SNA/M1.12/2.6

7th Meeting of the Advisory Expert Group on National Accounts, 23-25 April 2012, New York

Agenda item) **: II**
: Current research issues and the provision of further guidance on the implementation of the 2008 SNA
: Other issues (part I)

Introduction

On 25-27 October 2011, the OECD organised a workshop on the implementation of the 2008 SNA. At the workshop, a need for further clarification of a number of issues was expressed in. More specifically, questions were raised in relation to the delineation and classification of holding companies, head offices, and Special Purpose Entities (SPEs), the measurement of pension liabilities, the recording and measurement of land and natural resources, the measurement of (service lives of) military expenditures, and the definition of catastrophes in the measurement of non-life insurance. A paper by the ABS raises questions about the definition and measurement of capital services which were introduced in the 2008 SNA. Under this agenda item, these issues will be discussed, with the exception of the measurement of pension liabilities. The latter issue is included in a separate agenda item.

Guidance on documentation provided

Under this item, three issue notes are included:

- The recording and measurement of land and natural resources (and dwellings);
- The delineation and classification of holding companies, head offices, and Special Purpose Entities (SPEs);
- A combined note on issues related to military expenditures and the definition of catastrophes in the measurement of non-life insurance.
- The definition and measurement of capital services

Mains issues to be discussed

See the relevant issue notes.

SNA/M1.12/2.6.1

7th Meeting of the Advisory Expert Group on National Accounts, 23-25 April 2012, New York

Agenda item : II
Sub item : Other issues (part I)

ISSUES NOTE: THE RECORDING AND MEASUREMENT OF LAND AND NATURAL RESOURCES (AND DWELLINGS)

ISSUES NOTE: THE RECORDING AND MEASUREMENT OF LAND AND NATURAL RESOURCES (AND DWELLINGS)

INTRODUCTION

1. It is recognised that "land is a quantitatively important asset that is notoriously difficult to measure" (OECD, 2009). Previous country comparison exercises on the availability of methods to value land and related natural resources were undertaken by OECD (2007, 2008, and 2011). OECD (2009, Chapter 18) also captures specific practical issues related to the valuation of land and dwellings. These notes all highlight the difficulties in recording and measuring land and natural resources (now just referred to as land). The issue was given increased prominence more recently within Recommendation 15 (Sector Accounts) of the G20 Data Gaps initiative (Financial Stability Board, 2011), which describes a need for more detailed information on non-financial assets, including in particular land.

2. In response to this, the OECD developed and launched a questionnaire on land towards the end of 2011 as an input to its 2008 SNA Implementation Workshop. Delegates supported the idea of a dedicated Workshop to tackle issues related to land and also dwellings. Twenty three countries responded to the questionnaire. Experiences ranged widely, from having no information on the valuation of land to using specific estimation techniques and country related data to estimate either sub-aggregates or the total value of land. For example, of those countries that responded to the survey, the total value of land for the balance sheet was available for countries: Australia, Canada, Czech Republic, Finland, France, Japan, Korea, Mexico, Sweden and the United Kingdom. Partial estimates were available for sub-classifications for countries: Austria, Italy, and The Netherlands.

3. A number of countries requested greater guidance on practical issues relating to the recording and measurement of land. This short note captures the main issues raised by individual countries and proposes a series of specific discussion points for the AEG that could serve as input into the forthcoming Workshop.

SUMMARY OF PRACTICAL ISSUES

4. *Choice of methodology*: There is no common method used to estimate land. Similar findings were reported to the earlier country survey (OECD, 2008). The current available methods for valuing land can be grouped within four broad approaches: a) Direct collection via a survey or census, b) use of modeling, such as use of land-to-structure ratios, c) use of administrative data such as land registers or cadastrals, d) derivation by residual using land and dwellings data and deriving land as a residual. Each method has strengths and weaknesses and method choice will depend on the availability of data.

5. *Sub-classifications*: There is no commonly used approach to the sub-classification of land. Within the 2008 SNA there is now no formal disaggregation of land (10.178), as it notes that guidance should come from SEEA. The SEEA currently includes a very detailed sub-classification structure for land. Country experiences show that many different broad classifications of land are used in practice. For example, by use of land type, by taxable land and non-taxable land, and the 1993 SNA classification. The motivation for using different classifications is likely to have been driven by the availability of data, calculation and user requirements. A broad enough classification which facilitates and encourages estimates to be compiled should be considered, for example, of that currently highlighted in the 1993 SNA .

