.2 The powers, motivation and functions of government are different from those of other sectors. Governments use their powers to pass laws affecting the behaviour of other economic units. They are able to redistribute income and wealth by means of taxes and social benefits. The accounts for the general government sector show how the revenues raised are used to provide goods and services to the community as a whole or to individual households. The range of goods and services government provides and the prices charged are based on political and social considerations rather than on the profit-maximising objective of private corporations.
- 22.3 Fiscal operations are carried out by the government and financed through the budget under the usual budgetary procedures. However, some operations originated by government units may require the intervention of entities which are not ruled by the legal government framework, including public corporations. These actions may be described as quasi-fiscal operations. Operations related to privatisation and restructuring public corporations, securitisation of assets using the intervention of special purpose entities, including those abroad, as well as of restructuring units may be described in this way. Though such operations are not reported in the budget and might escape the usual control procedures, they may have significant impact on government revenue and expenditure. As well as providing services directly, governments often fulfill their public policy objectives through public corporations (for example, railways, airlines, public utilities and public financial corporations). Such public policy operations are known as quasi-fiscal activities. A public corporation may be required to provide services to areas of the economy that would not be covered otherwise and to subsidise prices. As a result, the public corporation may operate with a reduced profit or at a loss.
- 22.4 In order to analyse the full impact of government on the economy, therefore, it is useful to form a sector consisting of all the units of general government and all public corporations. This composite sector is referred to as the public sector.
- 22.5 For the general government and the public sectors, in addition to the usual sequence of accounts of the SNA, the accounts can be presented in a manner that is more suitable for government finance analysts and policy makers. The latter increasingly use aggregates and balancing items defined in terms of the concepts, definitions, classifications and accounting rules of the SNA so that these aggregates can be related to other macro-economic variables and compared with the same items in other countries. Some of these items, such as saving and net lending or borrowing, are already available in the sequence of accounts. Other items, such as total revenue, total expense and total outlays, the tax burden, the net operating balance and total debt, do not appear as such in the SNA. Aggregates and balancing items of this nature can be used to assess the use of resources to produce individual and collective services, the need to collect taxes and other revenues, the ability of government to borrow and repay debt and the sustainability of the desired level of government operations.
- 22.6 In order to derive an alternative presentation to that of the sequence of accounts, the transactions in the current accounts and the capital account are rearranged to derive aggregates and balancing items of specific interest to the general government and public sectors. For example, a combination of taxes, user fees and grants from other governments can be aggregated to form total revenue, as the amount available to use to fund government services. One reason for the present chapter is to describe this so-called public finance or government finance presentation of the accounts.
- 22.7 Section B summarizes the identification of government units and other units controlled by government units and explains how those units are grouped into sectors in the SNA.
- 22.8 Section C describes the presentation of government finance statistics.
- 22.9 Section D addresses a number of accounting issues that are unique to or exceptionally important for governments.
- 22.10 Finally, section E shows how information about the public sector may be prepared in a manner roughly parallel to the government finance statistics presentation described in section D.

1. Data sources

22.11 In practice, macroeconomic accounts can seldom be built up by simply aggregating the relevant micro-data. Government is an exception in that the statistics for government units and public corporations are often derived directly from the micro-data in government financial accounting databases. As a result, compilers of statistics for the government units and public corporations sometimes act more as accountants than as statisticians. In particular, the development in recent years of International Public Sector Accounting Standards by the International Public Sector Accounting Standards Board of the International Federation of Accountants has increased the need for clear guidance on the compilation of government finance statistics so that the detailed accounting data can be transposed correctly into the framework of the SNA. Such guidance is especially important when the government

financial accounts are compiled on a cash basis and must be converted to an accrual basis to comply with accounting basis of the SNA.

22.12 As a rule, the entries in the SNA are not consolidated. Consolidation involves the elimination of those transactions or debtor/creditor relationships that occur between two transactors belonging to the same institutional sector or sub-sector. As stated in chapter 3, however, consolidation may be relevant for the general government sector. For example, information on debt owned by government units to units outside the general government sector may be more relevant than gross figures that include debt owed to other government units. Guidance on consolidation is provided in Section C.

B. Defining the general government and public sectors

22.13 The public sector consists of all institutional units of the general government sector plus all public corporations, a public corporation being one that is controlled directly or indirectly by government. The general government sector consists of all government units plus non-market non-profit institutions (NPIs) that are controlled by government units. The definition of what is meant by control is thus fundamental to identifying the units falling within the public sector.

22.14 The criterion that determines whether a unit is treated as part of general government or as a public corporation is whether the output is made available to users at a price that is economically significant or not. The determination of when prices are economically significant is therefore also fundamental to identifying which units fall in which part of the public sector.

22.15 Units that make most of their output available at economically significant prices are market producers; those that make most of their output at prices that are not economically significant are non-market producers. The general government sector can be defined as the collection of all public institutional units that are non-market producers.

22.16 In order to identify the units falling in both the general government sector and the public sector, it is helpful to begin by re-stating the definition of government units from chapter 4 (paragraphs 4.115 to 116).

1. Government units

22.17 *Government units are unique kinds of legal entities established by political processes that 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. A government unit must have funds of its own either raised by taxing other units or received as transfers from other government units and it must have 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:

· 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. that are organized collectively by government and financed out of general taxation or other income;

· 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;

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

- 22.18 Within a single territory there may be many separate government units when there are different levels of government, specifically central, state or local governments. In addition, social security funds also constitute government units.
- 22.19 In all countries, there is an important institutional unit of the general government sector in terms of size and power, in particular the power to exercise control over many other units. It is a single unit of the central government that encompasses the fundamental activities of the national executive, legislative and judiciary powers. Its revenues as well as its expenses and expenditures normally are regulated and controlled by a Ministry of Finance or its functional equivalent by means of a general budget approved by the legislature. This unit is often referred to as national government or main budget account. Most of the ministries, departments, agencies, boards, commissions, judicial authorities, legislative bodies and other entities that make up this central government unit are not separate institutional units but are part of this primary central government unit. This is because they generally do not have the authority to own assets, incur liabilities, or engage in transactions in their own right. If there are state or local governments, as defined in sub-section 2 below, then it is likely that each of these governments will also have a primary government unit that includes the principal executive, legislative and judicial powers.
- 22.20 In addition, there may be government entities with a separate legal identity and substantial autonomy, including discretion over the volume and composition of their expenses and outlays and a direct source of revenue, such as earmarked taxes. Such entities are often established to carry out specific functions, such as road construction or the non-market production of health or education services. These entities should be treated as separate government units if they maintain full sets of accounts, own goods or assets in their own right, engage in non-market activities for which they are held accountable at law and are able to incur liabilities and enter into contracts. Such units are often referred to as extra-budgetary units because they have separate budgets and any transfers from the main budget account are supplemented by their own sources of revenue. Budgets vary widely among countries and various terms are often used to describe these units. These units are classified in the general government sector to the extent that they are non-market producers and are controlled by another government unit.
- 22.21 At the same time, the general budget of any government level might control market producers fulfilling the criteria to be a quasi-corporation as defined below. These units should not be classified in the general government sector, but in the non-financial or financial corporations sector, as relevant. As public units, they are, however, part of the public sector.
- 22.22 A social security fund is a particular kind of government unit that is devoted to the operation of one or more social security schemes. A social security fund must satisfy the general requirements of an institutional unit. That is, it must be separately organized from the other activities of government units, hold its assets and liabilities separately and engage in financial transactions on its own account.
- 22.23 As noted earlier, NPIs that are non-market producers and are controlled by a government are also units of the general government sector. Although they may legally be established to be independent from government, they are considered to be carrying out government policies and effectively are part of government. Governments may choose to use non-profit institutions rather than government agencies to carry out certain government policies because NPIs may be seen as detached, objective and not subject to political pressures. For example, research and development and the setting and maintenance of standards in fields such as health, safety, the environment and education are areas in which NPIs may be more effective than government agencies.
- 22.24 The case of units engaged in financial activities needs special consideration. Financial intermediation is usually considered a market activity and financial intermediaries are classified in the financial corporations sector. However, an important characteristic is that a financial intermediary does not simply act as an agent for other institutional units but places itself at risk by incurring liabilities on its own account. In this context, if a public financial unit does not place itself at risk by incurring liabilities on its own account, it will not be considered a financial corporation and the unit is classified in the general government sector rather than in the financial corporations sector.

