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Chapter 26: The rest of the world accounts

A. Introduction

- 26.1 This chapter is about the relationship between the rest of the world sector in the SNA and the international accounts as described in BPM6. It shows that the two manuals use the same macroeconomic framework, with the international accounts providing additional detail on aspects of particular relevance in international transactions or positions.
- 26.2 The international accounts for an economy summarize the economic relationships between residents of that economy and the rest of the world. They comprise:
- the balance of payments, which summarizes transactions between residents and non-residents during a specific time period;
 - the international investment position (IIP), which shows at a point in time the value of: financial assets of residents of an economy that are claims on non-residents or are gold bullion held as reserve assets; and the liabilities of residents of an economy to non-residents; and
 - the other changes in financial assets and liabilities accounts, a statement that shows other flows, such as valuation changes, which reconciles the balance of payments and IIP for a specific period by showing changes due to economic events other than transactions between residents and non-residents.
- These accounts correspond with the transactions, balance sheets and other changes in assets accounts in the SNA, respectively.
- 26.3 Section B of the chapter discusses the accounting rules of the international accounts. These are consistent with the SNA accounting rules and agreement has been reached on when the SNA and when the BPM6 takes the lead in defining the rules to be applied in both contexts. Residence is a case in point where the SNA follows BPM6.
- 26.4 The structure of the international accounts, and their relation to similar SNA accounts is the subject of section C.
- 26.5 A feature of the financial accounts and IIP of the international accounts is the introduction of a functional category that describes the main purpose of financial investment abroad. This is the subject of Section D.
- 26.6 Section E touches on some considerations of particular importance to the international accounts; global imbalances, exceptional financing, debt reorganisation, currency unions and currency conversions.

B. Accounting principles

1. Comparison with SNA accounting principles

- 26.7 The balance of payments has a double-entry accounting system. As a result, the balance of payments is, in principle, balanced. In practice, there may be an imbalance due to imperfections in source data and compilation. This imbalance, a usual feature of published balance of payments data, is labelled net errors and omissions. The balance of payments manuals have traditionally discussed this item, to emphasize that it should be published explicitly, rather than included indistinguishably in other items and that it should be used to indicate possible sources of mismeasurement.
- 26.8 In contrast to the balance of payments, the SNA has quadruple-entry recording, in that it records two entries for each party to the transaction, while the balance of payments for each individual economy shows the entries for the resident party. However, there has been increasing interest in estimates that are derived from counterpart reporting that has better coverage, valuation, etc. As well, there has been much work done on reconciling data from the view of both parties (for example, exports of one country, with the counterpart imports recorded by the partner country) and global totals. Counterparty data are also necessary to prepare consolidated data for a currency or economic union from the data of individual member countries. In effect, all this work is built on the fact that balance of payments statistics effectively become a quadruple-entry system when used at the bilateral or global level.
- 26.9 The recording in the international accounts is from the point of view of the resident units. It is therefore a mirror image of the rest of the world accounts in the SNA. Accordingly, exports are regarded as credits in the balance of payments, but a use by the rest of the world in the SNA. Similarly, the current external balance has the opposite sign, so the value of -32 in Table 2.14, for example, would be shown as a current account surplus of 32 in the balance of payments (illustrated in table 26.3 below). For the same reason, the assets of the rest of the world are shown as liabilities in the IIP, and vice versa.
- 26.10 Valuation principles are the same in the SNA and the international accounts. In both cases, market values are used, with nominal values used for some positions in instruments where market prices are not observable. In the international accounts, the valuation of exports and imports of goods is a special case where a uniform valuation point is used, namely the value at the customs frontier of the exporting economy, that is, the FOB-type valuation (free on board). This treatment brings about consistent valuation between exporter and importer and provides for a consistent basis for measurement in circumstances where the parties may have a wide range of different contractual arrangements, from “ex-works” at one extreme (where the importer is responsible for arranging all transport and insurance) to “delivered duty paid” at the other (where the exporter is responsible for arranging all transport, insurance and any import duties). In international transactions, there may be motivations for under- or over-invoicing in order to evade taxes or exchange controls, so *BPM6* provides guidance on how to develop market-equivalent prices when these cases are identified, and also discusses adjustments needed to items to maintain balance.
- 26.11 Timing and ownership principles are the same in the SNA and the international accounts. In practice, the timing of change of economic ownership of goods is often identified by when the goods are recorded in customs data. To the extent that there are differences between customs data and actual changes in ownership, such as for items with large values or goods sent on consignment (that is, dispatched before they are sold), adjustments are made. There are no longer any exceptions to the recording basis of the change of economic ownership. However, there is a different presentation in the case of merchanting; that is, where an owner buys and resells goods in the same condition without the goods passing through the territory of the owner. In that case, the acquisition of the goods is identified as a change of ownership, but shown as a negative export rather than an import.

- 26.12 Transactions, positions and income for financial assets and liabilities are presented primarily according to the international accounts functional categories. These categories are
- a. direct investment,
 - b. portfolio investment,
 - c. financial derivatives (other than reserves) and employee stock options,
 - d. other investment and
 - e. reserve assets.

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

2. Units

- 26.13 The international accounts and the SNA are built on the same definitions of institutional units and residence. Because the international accounts focus on economic relationships between residents and non-residents, more elaboration of borderline cases is provided in BPM6.

Economic territory

- 26.14 The most commonly used concept of economic territory is the area under the effective economic control of a single government. However, currency or economic unions, regions, or the world as a whole may also be used, as they may also be a focus for macroeconomic policy or analysis.
- 26.15 An economic territory includes the land area including islands, airspace, territorial waters and territorial enclaves in the rest of the world (such as embassies, consulates, military bases, scientific stations, information or immigration offices, that have immunity from the laws of the host territory) physically located in other territories. Economic territory has the dimensions of physical location as well as legal jurisdiction, so that corporations created under the law of that jurisdiction are part of that economy. The economic territory also includes special zones, such as free trade zones and offshore financial centres. These are under the control of the government so are part of the economy, even though different regulatory and tax regimes may apply. (However, it may also be useful to show separate data for such zones.) The territory excludes international organizations and enclaves of other governments that are physically located in the territory.