6. *Data sources*: Relevant data sources are one of the main issues in obtaining appropriate estimates. The two most commonly available data sources for asset information are the use of some form of survey or census, or existing records based on administrative data. Where censuses are used, some countries extrapolate the estimates for the intermediate years. Some countries use existing register data from other government departments. Each of these types of data sources has limitations, e.g. coverage, timeliness, or volatility. A combination of different data sources should be used where possible. For example, the use of comprehensive administrative data for addresses and land sizes could be supplemented by regular survey data for valuations to ensure the latest estimates are available. Practical guidance on how to use and update data sources where there is a change in ownership would also be useful.

7. *Separation of land from dwellings*: It is often easier to collect the value of dwellings and other buildings which also includes the value of land. It is then a difficult estimation exercise to separate the value of land. Many countries use a proportion or residual method to estimate the value of the land from the combined total. Other countries acknowledge this issue and do not attempt to apportion land from the total, and then just publish both estimates together. This can mean that volatility of one asset is reflected in both. The SNA notes that when the value of land cannot be separated the asset should be classified to the structure (10.177). This issue is primarily caused by the limitations of the available data sources. A PIM approach is often used to estimate land values, by firstly estimating the stock of dwellings and other buildings and structures and then subtracting this from a total estimate of land and buildings from the balance sheet. The can lead to estimation issues where the final estimate for land may be negative, or display unrealistic movements. The assumptions for the asset life and method of depreciation used should be assessed closely (see also below). It is important to note that the differentiation of land and building values is not merely an issue for balance sheets. Estimates of GDP can be affected too in those countries that take a user-cost approach to the measurement of imputed rent, typically in developing economies.

8. *Reliable price indices*: Reliable information on land prices is often limited with either no relevant price indices existing or the coverage is not appropriate. Prices are typically based on real estate transactions, survey of existing land values, housing price or construction price indices, and are also affected by the methods used to differentiate between land and buildings. Obtaining different prices for

different types of land is also a challenge, with prices needed for residential, non-residential and cultivated land, where each has different characteristics.

9. *Valuing different sub-classifications of land*: Different sub-classifications of land will have different valuation issues. For example, land prices can develop at different rates depending on the use of land and geographical location, and the ease of collection of relevant information will depend on the type of classification. The valuation of residential and non-residential land will typically require the underlying land to be distinguished from any dwellings or buildings. This can be done by using related data items such as building permits, or land-to-structure ratios. Cultivated land will typically not have these issues and may be able to be estimated directly using the agricultural land area.

10. *Valuing land improvements (investment)*: There are different methods used in practice depending on the data sources available. For example, the use of the PIM, administrative information on agriculture (e.g. capturing clearing of land), use of civil engineering or construction surveys. In the cases where land improvements are not estimated, then this would likely be included within the total value for land, implying a bias to the total estimate.

11. *Depreciation and service lives*: The PIM can be used to estimate the stock of dwellings and other buildings and structures. A value for land can then be derived as a residual by subtracting the stock of dwellings and building estimates from a combined land, dwelling and building value. In practice, the choice of depreciation method is central to the use of the PIM and the treatment of different assets may also differ. For example, buildings will depreciate over time while typically, land is assumed not to depreciate, even if the quality may change i.e. via a reclassification. Additional guidance to describe depreciation methods may be needed for these assets. A specific issue could be the treatment of historic buildings where older (historic) buildings often attract a higher value than newer buildings. Does this only reflect perceived differences in quality or is there a scarcity element that needs to be considered, particularly with regards to different depreciation rates and service lives for these type of assets?

12. *Revaluation and changes in volume*: SNA notes that any change in value that arises from a change in the classification of a building or land, for example from residential to commercial, should be reflected as a volume and not price change; implicitly this means a change in the volume of land (SNA 12.23). However there are some borderline issues where additional guidance might be needed. These relate to spillover effects. For example, if a park is reclassified as land on which residences can be built, the value of the properties overlooking the land is likely to decrease. The increase in the value of the park represents a quality change but the decrease in the value of the surrounding buildings reflects a price change, despite the fact that the 'quality' has changed. Is this consistent with the underlying principle that quality and volume changes are interchangeable? Should guidance be provided in this regard, if only to recommend that for practical purposes these cases should be treated as price changes as it would be difficult to do otherwise (see also 14 below)?