2. NPIs controlled by government

- 22.25 The criteria for deciding whether an NPI is controlled by government or not is described in paragraph 4.86. They are summarised here for convenience.
- 22.26 Control of an NPI is defined as the ability to determine the general policy or programme of the NPI. All NPIs allocated to the general government sector should retain their identity as NPIs in statistical records, to facilitate analysis of the complete set of NPIs. To determine if an NPI is controlled by the government, the following five indicators of control should be considered:
- a. The appointment of officers;
 - b. Other provisions of the enabling instrument;
 - c. Contractual agreements;
 - d. Degree of financing; and
 - e. Risk exposure.

A single indicator could be sufficient to establish control in some cases but sometimes a number of separate indicators may collectively indicate control. A decision based on the totality of all indicators will necessarily be judgmental in nature.

3. Corporations controlled by government

- 22.27 To be classified as a public corporation, an institutional unit must not only be controlled by another public unit, but it also must sell most of its output for economically significant prices. Control is defined as the ability to

determine the general policy or program of an institutional unit. Government is in a position to exercise control over many kinds of units: miscellaneous extra-budgetary agencies, non-profit institutions and corporations (non-financial or financial). The criteria for control of a corporation are described in paragraphs 4.71 to 4.74. The key factors to be considered are

- a. Ownership of the majority of the voting interest;
- b. Control of the board or other governing body;
- c. Control of the appointment and removal of key personnel;
- d. Control of key committees of the entity;
- e. Golden shares and options;
- f. Regulation and control;
- g. Control by a dominant customer; and
- h. Control attached to borrowing from the government.

Although a single indicator could be sufficient to establish control, in other cases, a number of separate indicators may collectively indicate control. A decision based on the totality of all indicators must necessarily be judgmental in nature, but there should be consistency in classification decisions for such judgments.

4. Economically significant prices

22.28 To be considered as a public corporation, not only must the unit be an institutional unit controlled by government or another public corporation, it must be a market producer. Market producers provide all or most of their output to others at prices that are economically significant. ***Economically significant prices are prices that have a significant effect on the amounts that producers are willing to supply and on the amounts purchasers wish to buy. These prices normally result when:***

- a. ***The producer has an incentive to adjust supply either with the goal of making a profit in the long run or, at a minimum, covering capital and other costs; and***
- b. ***Consumers have the freedom to purchase or not purchase and make the choice on the basis of the prices charged.***

22.29 These conditions usually mean that prices are economically significant if they cover the majority of the producer's costs (including consumption of fixed capital and a return to capital) and consumers are free to choose on the basis of the prices charged. Although there is no prescriptive numerical relationship between the value of output (excluding both taxes and subsidies on products) and the production costs, one would normally expect the value of goods and services sold (the sales) to average at least half of the production costs over a sustained multi-year period.

22.30 Because economic circumstances vary considerably, it may be desirable to accept different thresholds to achieve consistent economic measurement over time, between units and across countries. For the same reason, the distinction between market and non-market may be made for a group of entities undertaking similar activities rather than on a case-by-case basis. Examples may be higher educational institutions or transport systems. However, when compiling the general government sector accounts, this should never result in combining the accounts of market institutional units with those of non-market institutional units.

22.31 It can be presumed that prices are economically significant when the producers are private corporations. When there is public control, however, the unit's prices may be modified for public policy purposes, which may cause difficulties in determining whether the prices are economically significant. Public corporations are often established to provide goods that the market would not produce in the desired quantities or at the desired prices. The sales of such corporations may cover a large portion of their costs, but one can expect that they respond to market forces quite differently than would private corporations.

22.32 It is likely that corporations receiving substantial government financial support or that enjoy other risk reducing factors such as government guarantees will act differently from corporations without such advantages because their budget constraints are softer. A non-market producer is a producer that faces a very soft budget constraint so that the producer is not likely to respond to changes in the economic conditions in the same way as market producers.

22.33 The difference between a market and non-market producer that sells its output for a price, then, relates largely to the ways in which the producer responds to changes in market conditions. To decide this inherently difficult question, it is useful to consider a taxonomy that specifies which units are the consumers of the goods and services in question and whether the producer is the only supplier.

The output is sold only to government

22.34 If a public producer sells only to government and is the only supplier of its services, it is treated as a non-market unit unless it competes with a private producer in tendering for a contract with government on normally accepted commercial terms.

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

The output is sold to government and others

22.36 If a unit is the only supplier of its services, it is a market producer if its sales to non-government units are more than half of its total output or its sales to government satisfy the tender condition above.

22.37 If there are several suppliers, a public producer is a market producer if it competes with the other producers.

Mixed ownership

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

Definition of sales and of costs

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

22.40 Production costs are the sum of intermediate consumption, compensation of employees, consumption of fixed capital and taxes on production. Subsidies on production are not deducted.

5. A decision tree for government and other public units

22.41 Figure 22.1 shows the relationship between the general government sector, the public sector and the other main sectors of the domestic economy.

22.42 When classifying resident entities that might be public units, it is recommended to follow the following three steps:

- a. Is the entity an institutional unit? If it does not meet the criteria to be considered an institutional unit, is it part of the unit that controls it?
- b. Is the institutional unit a public unit? If the unit is a government unit or is controlled by a government unit or another public corporation, it is part of the public sector; if not, it is neither a government unit nor a public corporation and is not part of the public sector.

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

6. Sub-sectors of the general government sector

22.43 As described in chapter 4, the general government sector may be sub-sectored in either of two ways. One method is to have up to three sub-sectors; one for central government, one for state government and one for local government. In some cases there may be only one or two levels of general government; in some cases more levels of government must be accommodated within the three level structure. The other method of sub-sectoring is to exclude social security from each level of government and have a separate sub-sector for social security at all levels of government.