Institutional units

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

- 26.17 As discussed in Chapter 4, resident artificial subsidiaries and special purpose entities (SPEs) are combined with their owners into single legal entities. However, a legal entity that is resident in one jurisdiction is never combined with a legal entity resident in another. As a result, SPEs and other similar corporate structures owned by non-residents are considered to be resident of their territory of incorporation, even though most or all of their owners and most or all of their assets are in another economy.
- 26.18 Similarly, members of a household must all be resident in the same economy. So, if a person resides in a different economy from the other members of a household, that person is not a member of that household, even though they may share income and expenses, or hold assets together.

Branches

- 26.19 When a non-resident entity has substantial operations in an economic territory, but no separate legal entity, a branch may be identified as a separate institutional unit. A branch is a type of quasi-corporation. The identification of branches as separate institutional units requires indications of substantial operations that can be separated from the rest of the entity. A branch is recognized in the following cases:
- a. Either a complete set of accounts, including a balance sheet, exists for the branch, or it is possible and meaningful, from both an economic and legal viewpoint, to compile these accounts if required. The availability of separate records indicates that an actual unit exists and makes it practical to prepare statistics.

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

- b. The branch undertakes or intends to undertake production on a significant scale which is based in a territory other than that of its head office for one year or more:
 - (i) if the production process involves physical presence, then the operations should be physically located in that territory;
 - (ii) if the production does not involve physical presence, such as some cases of banking, insurance, other financial services, ownership of patents, and “virtual manufacturing,” the operations should be recognized as being in the territory by virtue of the registration or legal domicile of those operations in that territory;
 - c. The branch is recognized as being subject to the income tax system, if any, of the economy in which it is located even if it may have a tax-exempt status.
- 26.20 The identification of branches has implications for the statistical reporting of both the parent and branch. The operations of the branch should be excluded from the institutional unit of its head office and the delineation of parent and branch should be made consistently in both of the affected economies. A branch may be identified for construction projects or mobile operations such as transport, fishing or consulting. However, if the operations are not substantial enough to identify a branch, they are treated as an export of goods or services from the head office by delivering them to another location.
- 26.21 In some cases, a quasi-corporation is identified for preliminary operations related to a future direct investment project prior to incorporation. For example, licenses and legal expenses for a project are shown as being incurred by a quasi-corporation, and are part of direct investment flows rather than sales of licenses to non-residents, or exports of services, respectively, to the head office.

Notional resident units

- 26.22 When land located in a territory is owned by a non-resident entity, a notional resident unit is identified for statistical purposes as being the owner of the land. This notional resident unit is a kind

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

- 26.23 If necessary, a notional resident unit is also created if a non-resident has a long-term lease on an immovable asset such as a building.

Multi-territory enterprises

- 26.24 A few enterprises operate as a seamless operation over more than one economic territory, typically for cross-border activities such as airlines, shipping lines, hydroelectric schemes on border rivers, pipelines, bridges, tunnels and undersea cables. If possible, separate branches should be identified, but if the entity is run as a single operation with no separate accounts or decision-making for each territory that it operates in, it is not possible to delineate branches. In such cases, because of the central focus on data for each national economy, it is necessary to split the operations between economies. The operations should be prorated according to an appropriate enterprise-specific indicator of the proportions of operations in each territory. The prorating treatment may also be adopted for enterprises in zones subject to joint administration by two or more governments.

3. Residence

- 26.25 ***The residence of each institutional unit is the economic territory with which it has the strongest connection, expressed as its centre of predominant economic interest.*** An institutional unit is resident in an economic territory when there exists, within the economic territory, some location, dwelling, place of production, or other premises on which or from which the unit engages and intends to continue engaging, either indefinitely or over a finite but long period of time, in economic activities and transactions on a significant scale. The location need not be fixed so long as it remains within the economic territory. Actual or intended location for one year or more is used as an operational definition. While the choice of one year as a specific period is somewhat arbitrary, it is adopted to avoid uncertainty and facilitate international consistency. Most units have strong connections to only one economy but with globalization, a growing number have strong links to two or more economies.

Residence of households

- 26.26 A household is resident in the economic territory in which household members maintain or intend to maintain a dwelling or succession of dwellings treated and used by members of the household as their principal dwelling. If there is uncertainty about which dwelling is the principal dwelling, it is identified from the length of time spent there, rather than other factors such as cost, size, or length of tenure. Being present for one year or more in a territory or intending to do so is sufficient to qualify as having a principal dwelling there. The implications of the residence of a household for the recording of its flows and stocks are summarized in table 26.1.

- 26.27 In addition to the general principles, additional guidance in determining the residence of households is given in the following specific cases:

- a. *Students.* People who go abroad for full-time study generally continue to be resident in the territory in which they were resident prior to studying abroad. This treatment is adopted even though their course of study may exceed a year. However, students change to being residents of the territory in which they are studying when they develop an intention to continue their presence in the territory of study after the completion of the studies. Members of the same household who are accompanying dependents of students are also considered to be resident of the same economy as the student.

- b. *Patients.* People who go abroad for the purpose of medical treatment maintain their predominant centre of interest in the territory in which they were resident prior to the treatment, even in the rare cases where complex treatments take a year or more. As with students, accompanying dependents are treated in the same way.
- c. *Crew of ships etc.* Crew of ships, aircraft, oil rigs, space stations or other similar equipment that operate outside a territory or across several territories are treated as being resident in the territory of their home base.
- d. *Diplomats, military personnel, etc.* National diplomats, military personnel and other civil servants employed abroad in government enclaves and their households are considered to be residents of the economic territory of the employing government. However, other employees, such as locally recruited staff and international organization staff are resident in the location of their principal dwelling.
- e. *Cross-border workers.* There is no exception for these workers. The residence of the persons concerned is based on the principal dwelling, rather than the territory of employment, so employees who cross borders to undertake a job still have their residence determined from their principal dwelling.
- f. *Refugees.* No special treatment is adopted for refugees, so their residence will change from their home territory if they stay or intend to stay in another economy for a year or more, regardless of their legal status or intention to return.
- g. *Highly mobile individuals.* Some individuals have close connections with two or more economies. In cases of no principal dwelling, or two or more principal dwellings in different economies, the residence is determined on the basis of the territory in which the predominant amount of time is spent in the year. While these individuals need to be classified as residents of a single economy for statistical purposes, additional information may be needed in recognition of strong ties to another economy.