13. *Treatment of land under roads and rail*: Land under roads and rail is covered within SEEA which also gives guidance on the valuation. In this recent review only a small number of countries mentioned this aspect specifically so it was unclear if other countries took this into consideration. In one situation it was noted that land under roads were considered to be owned by government. In some countries, there are now examples of private tollways and private railways, where there would need to be a distinction made between land under the road, and the ownership of the actual road.

14. *Sectorisation and government land*: Full sectorisation of land data is not easily available, again primarily driven by availability of data sources. There was a general consensus that the valuation of government land should be included in the overall estimate of land as it does not constitute double counting although practice did differ between countries (e.g. examples of building a road which would

impact on the value of the surrounding land which may then reflect double counting, or where land is sold and its classification also changes). However, in some countries the value of the land owned by governments is not easily assessed or captured. In such cases the value of the land is derived using a relationship between the land area and surrounding land values. Additional guidance would be useful on deriving sectorised estimates and treatment of land where there is a change in ownership or sector.

15. *Economic value of national parks*: There was a distinct difference between the treatment of national parks between some countries. One country noted that a national park had no economic value and was not in scope of the value of land, while another determined that development of national park assets represented a stored economic value that could be utilized. This is mentioned in SNA 12.21 and one approach may be that the government is deemed to own the national park. Additional guidance may be helpful on this.

16. *Production boundary for resource leases*: This issue highlights a potential need for information on resource leases related to land in the SNA. For tenants (e.g. farmers) the production associated with the use of the land (agricultural output) is captured whereas the cost for using the land are only recorded as property income. The production accounts will therefore record no charge for the use of land which is needed for productivity measurement.

SPECIFIC POINTS FOR DISCUSSION

17. The items highlighted above are not meant to be exhaustive, nor categorised under order of importance. Many are only marginal issues in terms of their economic importance. Some however merit further discussion and so the AEG's views are sought on the following:

(a) Is the development of a comprehensive practical guide to the measurement of land, based on best practice from individual countries, required?

(b) What guidance can be developed to separate the value of land from the dwelling. Should there be an explicit recommendation that fixed ratios (over time) should not be used? [Point 7]

(c) Where estimates for land are derived as a residual, e.g. through the use of the PIM to estimate dwellings and deducting this from a total land and dwellings, what quality assurance mechanisms (including e.g. depreciation rates) can be used to ensure the quality of the final land estimates [Points 1, 11, 12]

(d) Which sub-classification of land is recommended for practical purposes? [Point 5]

(e) Is guidance needed to deal with spillover effects on quality? [Point 12]

(f) When there is a private road or rail, does the land under the structure belong to the government or the owner of the private road or rail? [Point 13]

(g) Should the economic value of National Parks be estimated and included in the total value of land? [Point 15]

(h) Should rents be separately identified on land within property income? [Point 16]

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7th Meeting of the Advisory Expert Group on National Accounts, 23-25 April 2012, New York

Agenda item : II
Sub item : Other issues (part I)

ISSUES NOTE: THE DELINEATION AND CLASSIFICATION OF HEAD OFFICES, HOLDING COMPANIES AND SPES

Issues note: The Delineation and Classification of Head Offices, Holding Companies and SPEs

INTRODUCTION

1. This issue note regarding the delineation and classification of head offices, holding companies and Special Purpose Entities (SPEs) is a follow-up of exchanges during the OECD Workshop on the Implementation of the 2008 SNA which took place in Paris on 25-27 October 2011. It includes the definitions currently available in the *System of National Accounts 2008* (2008 SNA), further clarification and developments in other international manuals as well as a short presentation of the main practical issues, as well as suggestions for dealing with them.

2. A need for further clarification of a number of issues was expressed at the OECD Workshop. In particular, some countries presented their experience in classifying head offices, holding companies and SPEs, also in relation to the new classification of financial subsectors, shared the problems they encountered and raised questions in relation to the delineation and classification of institutional units within these new sub-sectors.

3. Moreover, a survey was launched to better identify the difficulties experienced or envisaged by OECD countries when implementing the 2008 SNA and a large number of countries highlighted the difficulties regarding the delineation of the more detailed subsectors within financial corporation sector (and the provision of information relate to them), expressed the effects they envisaged due to the creation of new financial subsectors and to the move of SPEs and holding companies from the non-financial corporation sector (S11) to the financial corporation sector (S12), and stressed the need for further guidance.