22.44 Greater detail on sub-sectoring general government is given in section F of chapter 4.

7. Sub-sectors of the public sector

22.45 It is possible to construct sub-sectors of the public sector to meet analytical demands. Two methods of sub-sectoring the public sector may be considered. In the first, the public sector could be divided into the general government sector as one sub-sector and the aggregate of all public corporations as a second sub-sector. The public corporations might be further divided into non-financial public corporations, financial public corporations other than the central bank, and the central bank.

22.46 Secondly, the public sector could be divided by level of government in the same way as the general government sector is. In this case, the sub-sectors would be the central government public sector, the state government public sector and the local government public sector. Each of these sub-sectors would consist of the corresponding sub-sector of the general government sector plus all public corporations controlled by a unit of that level of government. Social security funds could form a separate sub-sector or could be combined with each level of government. It should be noted that autonomous

Figure 22.1: The public sector and its relation to institutional sectors

Non-financial corporations	Financial corporations	General government	NPISHs	Households
Public	Public	Public	Private	Private
Private	Private			

government employee pension funds are excluded from government social security funds.

8. Borderline cases

22.47 Certain entities created by government units need some specific guidance on their sectorization. These include quasi-corporations, restructuring agencies, special purpose entities, joint ventures and supranational authorities.

Quasi-corporations

22.48 Quasi-corporations are unincorporated enterprises that function as if they were corporations. Quasi-corporations are treated as if they were corporations: that is, as separate institutional units from the units to which they legally belong. Thus, quasi-corporations owned by government units are grouped with corporations in the non-financial or financial corporate sectors.

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

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

22.51 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 (that is, the amount of earnings retained within the quasi-corporation) is determined. The owner may invest more capital in the enterprise or withdraw capital from it by disposing of some of its assets and such flows of capital must also be identifiable in the accounts whenever they occur. Investment flows in the quasi-corporation are recorded in the same way as investment flows in corporations (see section D.4 in this chapter). In particular, investment grants are recorded as capital transfers.

22.52 The producer units that remain integrated with the government units that own them are those that cannot be treated as quasi-corporations. They are likely to consist largely of non-market producers, but it is perfectly possible for market establishments to exist within a non-market government unit or for a non-market establishment to have some incidental sales at economically significant prices. As a result, a non-zero net operating surplus is possible for a government unit.

The case of restructuring agencies

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

22.54 The first type of restructuring agency concerns the reorganisation of the public sector and the indirect management of privatisation. Two cases may be considered:

- a. The restructuring unit is a genuine holding company controlling and managing a group of subsidiaries and only a minor part of its activity is dedicated to channelling funds from one subsidiary to another on behalf of the government and for public policy purposes. The unit is classified as a corporation and the transactions made on behalf of the government should be rerouted through the general government.
- b. The restructuring unit, whatever its legal status, acts as a direct agent of the government and is not a market producer. Its main function is to redistribute national income and wealth, channelling funds from one unit to the other. The restructuring unit should be classified in the general government sector.

22.55 The second type of restructuring agency is mainly concerned with impaired assets, mainly in a context of banking or other financial crisis. Such a restructuring agency must be analysed according to the degree of risk it assumes, considering the degree of financing of the government. Again, two cases may be considered:

- a. The restructuring agency borrows on the market at its own risk to acquire financial or non-financial assets that it actively manages: in this case the unit should be classified as an institution in the financial corporations sector.

- b. The restructuring agency deliberately purchases assets at above market prices with direct or indirect financial support from the government. It is primarily engaged in the redistribution of national income (and wealth), does not place itself at risk and therefore should be classified in the general government sector.

Special purpose entities

- 22.56 Government units are always considered resident because, by definition, the economic territory of a country consists of the geographic territory administered by a government, as well as some territorial enclaves in the rest of the world, used by the government for diplomatic, military, scientific, or other purposes, normally with the formal agreement of the government of the country in which they are physically located. These enclaves are part of the general government sector.
- 22.57 Some governments may set up special purpose entities (SPEs) for financial convenience, the SPE being involved in fiscal or quasi-fiscal activities (including securitization of assets, borrowing etc.). Resident SPEs that function in only a passive manner relative to general government and that carry out fiscal activities are not regarded as separate institutional units in the SNA and are treated as part of general government regardless of their legal status. If they act independently, acquire assets and incur liabilities on their own behalf, accepting the associated risk, they are treated as separate institutional units and are classified to sector and industry according to their principal activity.
- 22.58 Non-resident SPEs are always classified as separate institutional units. When such entities are created, care must be taken to reflect faithfully the fiscal activities of the government. All flows and stock positions between the general government and the non-resident SPE should be recorded in the general government and SPE accounts when they occur.
- 22.59 A government may create a non-resident SPE to undertake government borrowing or incur government outlays abroad. Even if there are no actual economic flows recorded between the government and the SPE related to these fiscal activities, transactions should be imputed in the accounts of both the government and the non-resident entity to reflect the fiscal activities of the government. The special case of securitisation units is discussed in section D.

Joint ventures

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

referred to here as joint ventures; jointly-controlled operations; and jointly-controlled assets.

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

Supranational authorities

- 22.65 Some countries may be part of an institutional agreement that involves monetary transfers from the member countries to the associated supranational authority and the reverse. The supranational authority will also engage in non-market production. In the national accounts of the member countries, the supranational authorities are non-resident institutional units that are part of the rest of the world and can be classified in a specific sub-sector of the rest of the world.
- 22.66 Because the supranational authority is fulfilling the functions of a level of government, it is possible to construct a set of accounts for the authority as if it were a resident unit of the member country. Such an additional account may provide a useful supplement for the analysis of the economic activities of the member countries.

C. The government finance presentation of statistics

1. Introduction

22.67 The sequence of accounts for all institutional units and sectors is described in chapters 6 to 13. For the general government sector and, in some cases, the public sector, experience has shown that an alternative presentation, usually known as a government finance presentation, of the stocks and flows is better suited to certain analytical requirements.

22.68 Basically the government finance presentation consists of transactions that increase net worth leading to an aggregate called revenue and transactions that decrease net worth leading to the aggregate of expense. In addition there are two main balancing items, net operating balance and net lending. Additional accounts can be shown for other economic flows and balance sheets.

22.69 The following section provides general information about the concepts involved in government finance.

2. Revenue

22.70 A revenue transaction is one that increases net worth and improves net lending/borrowing. In the government finance presentation of the accounts, the concept of revenue is defined to include all resources acquired by government as recorded in the current accounts and capital transfers recorded in the capital account as receivable. Specifically, revenue can be determined as follows:

Revenue

equals Taxes,

plus Social contributions,

plus Other current revenue,

plus Capital transfers receivable.

22.71 Government revenue is usually dominated by compulsory levies in the form of taxes and social contributions. For some levels of government, grants (transfers from other government units and international organizations) is a major source of revenue. Other general categories of revenue include property income, sales of goods and services and miscellaneous transfers other than grants.

22.72 Estimating taxes and social contributions can be quite difficult. The problems involved and the recommended solutions are described in section D. Taxes are recorded in several of the accounts in the sequence of accounts. An advantage of the government finance presentation is that all taxes can be presented as one category of revenue, with sub-classifications according to the base on which the tax was levied. In particular, both current and capital taxes can be shown under a single heading of taxes.