26.28 When households change their economy of residence, there are changes to the status of the assets they own and liabilities they owe. These changes are recorded as reclassifications through the other changes in volumes account. Because of the treatment of having a notional resident unit for ownership of land by non-residents, new notional units may be identified or old ones converted to ownership of the assets as a result of changes in residence of the owners.

Table 26.1 Selected Effects of a Household's Residence Status on the Statistics of the Host Economy

| Economic flow or position | Resident (for example, long-term guest worker) | Non-resident (for example, short-term guest worker) |
|--|---|---|
| Compensation of employees received from enterprises in the reporting economy | Resident-to-resident compensation of employees | Resident-to-non-resident compensation of employees |
| Personal expenditure in the reporting economy | Resident-to-resident transaction | Exports of services, mainly travel |
| Transfers to relatives in home economy | Resident-to-non-resident current or capital transfers | Resident-to-resident transfer (There is often some international financial transaction of the short-term worker returning funds from his host to his home economy, for example via a bank in the host economy) |
| A resident institutional unit's | Resident-to-resident financial | International financial claim |

| | | |
|---|---|--|
| financial claims on or liabilities to the household | claim | |
| Land and buildings owned in host economy | Nonfinancial asset | Nonfinancial asset and direct investment liability of a notional resident unit |
| Land and buildings owned in home economy | Direct investment asset in notional resident unit | Not in balance sheet of host economy |

Residence of enterprises

- 26.29 An enterprise is resident in an economic territory when the enterprise is engaged in a significant amount of production of goods or services from a location in the territory. Taxation and other legal requirements tend to result in the use of a separate legal entity for operations in each legal jurisdiction. In addition, a separate institutional unit is identified for statistical purposes where a single legal entity has substantial operations in two or more territories (for example, for branches, land ownership and multiterritory enterprises, as noted above). As a result of splitting such legal entities, the residence of each of the subsequently identified enterprises is usually clear. The implications of the residence of an enterprise for the recording of its flows and stocks are summarized in table 26.2.
- 26.30 In some cases, the physical location of an enterprise is not sufficient to identify its residence because the enterprise has little or no physical presence, for example, its administration is entirely contracted out to other entities. Banking, insurance, investment funds, securitization vehicles and some special purpose entities may operate in this way. Many trusts, corporations, or foundations that hold private wealth also have little or no physical presence. Similarly, with virtual manufacturing, all the physical processes are outsourced to other units. In the absence of any significant physical dimension to an enterprise, its residence is determined according to the economic territory under whose laws the enterprise is incorporated or registered. The incorporation and registration represent a substantial degree of connection to the economy, associated with jurisdiction over the enterprise's existence and operations. In contrast, other connections such as ownership, location of assets, or location of its managers or administrators may be less clear-cut.
- 26.31 In some cases, laws allow enterprises to change their economy of residence, such as within an economic union. In such cases, as for households, a change of residence means that their assets and liabilities change their status through other changes in volumes. More commonly, what is called "corporate migration" involves the conveyance of assets and liabilities from a corporation in one economy to a related entity in another economy rather than a change of residence of the entity.

Table 26.2 Selected Effects of the Residence Status of an Enterprise Owned by a Non-resident on the Statistics of the Host Economy

| Economic flow or position | Resident enterprise (for example, major long-term construction project) | Non-resident enterprise (for example, minor short-term construction project) |
|--|--|---|
| Sales by enterprise to residents | Resident-to-resident transaction | Imports of goods and services |
| Purchases by enterprise from residents | Resident-to-resident transaction | Exports of goods and services |
| Compensation of employees payable to residents of host economy | Resident-to-resident compensation of employees | Non-resident-to-resident compensation of employees |
| Compensation of employees | Resident-to-non-resident | Not a transaction of host |

| | | |
|--|--|-----------------------------------|
| payable to residents of home economy | compensation of employees | economy |
| Net operating surplus | Dividends payable or reinvested earnings | Not a transaction of host economy |
| Injections of funds by owners | Direct investment liabilities of the reporting economy | Not a transaction of host economy |
| A resident institutional unit's financial claims on or liabilities to the enterprise | Resident-to-resident financial claims | International financial claims |

Residence of other entities

- 26.32 General government includes extraterritorial enclaves, such as embassies, consulates, military bases and other enclaves of foreign governments. However, an entity created by a government under the laws of another jurisdiction is an enterprise resident in the host jurisdiction and not part of the general government sector in either economy.
- 26.33 International organizations are resident in an economic territory of their own and not of the economy in which they are physically located. An international organization that operates military forces or acts as the interim administration in a territory remains as an international organization and is non-resident in that territory, even if it undertakes general government functions there. In cases where these organizations are significant, it may be desirable to identify them separately. Some international organizations cover a group of economies in a particular region, such as with economic or currency unions. If statistics are prepared for that region as a whole, these regional organizations are residents of the region as a whole, even though they are not residents of any member economy.
- 26.34 A nonprofit institution serving households (NPISH) has a centre of economic interest in the economy where the institution is legally created or otherwise officially recognized. When a NPISH is engaged in charity or relief work on an international scale, the foreign operations may be sufficiently substantial to be recognized as branches.

C. Structure of the international accounts

- 26.35 Like the SNA, the international accounts cover accounts for current transactions, accumulation accounts and balance sheets. The transaction accounts are collectively called the balance of payments. An overview of the international accounts presentation (using the SNA numerical example) is given in tables 26.3 and 26.4. The three current accounts are the goods and services account, primary income account and secondary income account. The primary income account corresponds to generation and allocation of primary income accounts in the SNA; while the secondary income corresponds to secondary distribution of income account in the SNA. The income accounts in BPM6 do not use distribution and redistribution in their titles, since they do not show distribution and redistribution from one party to another, but just show the income from the point of view of one party. Because there is no account corresponding to use of income in the international accounts, the change in pension entitlements term appears as a single item after secondary income account; cross-border pensions are minor for most economies.
- 26.36 The primary and secondary income accounts are broadly parallel to the SNA accounts allocation of primary income and secondary distribution of income accounts. There are no exact parallels in the international accounts for the production account and use of income account because the

international accounts do not describe production, consumption (or capital formation). Products imported and exported are treated as simple transactions in all cases; whether the products will eventually be used for intermediate consumption, final consumption, capital formation, or re-exported is unknown in the context of the international transaction. The use made of products is entirely domestic in nature.