4. This issues paper will serve as a basis for discussions and possible extended follow-up by the ISWGNA and AEG.

CURRENT INTERNATIONAL GUIDANCE

Head offices and holding companies

5. While the 1993 SNA did not give explicit guidance for the treatment of head offices, it recommended that holding companies were to be assigned to the institutional sector in which the main activity of the group of subsidiaries was concentrated. Consequently, they were to be classified as financial corporations only when the main activity of the group of corporations they controlled was financial. More precisely, financial holding corporations were to be allocated either to a specific financial subsector according to the type of financial activity carried out by the group it controlled, or to the subsector "Other financial intermediaries, except insurance corporations and pension funds", if a certain type of financial activity was not predominant; see 1993 SNA, para. 4.100.

6. According to the 2008 SNA, head offices are explicitly distinguished from holding companies. While a head office is assumed to be actively engaged in production, a holding company does not undertake any management activities.

7. The activities of a head office, as defined in section M class 7010 of the ISIC Rev. 4, are as follows:

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

It includes the production of non-financial or financial services depending upon the type of output of its subsidiaries. The 2008 SNA (para. 4.53 and 4.112) recommends that the head office should be allocated to the non-financial corporations sector (S11), unless all or most of its subsidiaries are financial corporations, in which case it is treated, by convention, as a financial auxiliary (S126) in the financial corporations sector (S12).

8. According to section K class 6420 of the ISIC Rev. 4, holding companies are defined as follows:

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

In para. 4.54 of the 2008 SNA, it is stated that "the type of unit properly called a holding company is a unit that holds the assets of subsidiary corporations but does not undertake any management activities". Such units are always allocated to the financial corporations sector and more precisely to the new sub-sector captive financial institutions and money lenders (S127), even if all the subsidiary corporations are non-financial corporations. (2008 SNA, para 4.114).

Special purpose entities

9. The 1993 SNA did not give explicit guidance for treatment of special purpose entities (SPEs). Currently, a variety of definitions of SPEs exist and there is no universal definition of such units. The 2008 SNA (para. 4.55 to 4.58) affirms that a number of institutional units may be described as special purpose entities (SPEs) or special purpose vehicles, but that there is no common definition of an SPE. Instead it gives some of the characteristics which may apply to SPEs (para. 4.56):

- Often no employees and no non-financial assets;

- Little physical presence beyond a “brass plate” confirming their place of registration;
- Always related to another corporation, often as a subsidiary;
- Often resident in a territory other than the territory of residence of the related corporations.

10. Furthermore, the 2008 SNA recommends that these units are treated in the same way as any other institutional unit by being allocated to sector and industry according to their principal activity, either to the non-financial corporation sector (S11) or to one of subsectors of the financial corporation sector (S12), unless they fall into one of the three following categories (para. 4.59 – 4.67):

a. *Captive financial institutions*: units with the characteristics as described in paragraph 9 above, holding companies simply owning the assets of subsidiaries, investment and pension funds and units used for holding and managing wealth for individuals and families, units used for holding assets for securitization, units used for issuing debt securities on behalf of related companies, securitization vehicles to carry out other financial functions.

b. *Artificial subsidiaries of corporations*: these types of SPEs do not satisfy the definition of an institutional unit in the SNA because they lack the ability to act independently from their parent corporation. They are thus treated as an integral part of their parent and their accounts are consolidated with those of their parent, unless they are resident in an economy different from that where their parent is resident.

c. *Special purpose units of general government*: these units, set up by the general government, do not have the power to act independently. As a consequence, if they are resident, they are treated as an integral part of general government and not as separate units, and if they are non-resident, they are treated as separate units.

11. In relation to captive financial institutions, the 2008 SNA goes on saying that, leaving apart the SPEs controlled by non-residents which are to be considered as separate institutional units by convention, “the degree of independence from its parent may be demonstrated by exercising some substantive control over its assets and liabilities to the extent of carrying the risks and reaping the rewards associated with the assets and liabilities”. Such units having a resident parent and having the characteristics of an institutional unit should be classified in S127 (Captive financial institutions and money lenders), together with the captive financial institutions controlled by non-residents. Artificial subsidiaries of corporations controlled by a non-resident parent are to be incorporated according to their main activity, whereas special purpose units of a non-resident general government are to be classified according to their main activity (probably in S125, Other financial intermediaries, except insurance corporations and pension funds, or S127).