22.73 As non-market producers, most of the output of government units consists of goods and services that are

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

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

3. Expense

22.75 An expense transaction is one that decreases net worth and worsens net lending/borrowing. In the government finance presentation of the accounts, the concept of expense is defined to include all uses incurred by government as recorded in the current accounts and capital transfers recorded in the capital account as payable. Specifically, expense can be determined as follows:

Expense

equals Production expenses (compensation of employees, use of goods and services and consumption of fixed capital),

plus Interest payable,

plus Grants,

plus Social benefits

plus Other current expenses

plus Capital transfers payable

22.76 The government finance presentation differs from the sequence of accounts in a number of ways. The absence of a production account in the government finance presentation makes it impossible to show both the cost structure of own account production and its final use. Thus, for instance, the salaries of employees engaged in own account capital formation are directly classified as acquisitions of capital formation and not as compensation of employees. Conversely, the salaries of employees that produce social benefits in kind are recorded as compensation of employees and not again as (part of) expense on social benefits in kind. The government finance

presentation uses some labels and definitions that differ from those in the sequence of accounts and also introduces various simplifications. For example, outlays on FISIM and insurance services are not distinguished from interest and net insurance premiums respectively.

22.77 Governments typically produce many services and some goods and then distribute them free or at prices that are not economically significant. In the SNA, the cost of these goods and services is recorded as a use when they are produced and again as a social benefit or final consumption expenditure when they are distributed. To reduce unnecessary duplication, these costs are recorded only as production expenses in the government finance presentation.

22.78 In principle, retirement benefits paid to government employees are considered the liquidation of a liability rather than a payment of a current expense. However, in practice social benefits as reported in government accounts may include retirement benefits paid to government employees from non-autonomous government employee pension schemes. To exclude these transactions of pension liabilities, the contributions must also be excluded from revenue and the item adjustment for changes in pension entitlements is excluded from expense.

4. Outlays

22.79 The purchase of a non-financial asset is not an expense because it has no net effect on net worth since it represents the exchange of one type of asset for another or the incurrence of a liability matched by the acquisition of an asset. It is however included in a total called outlays (or sometimes expenditure). Outlays are defined as follows:

Outlays

equals Expense,

plus Net acquisitions of non-financial assets.

The net acquisition of non-financial assets is the sum of the gross capital formation and acquisitions less disposals of non-produced non-financial assets.

5. Net operating balance

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

Net operating balance

equals Revenue,

less Expense.

6. Net lending or net borrowing

22.81 Net lending or net borrowing can be calculated as the net operating balance less the net acquisition of non-financial assets or total revenue less total outlays. It represents the amount the government has available to lend or must borrow to finance its non-financial operations. Specifically:

Net lending or borrowing

equals Net operating balance,

less Acquisitions less disposals of non-financial assets.

or, alternatively:

Net lending or borrowing

equals Revenue

less Outlays.

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

22.83 For analytical purposes, there is often interest in the relationship between net lending or net borrowing and the change in government liabilities. Attention to government liabilities usually centres on the amount owed to non-government units. There may be a substantial amount of liabilities incurred by one government unit and held by a second government unit. The government finance presentation consolidates all flows and stocks within each sub-sector and sector, and thus all asset and liability positions between units belonging to the same grouping is eliminated. This procedure still allows the separate identification of the debt of the general government sector, the central government sub-sector and the public sector, which are analytically useful.

22.84 The net level of government liabilities is increased by net borrowing and reduced by net lending. However, it is also affected by changes in the volume of assets and revaluation changes. Since government deficits may have accumulated over many years, these other changes may be significant. The consequences of these changes on the net level of government liabilities are as follows:

a. It is reduced by an acquisition of financial assets and increased by the disposal of financial assets.

b. It is increased by an incurrence of liabilities and reduced by repayments of liabilities.

c. It is either increased or decreased by other changes in the volume of debt liabilities, depending on whether these are upward or downwards adjustments.

- d. It is either increased or decreased by revaluations of debt liabilities depending on whether these are upwards or downwards adjustments.

7. Consolidation

22.85 Consolidation is a method of presenting statistics for a set of units as if they constituted a single unit. It involves eliminating transactions and reciprocal stock positions among the units that are being consolidated. Consolidation may be undertaken for any group of units, but it is particularly useful for the general government sector and its sub-sectors. For example, assessing the overall impact of government operations on the total economy or the sustainability of government operations is more effective when the transactions between different levels of government are eliminated and include only those transactions that are with other sectors or non-residents. This is of particular relevance for transactions such as property income (in particular interest), current and capital transfers and transactions in financial assets and liabilities. For example, the consolidated figures on the ratio of revenue or expense to GDP are more useful for some purposes than the unconsolidated figures.

22.86 In the SNA, consolidation is discouraged. Even in the government finance presentation, where consolidation is often useful, it takes place only within a single account where the matching credit (revenue) and debit (expense) entries appear. For this reason, consolidation adjustments do not affect balancing items. For example, a grant (or transfer) from a central government to a local government unit is consolidated by eliminating the expense from central government and the revenue from the local government, thus leaving the net operating balance of the general government sector unchanged.

22.87 Conceptually, the nature of consolidation is to eliminate all flows among the consolidated units, but practicality should be kept in mind. For example, it may be argued that transactions in the production account, such as output and intermediate consumption of goods and services, should not be consolidated. The decision about the level of detail employed in consolidation should be based on the policy usefulness of the consolidated data and the relative importance of the various types of transactions or stocks.

22.88 The major transactions considered for consolidation, in probable order of importance, are:

- a. Current and capital transfers, such as central government grants to lower levels of government;
- b. Transactions in financial assets and liabilities, such as loans to other governments for policy purposes, acquisitions of government securities by social security units and debt forgiveness;

- c. Interest revenue and expense on intergovernmental holdings of financial assets and liabilities;

- d. Acquisitions and disposals of non-financial assets, including intergovernmental transactions in land, buildings and equipment;

- e. Taxes paid by one government unit or entity to another;

- f. Purchases and sales of goods and services between government units.

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

22.90 Practical difficulties always arise with consolidation. For example, when a transaction to be consolidated is identified in the records of one unit, the corresponding transaction should appear in the accounts of the counterparty, but it may not be recorded there, it may be recorded in a different period, it may be recorded at a different value, or it may be classified as a different type of transaction. Such errors in the strict application of a quadruple accounting system may exist in relation to any transaction but become apparent when consolidation is attempted.

22.91 Even if transactions between the sub-sectors of government are being consolidated when presenting the accounts for general government as a whole, they should not be eliminated for the accounts of each sub-sector considered separately.

8. Classification of the functions of government

22.92 A classification of transactions on outlays using the Classification of Functions of Government (COFOG) is integral to the government finance presentation. This classification shows the purpose for which outlays are undertaken. These purposes may differ significantly from the administrative arrangement of governments. For example, an administrative unit responsible for health services may undertake some activities with an educational purpose, such as training of medical professionals. A cross classification of the transactions of government by both economic nature and according to functions is encouraged.