26.37 Tables 26.3 and 26.4 also show the restricted form of the capital account in the international accounts and the financial account using the functional classification of financial transactions rather than the instrument classification used in the SNA. The functional classification is described below in section D. (The explanation of the shaded cell for reserves liabilities is explained in section D also.).

Table 26.3 Overview of Balance of Payments

| | Credits | Debits | Balance |
|--|---------|--------|---------|
| Current accounts | | | |
| <i>Goods and services account</i> | | | |
| Goods | 462 | 392 | |
| Services | 78 | 107 | |
| <i>Goods and services</i> | 540 | 499 | 41 |
| <i>Primary income account</i> | | | |
| Compensation of employees | 6 | 2 | |
| Interest | 13 | 21 | |
| Distributed income of corporations | 36 | 17 | |
| Reinvested earnings | 14 | 0 | |
| <i>Primary income account</i> | 69 | 40 | 29 |
| <i>Goods, services and primary income</i> | 609 | 539 | 70 |
| <i>Secondary income account</i> | | | |
| Current taxes on income, wealth, etc. | 1 | 0 | |
| Net non-life insurance premiums | 2 | 11 | |
| Non-life insurance claims | 12 | 3 | |
| Current international transfers | 1 | 31 | |
| Miscellaneous current transfers | 1 | 10 | |
| <i>Secondary income</i> | 17 | 55 | -38 |
| <i>Current account balance</i> | | | 32 |
| Capital account | | | |
| Acquisition or disposals of non-produced assets | 0 | 0 | |
| Capital transfers | 1 | 4 | |
| <i>Capital account balance</i> | | | -3 |
| <i>Net lending (+) or net borrowing (-)</i> | | | |
| Financial account (by functional category) | | | |
| Direct investment | -4 | 8 | |
| Portfolio investment | 17 | 7 | |
| Financial derivatives (other than reserves) and ESOs | 3 | 0 | |
| Other investment | 42 | 22 | |
| Reserve assets | 8 | | |
| <i>Total changes in assets or liabilities</i> | 66 | 37 | |
| <i>Net lending (+) or net borrowing (-)</i> | | | 29 |
| <i>Net errors and omissions</i> | | | 0 |

1. Goods and services account

- 26.38 The goods and services account consists only of imports and exports of goods and services because these are the only transactions in goods and services with a cross-border dimension.
- 26.39 The balance of payments gives emphasis to the distinction between goods and services. This distinction reflects policy interests, in that there are separate international treaties covering goods and services. It also reflects data issues, in that data on goods are usually obtained from customs sources, while data on services are usually obtained from payments or surveys.
- 26.40 The main source of data for goods is international merchandise trade statistics (IMTS). International standards are given in United Nations, *International Merchandise Trade Statistics: Concepts and Definitions*. BPM6 identifies some sources of difference that may occur in some or all countries. It also recommends a standard reconciliation table to assist users in understanding these differences. One major source of difference is that the standards for IMTS use a CIF-type (cost, insurance and freight) valuation for imports, while the balance of payments use a uniform FOB valuation for both exports and imports. It is therefore necessary to exclude freight and insurance costs incurred between the customs frontier of the exporter and the customs frontier of the importer. Because of variations between the FOB-type valuation and actual contractual arrangements, some freight and insurance costs need to be rerouted.
- 26.41 The change of ownership basis used for the balance of payments means that goods entries will have a consistent time of reporting to the corresponding financial flows. In BPM6, there are no longer exceptions to the change of ownership principle. In contrast, IMTS follow the timing of customs processing. While this timing is often an acceptable approximation, adjustments may be needed in some cases, such as goods sent on consignment. In the case of goods sent abroad for processing with no change of ownership, the values of goods movements are included in IMTS, but changes in ownership are the primary presentation in the balance of payments (although the value of goods movements are recommended as supplementary items to understand the nature of these arrangements, including the proportion of value added). Further details of the recording of these processing arrangements are given in Chapter 21. Other adjustments to IMTS may be needed to bring estimates into line with the change of economic ownership of goods, either generally or because of the particular coverage of each country. Possible examples include merchanting, nonmonetary gold, goods entering or leaving the territory illegally, goods procured in ports by carriers, and goods where there has been no change of ownership.
- 26.42 Re-exports are foreign goods (goods produced in other economies and previously imported) that are exported with no substantial transformation from the state in which they were previously imported. Because re-exported goods are not produced in the economy concerned, they have less connection to the economy than other exports. Economies that are major trans-shipment points and locations of wholesalers often have large values of re-exports. Re-exports increase the figures for both imports and exports and when re-exporting is significant the proportions of imports and exports to economic aggregates are increased also. It is therefore useful to show re-exports separately.
- 26.43 Goods are presented at an aggregate level in the balance of payments. More detailed commodity breakdowns can be obtained from IMTS data.
- 26.44 Detail is produced for the following 12 standard components of services:
- a. Manufacturing services on physical inputs owned by others;
 - b. Maintenance and repair services n.i.e.;
 - c. Transport;
 - d. Travel;

- e. Construction;
- f. Insurance and pension services;
- g. Financial services;
- h. Charges for the use of intellectual property n.i.e.;
- i. Telecommunications, computer and information services;
- j. Other business services;
- k. Personal, cultural and recreational services; and
- l. Government goods and services n.i.e.

26.45 In addition, there are supplementary items and an extended list. Three of the standard components are transactor-based items, that is, they relate to the acquirer or provider, rather than the product itself. These categories are travel, construction and government goods and services n.i.e. To illustrate, travel covers all goods or services acquired by non-residents during visits whether for own use or to give away. Travel includes goods, local transport, accommodation, meals and other services. Besides the three transactor-based items, the remaining components are product-based, built from the more detailed classes of the Central Product Classification. Additional standards for services trade are shown in United Nations *Manual on Statistics of International Trade in Services*, which is fully harmonized with the international accounts.

