

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

Agenda item) : III

: Review of the SNA Research Agenda

The Concept of Income

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Introduction

1. This note seeks the guidance of the Advisory Expert Group (AEG) on how to approach one of the most central and inter-penetrating topics in the Research Agenda of the System of National Accounts 2008 (2008 SNA). There are 11 subheadings under The Concept of Income, and the broad question before the AEG is, what process can we set up for grouping and prioritizing these issues?
2. This heading comprises the following issues from 2008 SNA, Annex 4:

C. The Concept of income

1. Clarification of the income concept in the SNA

Broadly, this group of issues deals with the SNA's exclusion of holding gains and losses from income, in contrast with business accounting standards and economic theory.

- Should holding gains and losses be included in SNA income?

2. GDP at basic prices

GDP by expenditure is valued at purchasers' prices and GDP by production at basic prices, the difference between the two being taxes less subsidies on products. At issue is the treatment of taxes less subsidies on products.

- Should GDP be valued throughout at basic prices rather than the current valuation of GDP by expenditure at purchasers' prices and GDP by production at basic prices, with taxes and subsidies on products considered redistributive flows rather than as a component of incomes?

3. The role of taxes in the SNA

- Should taxes and subsidies on products be considered taxes on consumption rather than taxes on income?
- Should the rationale for the SNA's treatment of various taxes be clarified?

4. Life insurance

2008 SNA paragraph A4.27 characterizes this issue as follows. "Holding gains and losses are included in the property income accruing to defined benefit pension beneficiaries but not to the beneficiaries of life insurance policies, an inconsistency that may understate the output of life insurers."

However, as explained in the AEG issues paper 2.7.1, The treatment of holding gains/losses in the estimates of investment income attributable to insurance policyholders and pension beneficiaries, Chapter 17 includes holding gains and losses in the investment income earned on insurance reserves and thus in the premium supplements component of the value of life insurance output, but not in the output of defined benefit pension schemes. So the insurance consistency issue is opposite to the characterization of paragraph A4.27. Specifically:

- Should holding gains (losses) on insurance reserves belonging to the beneficiaries of defined benefit schemes be included in (excluded from) the output of these schemes, and thus treated in the same manner as they are for life insurance?

5. Reinvested earnings

- Should the SNA's (and BPM6's) treatment of the retained earnings of a foreign direct investment enterprise—distributing retained earnings to investors in proportion to their equity shares and reinvesting the earnings in the enterprise, implying that the saving of such enterprises is identically zero—be applied to all (and particularly to public) corporations, with potentially profound impact on national saving?

6. Accruing interest in the SNA

- Should interest on bonds be recorded following the creditor principle, whereby the interest flow (D.41) is equal to the current (market) yield to maturity (CYTM) times the current (market) value of the instrument: its amount therefore varies over time in sympathy with market yield changes, even for fixed-rate instruments?
- Or, should interest be recorded following the debtor principle (currently prescribed by the 2008 SNA), whereby the interest flow (D.41) is equal to the CYTM at time of issue of the instrument times the amount of principal outstanding: its amount is therefore fixed at time of issue for all successive future periods?

7. Calculation of FISIM

The SNA recommends that FISIM should be calculated with respect to a reference rate that contains no service element and reflects the risk and maturity structure of deposits and loans. Different reference rates may be needed for domestic and foreign financial institutions. The assumption behind the FISIM approach is that it is the service element, and not the interest flows, that reflect varying degrees of risk, with riskier clients paying a higher service charge. This assumption has been queried and is being investigated. (2008 SNA, paragraph A4.33)

The second to last sentence refers specifically to the SNA's loan FISIM calculation, but the issue of whether risk remuneration should be included in FISIM is relevant even if the reference rate is high enough that loan FISIM is negligible. (Detailed note below.)

- Should FISIM reflect risk remuneration?

8. High inflation

The impact of inflation on interest rates remains on the SNA Research Agenda, though addressed in Chapter 7 of *Inflation Accounting – A Manual on National Accounting Under Conditions of High Inflation* (OECD, 1996).

- How should expected inflation premia in interest rates be reflected in the national accounts?
9. The measurement of neutral and real holding gains and losses
- Should the decomposition of real and neutral holding gains and losses be based on a single price index or different price indexes for different classes of asset?
10. Income arising from assets
- Should the financial resources available to a producer contribute to value added?
11. Income from activities undertaken on an informal basis

Narrowly, this refers to the exhaustiveness of the national accounts, but provides a potential interface with recently important “progress of societies” initiatives.

- How should developments in measurement of income from informal activities be incorporated into the accounts?

Question for discussion

- How does the AEG prioritize this long and interpenetrating list of income topics?

There are various ways this list might be grouped and prioritized. Issues of consistent treatment of analogous circumstances across the accounts is an important consideration. Under this we might classify research agenda items (1), (4), and (5).

(1) deals with consistency between the SNA and the current state and evolution of commercial and public accounting treatment of holding gains and losses in income: the SNA excludes them while commercial and public accounting standards include holding gains in some form, either realized as well as unrealized holding gains¹, or realized holding gains only. Holding gains and losses also are included in the economic definition of income based on change in wealth over time.

(4) deals with the SNA’s internal consistency of treatment of holding gains in property income from defined benefit pensions (where they are included) versus from life insurance (where they are excluded). It is effectively an instance of issue (1).

(5) deals with the SNA’s internal consistency of treatment of reinvested earnings between direct investment enterprises and other corporations.

¹ For example, supervisory data on US banks includes both realized and unrealized holding gains and losses in net income.

Another approach would identify broad themes and prioritize by theme. For example, two recurring themes are inclusion of holding gains and losses in income ((1), (4), (7), (8), (9)) and the treatment of taxes less subsidies on products instead as taxes on income ((2), (3)).