D. Accounting issues particular to the general government and public sectors

22.93 The accounting rules of the SNA apply to general government and public sectors in the same way that they apply to all other sectors of the economy. However, due to the particular nature of the activities of government units, some additional guidance is useful to assist with the treatment of selected transactions. These topics are grouped under four headings:

- a. Clarification of the recording of taxes;
- b. Interaction with non-resident government-type authorities (including taxes paid to another authority);
- c. Issues related to debt;
- d. Interaction with the corporations sectors.

A separate section for each of these headings follows.

1. Clarification of the recording of taxes

22.94 This section discusses when the payment for a permit is treated as a tax, the application of the accrual principle to the recording of the collection of taxes and tax credits.

Government issued permits

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

22.96 As noted in chapters 7 and 8 when discussing the difference between a tax and a fee for a service, the borderline is not always clear cut in practice. The following recommendations apply.

- a. The payment is recorded as a tax when a licence or a permit is automatically granted by the government as a mandatory condition to perform an activity or acquire an asset and when the government unit performs little or no work other than a minimum control of the legal capacity of the acquirer to receive the permit (for instance, to confirm the applicant has not been convicted of a crime). The payment of the fee in such a case is not commensurate with the control function that the government exercises.

- b. The payment is recorded as the purchase of a service when, for instance, issuing the licence or permit implies a proper regulatory function of the government by exercising control on the activity, checking the competence or qualifications of the persons concerned etc. In such a case, the payment is proportionate to the costs of producing the service for all or any of the entities benefiting from the services and is borne by those benefiting.

22.97 Chapter 17 discusses the case of licences issued by government in strictly limited numbers.

- a. If the licence is not one to use a government-owned asset (including natural resources that qualify as assets and which the government controls on behalf of the community), then the payment for the licence is a tax. Notwithstanding, if the licence is legally and practically transferable to a third party, it may still be classified as an asset in the category of contracts, leases and licences.

- b. When the licence is to make use of a government-owned asset (including natural resources that qualify as assets and which the government controls on behalf of the community), payments for the licence are treated either as the acquisition of an asset in the category of contracts, leases or licences or as the payment of rent. The conditions that need to be considered in deciding between the acquisition of an asset and the payment of rent are described in detail in part 5 of chapter 17.

Accrual recording of taxes

22.98 Like all transactions in the system, government transactions should be recorded on an accrual basis. This is true on both the revenue side (for example, taxes and social contributions) and the expense side (for example, interest charges). Unless both parties to a transaction record their view of the transaction at the same point in time, the accounts are not balanced.

22.99 For the government, recording revenue and claims when the underlying event occurs is particularly difficult since government recordings are often on a cash basis. This is especially the case for taxes. Further, when accrued taxes are calculated from assessments of taxes due, there may be a risk of over recording tax revenue. Since tax revenue is a crucial government finance aggregate, such an overstatement must be avoided.

22.100 As explained in chapter 3, the period of time between the moment a tax or any distributive transaction is recorded as accruing in the non-financial accounts and the moment the payment is actually made is bridged by recording an account receivable or payable in the financial account. In cases where a prepayment covering two or more accounting periods is made to government, an account payable is recorded in the financial account of government for the amounts due in future periods. In effect this is a financial advance made to government by the payee. It is a liability of the government and an asset of the payee. This liability

is extinguished as the amounts fall due in future periods. However, such a liability is only recognised when the government has a legal or constructive obligation to make a refund to the payer for the pre-paid amounts in the event that they cease to be payable.

22.101 The amount of taxes recorded as accruing recognises that some taxes that may be due in principle are in practice unlikely to be collected. The alternative means of making the necessary adjustments are described in paragraphs 8.57 and 8.58.

Tax credits

22.102 Tax relief can take the form of a tax allowance, an exemption, a deduction or a tax credit. Tax allowances, exemptions and deductions are subtracted from the tax base before the tax liability is computed. A tax credit is subtracted directly from the tax liability due by the beneficiary household or corporation after the liability has been computed. Tax credits can sometimes be payable, in the sense that any amount of the credit that exceeds the tax liability is paid to the beneficiary. In contrast, some tax credits are non-payable (sometimes called wastable) and are limited to the size of the tax liability

22.103 In *OECD Revenue Statistics* and the *GFSM2001*, a tax relief that is embedded in the tax system is recorded as reducing the tax liability of the tax-payer and therefore as reducing government tax revenue. This is the case for tax allowances, exemptions and deductions, since they enter directly into the calculation of the tax liability. This is also the case for non-payable tax credits as their value to the taxpayer is limited to the size of their tax liability. For payable tax credits, only the excess over the corresponding liability, which corresponds to an outlay by government, is shown as an expense.

22.104 In contrast, in the SNA, the total amounts due as both payable and non-payable tax credits should be considered as expense and recorded as such at their total amount. In consequence, tax revenue should be recorded without any deduction for tax credits.

22.105 Treating payable tax credits in this way has no impact on the net borrowing or net lending of the general government, but has an impact on both the tax burden and the ratios of public expense or expenditure to GDP. However, showing the amount of tax credits payable explicitly allows a calculation to be made with all tax credits treated in the same way as allowances and deductions. Because of the need to explain differences in presentation between different statistical systems, however, in the SNA the amounts of non-payable tax credits and payable tax credits that are offset against tax liabilities should also be shown.

2. Transactions with other national, international and supranational organisations

22.106 Transactions may occur between government units and either international or supranational organisations, regarded

as non-resident units. Even when government acts as the unit channelling funds to or from the non-resident unit, the transactions are recorded as taking place directly with the non-resident unit. Six cases may be considered:

a. *Taxes*: Some taxes on products, such as import duties, excises and value added taxes, might be payable to a supranational organisation (for example, the European Union) because they are considered to be levied directly by the supranational organisation.

b. *Subsidies*: Any subsidies paid by a supranational organisation directly to a resident producer are recorded as payable by the supranational organisation rather than a resident government unit.

c. *Current international cooperation*: This consists of current transfers in cash or in kind between the governments of different countries or between governments and international organizations and includes specifically:

- Transfers between governments that are used by the recipients to finance current expenditures, including emergency aid after natural disasters; they include transfers in kind in the form of food, clothing, blankets, medicines, etc.;

- Annual or other regular contributions paid by member governments to international organizations (excluding taxes payable to supranational organizations);

- Payments by governments or international organizations to other governments to cover the salaries of those technical assistance staff who are resident in the country in which they are working and are employed by the host government.

d. *Miscellaneous current transfers*: These consist of payments to international or supranational authorities that are regarded as being compulsory but are not taxes.

e. *Capital transfers*: These include investment grants and other capital transfers, especially the counterpart transaction of debt cancellation or assumption either receivable or payable.

f. *Financial transactions*: Some financial transactions, usually loans, may be recorded when granted by international organisations (for example, the World Bank and the International Monetary Fund) or granted to other governments.

International membership dues

22.107 In a few cases, such as the participation in SDRs, membership dues and subscription fees may be such that there is a possibility of repayment, even if unlikely. In this case the payment is treated not as a current transfer but the acquisition of a financial asset.