26.46 In addition to the statistics on the international financial flows associated with direct investment, information on foreign-controlled enterprises is provided through statistics on the Activities of Multinational Enterprises (AMNE statistics) and the closely related Foreign Affiliates Statistics (FATS). These cover items such as exports, imports, domestic sales and domestic purchases of goods and services. They therefore provide a wider picture of the operations of multinational enterprises. Additional information is available in Eurostat *Recommendations Manual on the Production of Foreign Affiliates Statistics*, the OECD *Handbook on Economic Globalisation Indicators* and United Nations *Manual on Statistics of International Trade in Services*.

1. The primary income account

26.47 The entries in the primary income account are concerned with property income. Rent may arise in cross-border situations, but rarely, because all land and buildings are deemed to be owned by residents, if necessary by a notional resident unit. An example where rent may be recorded in the international accounts may be short-term fishing rights in territorial waters provided to foreign fishing fleets. It is therefore common in the international accounts to use the term investment income meaning property income excluding rent. Investment income therefore reflects income arising from the ownership of financial assets and the disaggregation of investment income matches that of financial assets and liabilities so that rates of return can be calculated.

26.48 In BPM6, interest flows are measured on exactly the same basis as in the SNA with FISIM separated and treated as an import or export of financial services.

Income of direct investment enterprises

26.49 The role of direct investment enterprises is particularly important and reflected in both the flows and positions in the international accounts.

26.50 As noted in the discussion of direct investment, the retained earnings of direct investment enterprises are deemed to be payable to the investor and reinvested in the enterprise. Reinvested

earnings is defined as the direct investor's share of the retained earnings of a direct investment enterprise. Retained earnings of an enterprise shows the net earnings from production, primary income and secondary income transactions before attributing reinvested earnings. It is equal to net operating surplus, plus primary income and current transfers receivable, minus primary income (excluding reinvested earnings payable to the enterprise's direct investors) and current transfers payable. Consistent with the SNA definitions of income and saving, the definition of reinvested earnings excludes holding gains or losses, write-offs of assets and provisions that are internal accounting entries. Retained earnings should be calculated using net income concepts from which consumption of fixed capital, on the standard SNA basis, is excluded. Reinvested earnings accrued from any immediate subsidiaries are included. Reinvested earnings may be negative, for example where the enterprise makes a loss or where dividends are distributed from holding gains, or in a quarter when an annual dividend is paid.

- 26.51 This definition of reinvested earnings is consistent with the SNA concepts of disposable income and saving of the enterprise, before deduction of reinvested earnings. As a consequence, fully-owned subsidiaries have no saving or disposable income of their own; the saving and income is all attributed to the direct investors.

2. Secondary income account

- 26.52 The entries in the secondary income account are transfers. Several of these are particularly important in the international accounts, especially current international cooperation and remittances sent to their home countries by individuals working abroad on either a short or long term basis.
- 26.53 Cross-border personal transfers are household-to-household transfers and are of interest because they are an important source of international funding for some countries that provide large numbers of long-term workers abroad. Personal transfers include remittances by long-term workers, that is, those who change their economy of residence to the host economy.
- 26.54 Other workers, such as border and seasonal workers do not change their economy of residence from the home economy. Instead of transfers, the international transactions of these workers include compensation of employees, taxes and travel costs. A supplementary presentation of personal remittances brings together personal transfers with these related items. Personal remittances include personal transfers, compensation of employees less taxes and travel, and capital transfers between households. For further details, see Appendix 5 Remittances in BPM6.
- 26.55 Insurance flows, especially flows relating to reinsurance, can be important internationally. These flows are recorded in the same way as in the SNA, both as regards the separation of a financial service charge and the treatment of direct insurance and reinsurance flows separately and not on a consolidated basis.

3. Balancing items in the current accounts of the international accounts

- 26.56 The structure of the balancing items in the balance of payments is somewhat different from that in the SNA, in that each account has its own balancing item and another that carries down to the next account. To illustrate, the primary account has its own balancing item (balance on primary income) and a cumulative balance (balance on goods, services and primary income). The external balance on primary income corresponds to balance of primary incomes and is the item feeding into GNI. The current external balance corresponds to saving.

4. The capital account

- 26.57 The elements of the capital account subject to international transactions are more restricted than those covered in the SNA. The entries in the capital account cover acquisitions and disposals of

nonproduced nonfinancial assets and capital transfers. There are no transactions recorded as capital formation of produced assets, as capital formation is an intra-enterprise process.

- 26.58 Like the SNA, net lending or net borrowing is the balancing item for the sum of the current and capital accounts and for the financial account. As in the SNA, it covers all instruments used for providing or acquiring funding, not just lending and borrowing. Conceptually, it has the same value as the national accounts item for the total economy, and the same as the national accounts item for the rest of the world but with the sign reversed.

5. The financial account and IIP

- 26.59 The financial account of the balance of payments and the IIP are of particular importance because they provide an understanding of international financing as well as of international liquidity and vulnerability. The integrated IIP statement, including the IIP and associated financial and other changes accounts, is shown in Table 26.4. The primary classification is based on functional categories, with additional data on instruments and institutional sectors.

- 26.60 The part of the balance sheets covered in the international accounts is called the IIP. The terminology highlights the specific components of the national balance sheet which are included. The IIP covers only financial assets and liabilities because, to be included in the IIP, there must be a cross-border element. In the case of financial claims, the cross-border element arises when one party is a resident and the other party is a non-resident. In addition, while gold bullion is an asset that has no counterpart liability, it is included in the IIP when held as reserve assets, because of its role in international payments. However, nonfinancial assets are excluded as they do not have a counterpart liability or other international aspect.

- 26.61 Stocks of assets and liabilities are usually called “positions” in the international accounts, as the term “stocks” is associated with shares. The balancing item on the IIP is the net IIP. The net IIP plus nonfinancial assets in the national balance sheet equal national net worth, because resident-to-resident financial claims net to zero in the national balance sheet.