SUMMARY OF PRACTICAL ISSUES

12. As stated above, a large number of OECD countries encounter difficulties to classify head offices, holding companies and SPEs to institutional sectors according to the (revised) definitions of the 2008 SNA. Most of them ask for additional clarification in definimg these three types of institutional units (e.g., the significance of the operational activity in distinguishing head offices from holding companies), but also a more precise identification of the corporations to be allocated to the new financial subsector S127 (captive financial institutions and money lenders).

13. Given the absence of clear definitions and guidance to assist countries, the decision of national compilers to allocate entities to the non-financial or financial corporations, and even more to the new financial subsectors may be quite different across countries, following their own interpretations and available sources. These ambiguities could lead to differences in national statistics and may seriously limit their comparability.

Head offices and Holding companies

14. One of the main challenges is the correct identification of head offices and holding companies according to the more precise definitions of both kind of units, i.e. the delineation of passive holders of financial assets (holding companies) from corporations having real economic activity by providing services to other units (head offices). Head offices, for which no guidance existed in 1993 SNA, are now to be treated either as non-financial corporations or, by convention, as financial auxiliaries. Holding companies, which used to be broadly defined in the 1993 SNA, possibly encompassing head offices, are now to be allocated exclusively to the subsector S127.

15. For some countries like Austria the consequence of the change in the sector allocation of holding companies from S11 to S12 is a decrease in assets and liabilities of the non-financial corporations sector (S11), and, as a result, a quite dramatic impact on some ratios (like the debt to equity ratio or leverage ratios) of S11 and S12. Furthermore, the position of the new subsector S127 (captive financial institutions and money lenders) will exceed the financial positions of all other financial subsectors (except S122 – Deposit-taking corporations except the Central Bank).

16. Israel has encountered some problems when trying to apply the new treatment in their accounts. The Central Bureau of Statistics found it unclear what level of management control is required to classify a unit as a head office or as a holding company, in particular in the case when the company is responsible for the main business decisions for the entire group and exercises managerial control over the companies of the group. It wonders whether such companies which carry out management type functions but are not actively engaged in production should be classified as holding companies rather than as head offices.

17. Furthermore, Hungary has questions regarding the institutional independence of holding companies. As they state, according to the 2010 ESA (para. 2.14), “head offices and holding companies are institutional units”, whereas according to the 2008 SNA, for holding companies linked to resident corporations, the independence test should be applied (2008 SNA, para. 4.60). On the other hand, the 2008 SNA (para. 4.59) states that holding companies “that simply own the assets of subsidiaries” are to be treated as captive financial institutions. This text phrase seems to suggest an absence of institutional independence. Also para. 4.114, defining the content of S127, contains the same ambiguity, although to a lesser extent. Finally, Hungary wonders about the treatment of holding companies owning only a single corporation, as the definition of holding companies refers to companies holding the assets of a group of subsidiary corporations.

Special Purpose Entities (SPEs)

18. Several definitions of SPEs as well as several denominations (special purpose entity, special purpose vehicle, financial vehicle corporation, special financial institution...) exist in various statistical manuals and there is no internationally standard definition of such entities.[1] Even if an important step forward was made in the 2008 SNA to provide some guidance on the characteristics of SPEs as well as some guidance regarding their allocation to financial subsectors (see above), it does not go into great detail and leaves room for interpretation, and as a consequence for various national statistical treatments.

[1] The OECD Working Party on Financial Statistics is currently establishing a Glossary of main terms and concepts used in the context of the securitization process, of which SPEs.

19. Despite the additional guidance, the criteria for identifying SPEs are not clear enough, which not only results in a set of different types of SPEs, but also in the treatment of other entities as SPEs even if not stricto sensu SPEs. The guide “The Impact of Globalization on National Accounts” dedicates a complete chapter to the statistical treatment of SPEs, and gives practical examples and problems encountered by countries. It also includes decision trees proposed by Eurostat (page 44) and the Netherlands (page 49) which could be useful operational tools for the identification SPEs by national compilers. The same is true for the Eurostat classification scheme on page 64-65 of the same guide, although the groups of units considered as SPEs seems to be very broad.