International assistance

- 22.108 International assistance sometimes takes the form of making goods, such as food and clothing, available. In the system, these are recorded as a transfer in cash followed by a purchase of the goods, which will be included in exports of the donor country and imports for the recipient.
- 22.109 The prices of the goods or services in the receiving country might be quite different from the prices in the donor country. As a general principle, the value of the donation to the recipient should be regarded as equal to the cost of providing the assistance to the recipient. It follows that the prices of the donor country should be used as a basis for the calculation of the value of the donation. In addition to the goods or services themselves, all supplemental costs identifiable with the delivery of the goods or services should be included, such as transportation to the foreign country, delivery within that country, the compensation of government employees of the donating country to prepare the shipments or oversee their delivery, insurance and so forth.

3. Debt and Related Operations

Debt operations

- 22.110 Debt is a commonly used concept, defined as a specific sub-set of liabilities identified according to the types of financial instruments included or excluded. Generally, debt is defined as all liabilities that require payment or payments of interest or principal by the debtor to the creditor at a date or dates in the future. Consequently, all debt instruments are liabilities, but some liabilities such as shares, equity and financial derivatives are not debt. However, due to specific legal, institutional or practical arrangements some other definitions of debt may also exist. It is therefore useful in all cases to clearly identify the definition of debt according to the instruments included.
- 22.111 Debt operations are often used by government as a means of providing economic aid to other units. The recording of these operations is covered in chapter 11 but it is useful to recall the following recommendations here. The general principle for any cancellation or assumption of debt of one unit by another unit made by mutual agreement is to consider that there is a voluntary transfer of wealth between the two units. This means that the counterpart transaction of the liability assumed or of the claim cancelled is a capital transfer.
- 22.112 *Debt assumption* occurs when one unit assumes responsibility for another unit's outstanding liability to a creditor. When a government assumes a debt, in most instances the counterpart transaction of the new government liability is a capital transfer in favour of the defaulting debtor. However, if the government acquires an effective legal claim against the defaulting unit and there is a realistic probability that the claim will be paid, the government may record, as the counterpart transaction of its new liability, the acquisition of a financial asset equal to the present value of the amount expected to be received. If this amount is equal to the liability assumed, no further entries are required. If the amount expected to be recovered is less than the liability assumed, the government records a capital transfer for the difference between the liability incurred and any asset acquired. Similarly, if a government has its debt assumed by another government, then it records a capital transfer receivable, a new debt to the assuming government unit, or a combination of the two.
- 22.113 Debt assumption frequently occurs when a government guarantees a debt of another unit and the guarantee is called (or activated). The treatment of the guarantee itself is described in a later item.
- 22.114 *Debt payments on behalf of others* are similar to debt assumptions, but the unit making the payments does not assume the entire debt. The transactions recorded are similar.
- 22.115 *Debt forgiveness* (or debt cancellation) is the extinction or reduction of a debt by contractual agreement between the creditor and the debtor. In addition to the financial transaction concerned, the forgiving unit records a capital transfer payable for the amount forgiven and the other unit records a capital transfer receivable.
- 22.116 *Debt restructuring* is an agreement to alter the terms and conditions for servicing an existing debt, usually on more favourable terms for the debtor. The debt instrument that is being restructured is considered to be extinguished and replaced by a new debt instrument with the new terms and conditions. If there is a difference in value between the extinguished debt instrument and the new debt instrument, it is a type of debt forgiveness and a capital transfer is necessary to account for the difference.
- 22.117 *A debt-for-equity swap* occurs when a creditor agrees to replace a debt owed to it by an equity security. For example, the government may agree with a public enterprise to accept an increase in its equity stake in the public enterprises in place of a loan. Any difference in the value of the debt instrument being extinguished and the replacement equity is a capital transfer if the agreement had an explicit debt forgiveness element, otherwise the difference should be recorded as a revaluation.
- 22.118 *Debt write-offs* refer to unilateral reductions by a creditor in the amount owed to it, usually when a creditor concludes that a debt obligation has no value or a reduced value because part or all of the debt is not going to be paid. Frequently the debtor is bankrupt or has disappeared. An other change in the volume of assets is used to record the write off. Thus, contrary to debt assumption and debt forgiveness, no capital transfer is recorded and therefore there is no impact on net lending or borrowing of government.
- 22.119 *Debt arrears* occur when a debtor misses an interest or principal payment. The debt instrument will not normally change, but knowing the amount of debts in arrears can provide important information. When feasible and important, therefore, each category of debt should be divided into those instruments that are in arrears and those not in arrears.
- 22.120 *Debt defeasance* allows a debtor (whose debts are in the form generally of debt securities and loans) to remove

certain liabilities from the balance sheet by pairing irrevocably assets of equal value to the liabilities. Defeasance may be carried out (a) by placing the paired assets and liabilities in a trust account within the institutional unit concerned, or (b) they may be transferred to another institutional unit. In the former case, there are no transactions with respect to defeasance and the assets and liabilities should not be excluded from the balance sheet of the unit. In the latter case, the assets and liabilities in question are moved to the balance sheet of second statistical unit. It should be noted that a special purpose entity is usually not recognized as a separate institutional unit. Only special purpose entities created abroad are treated as institutional units by convention. Defeasance in special purpose entities are thus treated as (a) cases, except for special purpose entities created abroad that are treated as (b) cases.

- 22.121 *Debt issued on concessional terms.* There is no precise definition of concessional loans, but it is generally accepted that they occur when units lend to other units and the contractual interest rate is intentionally set below the market interest rate that otherwise would apply. The degree of concessionalism can be enhanced with grace periods, frequencies of payments and a maturity period favourable to the debtor. Since the terms of a concessional loan are more favourable to the debtor than market conditions would otherwise permit, concessional loans effectively include a transfer from the creditor to the debtor.
- 22.122 Loans with concessional interest rates to a foreign government could be seen as providing a current transfer equal to the difference between the actual interest and the market equivalent interest. If such a transfer were recognized, it would usually be recorded as current international cooperation, and the interest recorded would be adjusted by the same amount. However, the means of incorporating the impact within the SNA and international accounts have not been fully developed, although various alternatives have been advanced. Accordingly, until the appropriate treatment of concessional debt is agreed, information on concessional debt should be provided through supplementary information.

