

UPDATE OF THE 1993 SNA – ISSUE No. 34
JULY 2005 MEETING OF THE ADVISORY EXPERT GROUP ON NATIONAL ACCOUNTS

Government Transactions with Public Corporations
(Earnings and Funding: Super Dividends, Capital Injections and Reinvested Earnings)

For information

From

The Task Force on the Harmonization of Public Sector Accounting

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1. The provisions of the *System of National Accounts, 1993 (SNA)*, for recording transactions between the government and public corporations have appeared, in practice, unclear or unsatisfactory. This is in particular the case of superdividend and capital injection payments:

- A. Dividends and superdividends: As owner and shareholder, general government is entitled to property income (revenue) in the form of dividend payments from public corporations. (§7.113) No distinction is made between dividends that are derived from entrepreneurial income in the current period and superdividends that are the result of a build up of undistributed entrepreneurial income from previous periods (superdividends).
- B. Capital injections: General government is to record regular payments to public corporations for persistent losses as subsidies. (§7.78(c)) Payments from general government covering large operating deficits accumulated over two or more years are capital transfers. (§10.141(b)). Some capital injections may also be recorded as financial transactions in equity (F.5). The criteria are not clear in the System.

2. Recording superdividends as government revenue has several drawbacks:

- Superdividends are net worth neutral, because general government's equity stake in the public corporation falls by the amount paid. Consequently, superdividends do not appear to meet the criteria for general government "revenue" established in the *Government Finance Statistics Manual, 2001 (GFSM, §5.1)* or the *SNA* income criteria (§8.15)
- The time of recording is inappropriate. The appropriate timing of the underlying economic event for general government's income is when it is earned, not when it is distributed by the public corporation. The distribution is a financial choice for controlled entities.
- Superdividends permit general government to adjust its deficits at will by tapping into accumulated reserves, thereby distorting fiscal realities.

3. Similarly, recording capital injections to public corporations as an expense has several drawbacks:

- Capital injections are net worth neutral (the value of the public corporation increases by the amount paid by government); net worth neutral transactions are financial in nature.
- The time of recording capital injections is inappropriate; it does not match the timing of the loss that it is intended to subsidize. The payment is a financial choice of general government.
- Capital injections permit general government to adjust its deficits at will by choosing the timing of payments to public corporations, thereby distorting fiscal realities.

4. Moreover, the inappropriate recording of superdividends and capital injections produces the following outcomes: (A) It conflicts with other national economic accounting conceptual and timing principles; (B) it is inconsistent with current international accounting standards; (C) it

prevents national accountants from estimating the appropriate returns to the factors of production for each sector of the economy in each accounting period; and (D) it reduces international comparability.

5. The Task Force on the Harmonization of Public Sector Accounting (TFHPSA) has been assessing Issue 34 in an effort to develop a comprehensive set of recommendations for improving the treatment of superdividends and capital injections in an updated *SNA* as well as the overall coherence of the System in this domain. Multiple discussion papers have been prepared, a survey has been conducted on the issue among nations participating in the task force, and the issue has been discussed at three TFHPSA meetings.

6. The task force intends to complete and transmit a paper on Issue 34 to the Advisory Experts Group (AEG) for consideration during its January 2006 meeting. The paper will provide a menu of recommendations on the full treatment of these transactions, in particular superdividends and capital injections. The primary recommendation will be to refer to the “reinvested earnings” (SNA account D.43) treatment, which is currently reserved for direct foreign investment. (§7.120 and §14.152). The TFHPSA has also discussed an alternative approach. In case the “reinvested earnings” would not be accepted, we would not like to end up with the status quo, which is very unsatisfactory. The alternative secondary approach will also be presented in the paper.

7. TFHPSA and AEG efforts on Issue 34 can produce very desirable results and fulfillment of key SNA revision process objectives, including: Improved economic reporting by nations; harmonization of accounting standards and guidelines; and greater comparability among nations’ economic accounts. The task force requests that the AEG give the forthcoming issue paper full consideration.