20. In Hungarian accounts, SPEs, which are all foreign-controlled resident corporations, are identified and separately presented among the non-financial corporations since 2006, because they do not fulfil the criteria laid down in the 1993 SNA for being financial intermediaries and in particular, because none of them are engaged in securitization transactions. According to the new rules in the 2008 SNA, the relevant units should be reclassified into the new S127 subsector (captive financial institutions and money lenders). In this respect, they make a distinction between (i) foreign-controlled SPEs having financial links exclusively with non-residents, to be recorded as captive financial institutions, (ii) other foreign-controlled SPE-type units having financial links with resident corporations, also to be recorded as captive financial institutions, and (iii) SPEs controlled by residents, to be consolidated with their parent.

21. However, Hungary questions the recording of foreign-controlled SPEs having financial links with resident corporations. They would prefer to classify these units in the non-financial corporations sector (consolidated with resident partners). Their balance sheet amounts are not significant enough to distort the figures of the non-financial corporations sector or to improve the quality of the financial corporations sector, but their reclassification into S127 would impact the foreign direct investment transactions and thus not promote the presentation of the Hungarian economic reality. Indeed, large cross-border financial transactions are typical for this category of SPEs which in some countries may form the largest group of SPEs like in the Netherlands.

SPECIFIC POINTS FOR DISCUSSION

22. The items highlighted above are not meant to be exhaustive, nor are they categorized in order of importance. Many may only be marginal issues in terms of their economic importance or correspond to difficulties raised by OECD countries. Some however merit further discussion and so the AEG's views are sought on the following:

(a) What further guidance may need to be developed to define the new financial subsectors: S125 (Other financial intermediaries, except insurance corporations and pension funds), S126 (Financial auxiliaries) and S127 (Captive financial institutions and money lenders)? Which reliable data sources should be developed to better capture these three categories?

(b) What is the exact difference between head offices and holding companies? In particular, what level of management control over its subsidiaries is required for a company to be classified as head office? How to measure the borderline between “providing” and “not providing” any other services? Is a company which has no significant production at its own and does not undertake any day-to-day operations, but issues bonds and provides part of the management services a holding company or a head office? Can a head office hold the assets of its subsidiaries? Is there a more precise definition of the assets held by holding companies? Does the income of holding companies only relate to the assets of the group of the subsidiary corporations?

(c) What are the defining characteristics to test the independence of holding companies? Should a company which only hold the assets of a single corporation be treated the same way as holding companies which are defined as units that hold the assets of a group of subsidiary corporations?

(d) Are all head offices to be classified as financial auxiliaries, when most of their subsidiaries are financial corporations, even if these subsidiaries belong to the same financial subsector, for example insurance corporations (S128)?

(e) What is the difference between Financial Vehicle Corporations (FVCs) engaged in securitization, to be classified in S125, and SPEs holding assets for securitization, to be classified in S127?

(f) In which subsector should SPEs of non-resident general government be classified?

(g) More generally, could the AEG provide more guidance on the definition and classification of SPEs?

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7th Meeting of the Advisory Expert Group on National Accounts, 23-25 April 2012, New York

Agenda item : II
Sub item : Other issues (part I)

ISSUES NOTE: CONSUMPTION OF FIXED CAPITAL ON MILITARY EXPENDITURES AND THE DEFINITION OF CATASTROPHES IN THE MEASUREMENT OF NON-LIFE INSURANCE

ISSUES NOTE: CONSUMPTION OF FIXED CAPITAL ON MILITARY EXPENDITURES AND THE DEFINITION OF CATASTROPHES IN THE MEASUREMENT OF NON-LIFE INSURANCE

INTRODUCTION

18. At the OECD Workshop on the implementation of the 2008 SNA, issues were raised in relation to the recording and measurement of consumption of fixed capital on military expenditures and the definition of catastrophes in the measurement of non-life insurance. This issue note shortly describes the related problems. The AEG is requested to provide further advice on both issues.

CONSUMPTION OF FIXED CAPITAL ON MILITARY EXPENDITURES

19. One of the more significant changes from the 1993 SNA relates to the recording of expenditures on military weapons systems as gross fixed capital formation, instead of intermediate consumption. Military weapons systems comprise of "… vehicles and other equipment such as warships, submarines, military aircraft, tanks, missile carriers and launchers, etc." (2008 SNA, para A3.55). The relevant expenditures are considered as being "… used continuously in the production of defence services, even if their peacetime use is simply to provide deterrence" (para. A3.55). Furthermore, "single-use items, such as ammunition, missiles, rockets, bombs, etc., delivered by weapons or weapons systems are treated as military inventories. However, some single-use items, such as certain types of ballistic missiles with a highly destructive capability, may provide an ongoing service of deterrence against aggressors and therefore meet the general criteria for classification as fixed assets". (para. A3.56).