Government loan guarantees

- 22.123 Three types of guarantees are recognised in the SNA, standardized loan guarantees, guarantees that meet the definition of a financial derivative and one-off guarantees. The recording of standardized loan guarantees (for government and other units offering such guarantees) is described in part 3 of chapter 17.
- 22.124 Guarantees that meet the definition of financial derivatives are those that are actively traded on financial markets, such as credit default swaps. The derivative is based on the risk of default of a reference instrument and so is not actually linked to an individual loan or bond.
- 22.125 One-off guarantees exist where the conditions of the loan or the security are so particular that it is not possible for the degree of risk associated with the loan to be calculated with any degree of accuracy. In most cases, the granting of a one-off guarantee is considered a contingency and is not recorded as a financial liability for the guarantor. As an exception, one-off guarantees granted by governments to corporations in certain well-defined financially distressed situations and with a very high likelihood to be called are treated as if these guarantees were called at inception. A particular case in point is a bailout by government, which is discussed below.
- 22.126 The activation of a one-off guarantee is treated in the same way as a debt assumption. The original debt is liquidated and a new debt is created between the guarantor and the creditor. In most instances, the guarantor is deemed to make a capital transfer to the original debtor, unless the guarantor acquires an effective claim on the creditor, in which case it leads to the recognition of a financial asset (a liability of the debtor).
- 22.127 The activation of a guarantee may or may not require repayment of debt at once. The accrual principle for time of recording requires that the total amount of debt assumed is recorded at the time the guarantee is activated and the debt assumed. Repayments of principal by the guarantor (the new debtor) and interest accruals on the assumed debt are recorded as these flows occur.

Bailouts

- 22.128 A bailout is a loosely defined term meaning a rescue from financial distress. It is often used when a government unit provides short-term financial assistance to a corporation to help it survive a period of financial difficulty or a more permanent injection of financial resources to help recapitalize the corporation. Bailouts of financial institutions are particularly noteworthy. Bailouts are likely to involve highly publicized one-time transactions with large values and are therefore easy to identify.
- 22.129 Intervention of general government may take various forms. For instance:
- A government may guarantee certain liabilities of the enterprise to be assisted.
 - A government might provide equity financing on exceptionally favourable terms.
 - A government might purchase assets from the enterprise to be assisted for prices greater than their true market value.
 - A government might create a special purpose entity or other type of public body to finance or to manage the sales of assets or liabilities of the enterprise to be assisted.
- 22.130 In all these cases, the assistance provided by government to the unit suffering financial distress is recorded as a capital transfer. In determining the magnitude of the capital transfers, the following points need to be taken into account.
- 22.131 If the government buys assets from the enterprise to be assisted, the amount paid will normally be more than the true market price of the assets. The purchase should be recorded at the actual market price and a capital transfer

should be recorded for the difference between the market price and the total amount paid.

22.132 Governments often buy loans from financial institutions during a bailout for their nominal value rather than their market value. Loans that have not become marketable are valued at nominal prices in the SNA since a single transaction in a loan is not sufficient to classify the loan as having become tradeable.

22.133 Because loans are measured at nominal value in the SNA, if government buys a loan at nominal value when the fair value is much less, there may not be justification for recording a capital transfer even though there clearly has been a transfer. If there is reliable information that some loans are irrecoverable (fully or for nearly their total amount), these loans should be accounted for at zero and a capital transfer should be recorded for their former nominal value. A revaluation entry is also needed for the change in value of the loan.

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

Securitisation

22.135 Securitisation occurs when a unit, named the originator, conveys the ownership rights over financial or non-financial assets or the right to receive specific future flows, to another unit, named the securitisation unit. In return, the securitisation unit pays an amount to the originator from its own source of financing. The securitisation unit is often a special purpose entity. The securitisation unit obtains its own financing by issuing securities using the assets or rights to future flows transferred by the originator as collateral. Government units have made widespread use of this source of finance.

22.136 The first case involving government to be considered is when the securitisation comprises the sale (or the transfer) of an asset. (In the SNA, a stream of future tax receipts is not recognized as a government asset that could be used for securitization.) The key question for how to record the transaction properly is to determine whether the transfer of the asset is a sale of an existing asset to the securitisation unit or a way to borrow using possible future flows of revenues as collateral. In order to be treated as a sale, the asset must already appear in the balance sheet of the government and there must be a full change of ownership to the securitisation unit as evidenced by the transfer of the risks and rewards linked to the asset. The following factors must also be considered:

a. The purchase price should equal the current market price to be a sale.

b. If the government, as the originator, guarantees repayment of any debt related to the asset incurred by the securitisation unit, it is unlikely that all of the risks associated with the asset have been transferred.

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

Government assumption of pension liabilities

22.138 On occasion, large one-off transactions may occur between a government and another unit, usually a public corporation, linked to pension reforms or to privatizations of public corporations. The goal may be to make a public corporation competitive and financially more attractive by removing existing pension liabilities from the balance sheet of the public corporation. This goal is achieved by the government assuming the liability in question in exchange for a cash payment of the same value. If the cash payment is not equal in value to the liability incurred, a capital transfer is recorded for the difference.

4. Relations of general government with corporations

Earnings from equity investment

22.139 Any government unit has a close relationship with any public corporation or quasi-corporation that it controls. Despite this close relationship, flows related to the equity investment between a government unit and its controlled corporation are treated in the same way as flows between any corporation and its owners. An equity investment is the action by economic agents of placing funds at the disposal of corporations in exchange for specific financial assets. The amounts invested, described as equity capital, are part of the own funds of the corporation and the corporation has a large degree of freedom in the way in which they are used. In return, the owners receive shares or some other form of equity securities. These financial assets represent property rights on corporations and quasi-corporations and entitle the holders to:

a. A share of any dividends (or withdrawals of income from quasi-corporations) paid at the choice of the corporation but not to a fixed and predetermined income, and

b. A share in the net assets of the corporation in the event of its liquidation.

22.140 It is important to distinguish between the return of the equity investment by the corporation to its owner and the payment of income in the form of dividends. Only regular distributions from the entrepreneurial income are recorded as dividends or withdrawals of income from quasi-corporations. Large and irregular payments to the owner should be recorded as a withdrawal of equity.

Dividends versus withdrawal of equity

22.141 The earnings from equity investment in public corporations may be recorded as a distributive transaction (usually dividends) or, in some cases, as a purely financial transaction. Dividends are one form of property income. The case of large and irregular payments, based on accumulated reserves or sale of assets is different; these payments are to be recorded as a withdrawal of equity.

Acquisition of equity, capital transfers and subsidies

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

- a. Payments to cover accumulated losses provided for public policy purposes should be recorded as a capital transfer.
- b. A payment made in a commercial or competitive context can be treated as an acquisition of equity. This should be limited to cases where the government is acting similarly to a private shareholder in that it has a valid expectation of a cash return in the form of future property income. In this case, the corporation will probably issue new shares to the government and enjoy a large degree of freedom over how the funds provided are used.

22.143 In many cases, payments made by government units to public corporations are intended to compensate for losses. Treating the payments as the acquisition of equity depends on evidence of the corporation’s profitability and its ability to pay dividends in future.

Privatization

22.144 Privatization is usually understood to consist of the sale of shares and equity in a public corporation held by government to units outside the public sector. Such sales are purely financial transactions, recorded in the financial account of the SNA. The assets owned by the public corporation continue to belong to the corporation; it is the ownership of the corporation itself, as represented by the ownership of the equity in it, that changes hands. In effect, the government’s claim on the public corporation reduces because government exchanges shares or equity in the public corporation for cash or other financial assets. The cost of any financial services that government must

purchase to achieve the sale are treated as an expense that should be recorded as intermediate consumption in the SNA.