- 26.62 It is useful to group the different types of debt instruments, because debt instruments have particular implications for international liquidity and risk. Debt instruments are those instruments that require the payment of principal or interest or both at some point(s) in the future. Debt instruments comprise special drawing rights, currency and deposits, debt securities, loans, insurance technical reserves and provision for calls under standardized guarantees, and other accounts receivable/payable. Debt instruments can be contrasted with equity and investment shares in the nature of the liability and risk. While equity gives a residual claim on the assets of the entity, a debt instrument involves an obligation to pay an amount of principal or interest usually according to a predefined formula, which means that the creditor has a more limited risk exposure. In contrast, the return on equity is largely dependent on the economic performance of the issuer, so the holders bear more of the risk. Additional information is provided in IMF, *External Debt Statistics: Guide for Compilers and Users*.

- 26.63 Debt instrument flows and positions are shown divided between long-term and short-term. Primarily, this split is according to their original maturity, that is, the period from issue until contractually scheduled final payment. In addition, because of the international accounts concern with international liquidity issues, liability data can also be prepared on the basis of remaining maturity, that is, the period from the reference date until contractually scheduled final payment.

- 26.64 The same level of detail is used for investment income and the IIP. As a result, average rates of return can be calculated. Rates of return can be compared over time and for different instruments and maturities. For example, the trends in return on direct investment can be analyzed, or the return can be compared with other instruments.

6. The other changes in assets accounts

26.65 The breakdown into assets and liabilities denominated in domestic and foreign currency may be of particular interest in international accounts, because of the different implications of exchange rate movements.

26.66 International assets and liabilities may be subject to other changes in the volume of assets and liabilities and to revaluation changes. Because instruments are often denominated in foreign currencies and analysis of the effect of exchange rate movements is particularly important, there is a breakdown of revaluations into exchange rate changes and other factors.

Table 26.4 Overview of Integrated International Investment Position Statement

| | Opening position | Transactions (Financial account) | Other changes in the volume of assets | Revaluation | Closing position |
|--|------------------|----------------------------------|---------------------------------------|-------------|------------------|
| Assets (by functional category) | | | | | |
| Direct investment | 42 | -4 | 0 | 1 | 39 |
| Portfolio investment | 40 | 17 | 0 | 2 | 59 |
| Financial derivatives (other than reserves) and ESOs | 0 | 3 | 0 | 0 | 3 |
| Other investment | 152 | 42 | 0 | 0 | 194 |
| Reserve assets | 63 | 8 | 0 | 0 | 71 |
| <i>Total</i> | 297 | 66 | 0 | 3 | 366 |
| Liabilities (by functional category) | | | | | |
| Direct investment | 132 | 8 | 0 | 2 | 142 |
| Portfolio investment | 180 | 7 | 0 | 5 | 192 |
| Financial derivatives (other than reserves) and ESOs | 0 | 0 | 0 | 0 | 0 |
| Other investment | 261 | 22 | 0 | 0 | 283 |
| <i>Total</i> | 573 | 37 | 0 | 7 | 617 |
| Net IIP | -276 | 29 | 0 | -4 | -251 |

D. International accounts functional categories

26.67 The international accounts functional categories are the primary classification used for each of investment income, financial transactions and positions in the international accounts. The following five categories are identified:

- a. direct investment;
- b. portfolio investment;
- c. financial derivatives (other than reserves) and employee stock options;
- d. other investment; and
- e. reserve assets.

26.68 Detailed definitions are given later in this section. The functional categories are built on the classification of financial instruments discussed in Chapters 11 and 13, but with an additional dimension that takes into account some aspects of the relationship between the parties and the motivation for investment. As a result, the different categories exhibit different patterns of

behaviour. For example, there is a different type of relationship between the parties for direct investors compared to portfolio investors holding equity. Direct investment is related to control or a significant degree of influence, and tends to be associated with a lasting relationship although it may be short-term. In addition to funds, direct investors often supply additional factors such as knowhow, technology, management and marketing. As well, related companies are more likely to trade with and lend to each other. In contrast, portfolio investors typically have a smaller role in the decision-making of the enterprise, with potentially important implications for future flows, and for the volatility of the price and volume of positions. Portfolio investment differs from other investment in that it provides a direct way to access financial markets, and so can provide liquidity and flexibility.

- 26.69 Reserve assets include a range of instruments that are shown under other categories when not owned by monetary authorities or other units authorised by the monetary authorities. However, as reserve assets, they are managed as a whole and have the distinctive motivation of being available to meet international payments financing needs and undertake market intervention to influence the exchange rate.
- 26.70 The instrument classification alone does not fully reflect these behavioural differences. For example, a loan can appear under direct investment or other investment, but the different nature of the relationship between the parties means that the risks and motivations behind the transaction tend to differ. A direct investment loan is more likely to be provided and involves less vulnerability on the part of the borrowing economy because of the relationship between the parties. Table 26.5 shows the relationship between instruments and functional categories.

1. Direct investment

- 26.71 *Direct investment is a category of cross-border investment associated with a resident in one economy having control or a significant degree of influence on the management of an enterprise that is resident in another economy.* As well as the equity that gives rise to control or influence, direct investment also includes associated debt (except debt between affiliated financial intermediaries).
- 26.72 Control is determined to exist if the direct investor owns more than 50 per cent of the voting power in the direct investment enterprise. Such an enterprise is called a subsidiary. A significant degree of influence is determined to exist if the direct investor owns from 10 to 50 percent of the voting power in the direct investment enterprise. Such an enterprise is called an associate. In order to achieve bilateral consistency and avoid subjective decisions about actual control or influence, these operational definitions should be used in all cases.
- 26.73 As well as immediate direct investment relationships, there may be indirect direct investment relationships, as a result of a chain of ownership. In addition, fellow enterprises may be an important part of direct investment. (Fellow enterprises are direct investment enterprises that have less than ten per cent equity in each other but which share a common investor that is a direct investor of at least one of the fellows). Reverse investment arises when direct investment enterprises invest in their own direct investors.
- 26.74 Direct investment includes debt between the parties as well as equity. Such debt between related companies may be called intercompany lending. One of the features of a group of direct investment group is that its members are more likely to extend loans and trade credit to each other than are unrelated enterprises.
- 26.75 Because of the relationship of control or influence, the direct investor's share of retained earnings of a subsidiary or associate is imputed as being paid out and reinvested. A second imputation is made to show the direct investor reinvesting the same value in the company. The income item is called reinvested earnings, with a corresponding equal entry in the financial account called reinvestment of earnings. Reinvested earnings are defined as the direct investor's share in the disposable income or

saving of the enterprise, and so are consistent with the corresponding SNA items. A consequence is that there will be no saving by a fully-owned subsidiary, because all saving will be attributed to its direct investor. In other words, the direct investor will be shown as making the relevant saving and investment decisions.