20. As a consequence of the above change, intermediate consumption of general government will decrease and consumption of fixed capital will increase. The impact on government output will depend on the difference between both items. If the decrease of intermediate consumption is higher than the increase

of consumption of fixed capital, output will become lower, and vice versa. Value added (gross) of government and GDP will increase with the value of the extra consumption of fixed capital.

21. One conceptual issue in relation to the recording of expenditures on military weapons systems concerns the delineation between other changes in the volume of assets and consumption of fixed capital. Question here is how to account for losses due to the use of weapons systems during wartime and other military operations. The 2008 SNA is not explicit on this delineation. Para. 12.9 does state in more general terms that other changes in the volume of assets do include "… the effects of exceptional, unanticipated events … These events also include those that destroy assets, such as natural disaster or war". However, one could argue that the whole purpose of military weapons systems is deterrence and the possible use in wartime and military operations. On the other hand, wars usually can be considered as exceptional events. All in all, it is proposed here to treat exceptional losses due to wars, etc. as other changes in volume of assets.

22. Another issue relates to the measurement of consumption of fixed capital. Here, the question basically comes down to what service lives and what depreciation profiles are to be used. The US Bureau for Economic Analysis (BEA) consulted with their Department of Defense, and came up with geometric depreciation rates and service lives as presented in the table below. One wonders whether other members of the AEG can provide similar information. And if not, whether the information below could be useful as proxies for other countries as well.

Asset type	**Geometric depreciation rate (percent)**	**Service life (years)**
Aircraft:		
- Air frames	7 to 11	15 to 25
- Engines	28	6
Strategic missiles	N.A. (straight line)	20
Ships	6 to 7	25 to 30
Tanks and armored personnel carriers	8	20

DEFINITION OF CATASTROPHES IN THE MEASUREMENT OF NON-LIFE INSURANCE

23. According to the 1993 SNA, output of non-life insurance should be measured as premiums (including premium supplements in the form of investment income attributed to policy holders) minus claims, all recorded on an accrual basis. This measure could be extremely volatile, and even negative, in the case of very high claims resulting from a major catastrophe. Therefore, the measurement of non-life insurance output has been changed, in the sense that adjusted premiums and adjusted claims are to be applied. Doing so, the 2008 SNA recommends three approaches: the "expectations approach", the

"accounting approach" and the "cost approach". For more details, see 2008 SNA, para. 6.184 – 6.191 and para. A3.32 – A3.36.

24. Another change related to the recording of non-life insurance transactions and catastrophes concerns the recording of claims. According to the 1993 SNA, these claims are to be recorded as current transfers. On the other hand, according to the 2008 SNA, exceptionally large claims, such as those following a catastrophe, may be recorded as capital transfers, as the recording as an income transfer could distort measures such as disposable income and saving. Here, the question arises which claims are to be considered as resulting from a major catastrophe and, consequently, are to be recorded as a capital transfer.

25. At a micro-level, one could probably argue that every claim constitutes a capital transfer, as the claim will relate to the reimbursement of damaged/stolen durable goods and/or assets. Also, again looking from the micro point of view, most claims will distort the disposable income and saving of an individual household or enterprise. However, this certainly is not what the 2008 SNA is suggesting. The 2008 SNA seems to imply that (major) catastrophes are to be defined at a much higher level, e.g. at the national level. However, what constitutes a major catastrophe in a small country may be more or less irrelevant in a major economy. As a consequence, one country may record part of the claims as capital transfers, whereas another country considers them as income transfers. In the case of international trans-border transactions, this may lead to inconsistencies. An alternative approach is to ask the insurance industry to provide data on claims related to major catastrophes, as suggested by the US BEA. Although this may also contain a rather subjective element, it may indeed be the most viable solution.

SPECIFIC POINTS FOR DISCUSSION

26. Regarding military weapons systems, the AEG's views are sought on the following:

(a) What guidance could be given on the recording of the destruction of military weapons systems during wartime and other military operations?

(b) What guidance could be given on the depreciation rates and service lives of military weapons systems?

27. Regarding the recording of transactions related to non-life insurance, the AEG's views are sought on the following:

(a) What guidance could be given in relation to the measurement of capital transfers resulting from major catastrophes?