22.145 The sale of non-financial assets owned by public corporations, such as buildings and land, does not by itself constitute privatization and is recorded in the capital account of the corporations sector as disposals of fixed assets or other non-financial assets. However, if the public corporation sells assets and then surrenders the proceeds of such a sale to general government, this is recorded as a withdrawal of government’s equity in the corporation.

22.146 Privatization may be organized in more complicated institutional arrangements. For instance, some or all of the non-financial assets of a public corporation may be sold by a public holding company, or other public agency, controlled by a government and all or part of the proceeds paid to the government. In all cases, the public corporation will record the disposal of non-financial assets in the capital account, while the payment to the government of the proceeds from the sale is recorded as a withdrawal of equity.

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

- a. The restructuring unit, whatever its legal status, acts as a direct agent of government and is not a market producer or a financial institution. Its main function is simply to restructure and change the ownership status of public corporations and to channel funds from one unit to the other. The unit is classified in the general government sector.
- b. The restructuring unit is a genuine head office controlling a group of subsidiaries and only a minor part of its activity is dedicated to channelling funds in the way described above, on behalf of government and for public policy purposes. The public head office is classified as a financial or non-financial corporation according to its main activity. The recommended treatment in this context is to reroute the transactions made by the head office on behalf of government in such a way that it discloses the economic impact of government’s policy decision in the government.

Nationalization

22.148 Nationalisation is a process whereby government takes control of specific assets or an entire corporation, usually by acquiring the majority or the whole stake in the corporation. The recording of flows differs according to the way the government takes control.

- a. *Appropriation or confiscation*: the change in ownership of assets is not the result of a transaction made by mutual agreement. There is no payment to the owners (or the compensation is not commensurate with the fair value of the assets). The difference between the market value of the assets acquired and any compensation

provided is recorded as an uncompensated seizure in the other changes in the volume of assets account.

- b. *Purchase of shares:* the government buys all or some of the shares in the corporation at a price that is the market price or very close to it. There is usually a legal context for the transaction which ensures that it is made by mutual agreement, even though the former owner may have little choice whether or not to accept the offer, or to negotiate the price. The purchase of shares is a financial transaction recorded in the financial account.

Restructures, mergers and reclassifications

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

Transactions with the central bank

- 22.152 It is appropriate to begin by recalling the definition of the central bank and associated explanations from chapter 4.
- 22.153 The central bank is the national financial institution that exercises control over key aspects of the financial system.
- 22.154 In general, the following financial institutions are classified in this sub-sector:
 - a. The national central bank, including where it is part of a system of central banks; and
 - b. Central monetary agencies of essentially public origin (for example, agencies managing foreign exchange or issuing banknotes and coin) that keep a complete set of accounts but are not classified as part of central government. Supervisory authorities that are separate institutional units are not included with the central bank but are included with financial auxiliaries.

As long as the central bank is a separate institutional unit, it is always allocated to the financial corporations sector even if it is primarily a non-market producer.

- 22.155 While the bank may be legally independent of government, because it is charged with carrying out government policy and is the single exception to the rule that a unit whose

output is primarily non-market should be allocated to the general government sector, the central bank is always treated as being controlled by government and is included in the public sector.

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

- 22.157 The measurement of output of the central banks is described in paragraphs 6.148 to 6.153. As part of government policy, the central bank may pay interest on deposits at artificially high or low rates. The treatment of interest payments in this case is described in paragraphs 7.114 to 7.118.

Public-private partnerships

- 22.158 Public-private partnerships (PPPs) are long-term contracts between two units, whereby one unit acquires or builds an asset or set of assets, operates it for a period and then hands the asset over to a second unit. Such arrangements are usually between a private enterprise and government but other combinations are possible, with a public corporation as either party or a private NPI as the second party. These schemes are described variously as public-private partnerships, private finance initiatives (PFI), build, own, operate, transfer schemes (BOOT) and so on. The basic principles of all are the same and are treated the same way in the SNA.
- 22.159 After the first party to the agreement has built or otherwise acquired the assets in question, they operate them for a period of time to produce and deliver services either to the second party or to the general public on behalf of the second party. At the end of the contract, the second party often acquires legal ownership of the fixed assets, sometimes without payment or for a payment that clearly is less than the market value. In order to compensate the first party for the loss of value of the assets, the first party is allowed to charge above market prices during the period it controls the assets.

- 22.160 The fixed assets are often referred to as infrastructure assets because many of the large projects undertaken by means of

PPPs involve the provision of transportation, communications and utilities.

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

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

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

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

- a. The degree to which the government controls the design, quality, size and maintenance of the assets;
- b. The degree to which the government is able to control the services produced, the units to which the services are provided and the prices of the services produced;
- c. Construction risk, which includes the possibility of additional costs resulting from late delivery, not meeting specifications or building codes and environmental and other risks requiring payments to third parties;
- d. Availability risk, which includes the possibility of additional costs or the incurrence of penalties because the volume and/or quality of the services do not meet the standards specified in the contract;
- e. Demand risk, which includes the possibility that the demand for the services is higher or lower than expected;
- f. Residual value and obsolescence risk, which includes the risk that the value of the asset will be less than its expected value at the end of the contract and the degree to which the government has an option to acquire the assets;
- g. The presence, if any, of third party revenues, the greater the reliance on sales to the public, the more the private enterprise should be assessed to be the economic owner.

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

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

22.167 If the private enterprise is assessed as being the economic owner and if, as usual, the government obtains legal and economic ownership at the end of the contract without an explicit payment, a transaction must be recorded for the government's acquisition of the assets. One general approach is for the government gradually to build up a financial claim and the private unit gradually to accrue a corresponding liability such that the value of both are expected to be equal to the residual value of the assets at the end of the contract period. Implementing this approach requires existing monetary transactions to be rearranged or new transactions to be constructed using assumptions about expected asset values and interest rates.

22.168 Another important problem arises when the government is assessed as being the economic owner of the assets but

does not make any explicit payment at the beginning of the contract. A transaction must be constructed to accomplish the acquisition. The most common suggestion is that the acquisition be made via an imputed financial lease because of the similarity with actual financial leases. The implementation of that choice, however, depends on the specific contract provisions, how they are interpreted and

possibly other factors. For example, a loan could be imputed and actual government payments to the private unit, if they exist, could be partitioned so that a portion of each payment represents repayment of the loan. If there are no actual government payments, then non-monetary transactions could be constructed for the loan payments.

E. The public sector presentation of statistics

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

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

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

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

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

22.173 The same balancing items as stressed for the general government sector are likely to be important for the public sector. The public sector net operating balance (or saving in the sequence of accounts) will indicate trends in net worth resulting from the public sector's current operations. This is particularly useful if there are public corporations operating at significant losses.

22.174 Net lending or net borrowing for the total public sector is known as the public sector borrowing requirement. Net lending indicates the net financing supplied to the rest of the economy or the rest of the world; net borrowing indicates net financing obtained by the public sector from the rest of the economy or the rest of the world.

22.175 The balance sheet provides information of net worth, determined as the value of total assets less total liabilities and financial net worth, determined as the difference between the value of total financial assets and the total liabilities. The latter is often cited because of the public sector's influence on the financial system and because it is often difficult to value government-unique non-financial assets.