- 26.76 Direct investment enterprises approximately correspond to the SNA's foreign-controlled enterprises. However they differ to the extent that direct investment includes enterprises with a significant degree of influence and seeks to avoid discretionary aspects to the concept of control used in the SNA. The SNA's foreign-controlled enterprises are limited to inward direct investment, while the international accounts are also concerned with outward direct investment. Reinvested earnings on foreign direct investment in the SNA has the same scope as the balance of payments (although "foreign" is not used because it is redundant in the context of the international accounts).

1. Portfolio investment

- 26.77 *Portfolio investment is defined as cross-border transactions and positions involving debt or equity securities, other than those included in direct investment or reserve assets.* Securities are instruments designed for convenient negotiability between parties, such as shares, bonds, notes and money market instruments. The negotiability of securities is a way of facilitating trading, allowing them to be held by different parties during their lives. Negotiability allows investors to diversify their portfolios and to withdraw their investment readily.

- 26.78 Portfolio investment depends on organized financial markets, and with associated bodies such as dealers, exchanges, and regulators. In contrast, the parties to direct and other investment instruments usually deal directly with each other. The negotiability of portfolio investment instruments makes them a convenient and flexible investment channel, but also may be associated with volatility.

2. Financial Derivatives (Other than Reserves) and Employee Stock Options

- 26.79 The definition of the functional category financial derivatives and employee stock options (other than reserves) largely coincides with the corresponding financial instrument class, discussed in Chapters 11 and 13. The difference in coverage between the functional category and the financial instrument is that financial derivatives associated with reserve asset management are excluded from the functional category and included in reserve assets. This category is identified separately because it relates to risk transfer, rather than supply of funds or other resources.

3. Other investment

- 26.80 Other investment is a residual category that includes positions and transactions other than those included in direct investment, portfolio investment, financial derivatives and employee stock options and reserve assets. It includes the remainder of the following classes of financial assets and liabilities:

- a. other equity;
- b. currency and deposits;
- c. loans (including use of IMF credit and loans from the IMF);
- d. non-life insurance technical reserves, life insurance and annuities entitlements, pension entitlements and provisions for calls under standardized guarantees;
- e. trade credit and advances;
- f. other accounts receivable/payable; and

g. SDR allocations (SDR holdings are included in reserve assets.).

4. Reserve assets

26.81 Reserve assets are those external assets that are readily available to and controlled by monetary authorities for meeting balance of payments financing needs, for intervention in exchange markets to affect the currency exchange rate and for other related purposes (such as maintaining confidence in the currency and the economy, and serving as a basis for foreign borrowing). Reserve assets must be denominated and settled in foreign currency and potential assets are excluded. Underlying the concept of reserve assets are the notions of “control” and “availability for use” by the monetary authorities.

26.82 In general, only external claims actually owned by the monetary authorities can be classified as reserve assets. Nonetheless, ownership is not the only condition that confers control. In cases where institutional units (other than the monetary authorities) in the reporting economy hold legal title to external foreign currency assets and are permitted to do so only on terms specified by the monetary authorities or only with their express approval, such assets can be considered reserve assets. This is because such assets are under the direct and effective control of the monetary authorities.

26.83 Reserve assets must be readily available in the most unconditional form. A reserve asset is liquid in that the asset can be bought, sold and liquidated for foreign currency (cash) with minimum cost and time, and without unduly affecting the value of the asset. This concept refers to both nonmarketable assets, such as demand deposits, and marketable assets, such as securities where there are ready and willing sellers and buyers. In order to be readily available to the authorities to meet balance of payments financing needs and other related purposes under adverse circumstances, reserve assets generally should be of high quality.

26.84 Reserve assets are limited to assets, but a memorandum item is provided for reserve-related liabilities that are included in other functional categories, mainly portfolio and other investment. (This is why the liabilities cell for reserves in table 2,1 is shaded.)

Table 26.5 Link between Financial Assets Classification and Functional Categories

| SNA/MFSM Financial Assets and Liabilities Classification | Functional categories | | | | |
|--|-----------------------|----|----|-----|-----|
| | DI | PI | FD | OI | RA |
| Monetary gold | | | | | X |
| Special drawing rights | | | | X*1 | X*1 |
| Currency and deposits: | | | | | |
| Currency | | | | X | X |
| Interbank positions | | | | X | X |
| Other transferable deposits | X | | | X | X |
| Other deposits | X | | | X | X |
| Debt securities | X | X | | | X |
| Loans | X | | | X | X |
| Equity and investment fund shares: | | | | | |
| Equity: | | | | | |
| Listed shares | X | X | | | X |
| Unlisted shares | X | X | | | X*2 |
| Other equity | X | | | x | |
| Investment fund shares/units: | | | | | |
| Money market fund shares/units | x | X | | | X |
| Other investment fund shares/units | x | X | | x | X |

| | | | | | |
|--|---|--|---|---|---|
| Insurance, pension and standardized guarantee schemes: | | | | | |
| Nonlife insurance technical reserves | x | | | X | |
| Life insurance and annuity entitlements | x | | | X | |
| Pension entitlements | | | | X | |
| Claims of pension funds on sponsors | X | | | X | |
| Entitlements to nonpension benefits | | | | X | |
| Provisions for calls under standardized guarantees | X | | | X | |
| Financial derivatives and employee stock options: | | | | | |
| Financial derivatives | | | X | | X |
| Employee stock options | | | X | | |
| Other accounts receivable/payable: | | | | | |
| Trade credit and advances | X | | | X | |
| Other accounts receivable/payable | X | | | X | |

DI—direct investment; PI—portfolio investment; FD—financial derivatives (other than reserves) and employee stock options; OI—other investment; RA—reserve assets.

X shows applicable functional categories; x shows cases that are considered to be relatively uncommon.

*1 SDRs: Assets—Reserve assets; Liabilities—Other investment.

*2 Unlisted shares must be liquid.

E. Special international accounts considerations

1. Global imbalances

26.85 In recent years, the IMF has done extensive work on global imbalances. By summing data for all economies, global totals can be derived. There is conceptual consistency between corresponding credit and debit items, investment income payable and receivable, portfolio investment assets and portfolio investment liabilities, and so on. (Although as a functional category, reserve assets have no counterpart liability, the constituent instruments can be allocated to their counterpart liabilities for an exercise of the type described here.) The extent of actual inconsistency has been used to identify systematic biases, that can indicate reporting problems, for example, that services credits have higher coverage than services debits.

1. Exceptional financing

26.86 Exceptional financing brings together financial arrangements made by the authorities to meet balance of payments needs. Exceptional financing therefore identifies transactions according to their motivation. In addition, the incurrence of arrears is included in exceptional financing. Although it is unilateral, and therefore not a transaction, it is an action the monetary authorities may take to manage their payments requirements.

26.87 Exceptional financing is presented in the “analytic” presentation of the balance of payments, as published in the IMF’s *Balance of Payments Statistics Yearbook*. In this presentation, entries relating to reserves, IMF credit and exceptional financing are presented “below-the-line” while all the other entries, which will require funding, are shown above-the-line. This presentation facilitates looking at the monetary authorities’ international liquidity.

2. Debt reorganization

26.88 Debt reorganization (also referred as debt restructuring) is defined as arrangements involving both the creditor and the debtor (and sometimes third parties) that alter the terms established for servicing an existing debt. Governments are often involved in debt reorganization, as a debtor, or a creditor or a guarantor, but debt reorganization can also involve the private sector, such as through debt exchanges. Debt reorganization involves a range of different types of transactions as well as valuation and timing issues.

26.89 The four main types of debt reorganization are:

- a. Debt forgiveness; a reduction in the amount of, or the extinguishing of, a debt obligation by the creditor via a contractual arrangement with the debtor;
- b. Debt rescheduling or refinancing; a change in the terms and conditions of the amount owed, which may result, or not, in a reduction in burden in present value terms;
- c. Debt conversion; the creditor exchanges the debt claim for something of economic value, other than another debt claim on the same debtor, such as debt-for-equity swaps, debt-for-real-estate swaps, debt-for-development swaps, debt-for-nature swaps, and for debt prepayments, debt-for-cash; and
- d. Debt assumption and debt payments on behalf of others when a third party is also involved.

Debt forgiveness across economies often involves government and there is further guidance on the treatments of these arrangements in chapter 22, BPM6 and specialised manuals such as the *External Debt Guide*.

3. Regional arrangements, including currency unions

26.90 Regional arrangements include:

- a. monetary and currency unions, which provide for a single monetary policy across an area. Some of the same issues apply when one economy unilaterally adopts the currency of another economy, such as with “dollarization”;
- b. economic unions, which harmonize certain economic policies to foster greater economic integration; and
- c. customs unions, which have common tariff and other trade policies with nonmember economies.

Among the issues that are dealt with are the production of consolidated data for a union as a whole, the treatment of regional organizations, including the central bank, treatment of banknotes in a currency union, and revenue-sharing arrangements in a currency union. BPM6 gives detailed guidance on the treatments of these arrangements.

4. Currency conversion, including multiple exchange rates

26.91 Exchange rates must be considered carefully when measuring international transactions and positions, as changes can distort measurement. Flows denominated in a foreign currency are converted to their value in the domestic currency at the rate prevailing when the flows take place, and positions are converted at the rate prevailing on the balance sheet date. The midpoint between the buying and selling rates should be used at the time of transaction (for transactions) and at the close of business on the reference date for positions. The difference between buying/selling prices and midpoint prices represents a service charge.

26.92 In principle, the actual exchange rate applicable to each transaction should be used for currency conversion. The use of a daily average exchange rate for daily transactions usually provides a very

good approximation. If daily rates cannot be applied, average rates for the shortest period should be used. Some transactions occur on a continuous basis, such as the accrual of interest, over a period of time. For such flows, therefore, an average exchange rate for the period in which the flows occur should be used for currency conversion.

- 26.93 Under a multiple exchange rate regime, two or more exchange rates are applicable to different categories of transactions; the rates favour some categories and discourage others. Such rates incorporate elements similar to taxes or subsidies. Because the multiple rates influence the values and the undertaking of transactions expressed in domestic currency, net proceeds implicitly accruing to authorities as a result of these transactions are calculated as implicit taxes or subsidies. The amount of the implicit tax or subsidy for each transaction can be calculated as the difference between the value of the transaction in domestic currency at the actual exchange rate applicable and the value of the transaction at a unitary rate that is calculated as a weighted average of all official rates used for external transactions. For conversion of positions of external financial assets and liabilities in a multiple rate system, the actual exchange rate applicable to specific assets or liabilities at the beginning or end of the accounting period is used.
- 26.94 Parallel (unofficial) or black market rates cannot be ignored in the context of a multiple rate regime and can be treated in different ways. For instance, if there is one official rate and a parallel market rate, the two should be handled separately. Transactions in parallel markets should be converted using the exchange rate applicable in that market. If there are multiple official rates and a parallel rate, the official rates and the parallel rate should be treated as distinct markets in any calculation of a unitary rate. Transactions effected at the parallel rate usually should be separately converted at that rate. However, in some instances, parallel markets may be considered effectively integrated with the official exchange rate regime. Such is the case when most or all transactions in the parallel market are sanctioned by the authorities or when the authorities actively intervene in the market to affect the parallel rate. In this instance, the calculation of the unitary rate should include both the official and parallel market rates. If only limited transactions in the parallel market are sanctioned by the authorities, the parallel rate should not be included in the calculation of a unitary rate.