JOHNS HOPKINS
U N I V E R S I T Y

Institute for Policy Studies
Wyman Park Building / 3400 North Charles Street / Baltimore, MD 21218-2688
410-516-7174 / FAX 410-516-8233 / E-mail: ccss@jhunix.hcf.jhu.edu

Center for Civil Society Studies

November 30, 2005

Mr. Ivo Havinga
Economic Statistics Division
United Nations Statistics Division
Two U.N. Plaza
New York, NY 10017

Dear Ivo:

We are writing in response to your invitation to follow up on Lester Salamon's letter of March 7, 2005, concerning possible changes in the treatment of nonprofit institutions (NPIs) in the update of the 1993 SNA that is now underway.

As you know, NPIs have become an enormous economic force in countries throughout the world—accounting for 8-10 percent of the paid labor force in many countries—but existing national accounts treatment of these institutions unfortunately obscures their true scale and importance. This is so chiefly because the sectoring guidelines that are part of the 1993 SNA effectively lead to the allocation of the economically most significant NPIs to other economic sectors—chiefly corporations and general government—where they lose their identity as NPIs. As a consequence, the Non-profit Institutions Serving Households (NPISH) sector, the only place where NPIs are visible in national accounts, has become a tiny residual that covers only a fraction of the actual NPI economic activity. Beyond this, SNA does not capture the value of the volunteer contribution to the work of NPIs, further understating the true economic weight of these institutions.

Fortunately, as you know, the United Nations Statistics Division acknowledged this problem when it issued its *Handbook on Non-Profit Institutions in the System of National Accounts* (UN *NPI Handbook*), which calls for the development of regular "satellite accounts" on nonprofit institutions and volunteering. Nineteen countries have now formally committed to implementing this new *Handbook*, and seven of them (Australia, Canada, Belgium, the United States, Italy, France, and Israel) have produced either published NPI satellite accounts or partial NPI satellite account data for internal uses. This suggests the growing recognition on the part of national accounts agencies of the need to improve the treatment of NPIs within the SNA system as well as the feasibility of the approach to this issue recommended in the *NPI Handbook*. It therefore seems sensible to take advantage of the SNA update process that is now under way to incorporate the lessons that have emerged from this *Handbook* implementation into the core national accounts system, where they are more likely to be applied.

Fortunately, one of the SNA update Task Forces–the Task Force on Harmonisation of Public Sector Accounting (TFHPSA)—has recommended a number of clarifications of the 1993 SNA that would help move it in a direction consistent with the UN *NPI Handbook.* By building on these recommendations it would be possible to clarify even further the picture that the core SNA provides of the NPI sector. The purpose of this letter is to suggest a number of steps that would accomplish this objective. More specifically, the letter makes six recommendations for building on the TFHPSA suggestions:

1) Acceptance of the TFHPSA's recommended guidance for assignment of NPIs to the general government sector, which places emphasis on "control by" government rather than "finance by government" and usefully clarifies the meaning of "control";

2) Extension and adaptation to NPIs of key features of the TFHPSA's recommended guidance for differentiating market from non-market public sector units. Such guidance would make clear that NPIs should be considered to be market producers and allocated to the corporations sector if (a) they are trade associations clearly serving business; or (b) their sales, exclusive of non-competitive sales to government, exceed their costs of production. All other NPIs should be considered to be non-market NPIs and allocated to a broadened NPI sector.

3) Clarification of the coverage of the sector that will result from these recommendations by dropping the phrase "serving households" and calling the resulting sector "Nonprofit Institutions (NPIs)";

4) Acceptance of the TFHPSA's recommendations to identify as NPIs any NPIs still allocated to the General Government and Corporations sectors after the application of these recommendations, and creation of NPI subsectors within the General Government and Corporations sectors to facilitate this;

5) Separate identification of the portion of NPI sales revenue that originates with government;

6) Development of procedures to capture the value of volunteer inputs to NPIs either as part of the core SNA, through a continuation of the *NPI* "satellite account," through the issuance of a "compilation guide," or through some other means.

Given the increased policy attention this set of institutions is attracting around the world, these proposals would significantly enhance the utility of SNA to policy-makers. In the process, it would produce a clearer picture of both the corporations and general government sectors, which now contain substantial amounts of economic activity carried out by NPIs.

The remainder of this letter first reviews the issues that make these recommendations necessary, then assesses the extent to which the recommendations advanced by the TFHPSA address these issues, and finally suggests some extensions of these recommendations to apply them more explicitly to NPIs.

I. The Problem: The Treatment of NPIs in the 1993 SNA

As noted earlier, the decision to produce the UN *NPI Handbook* was motivated by the growing interest in nonprofit institutions and volunteering by government policymakers around the world and the realization that existing national accounts data systems provide a very incomplete picture of this increasingly important set of institutions. This is due, as noted above, largely to the sectoring guidelines built into the 1993 SNA, which effectively allocate NPIs among institutional sectors largely on the basis of their source of revenue. Thus NPIs that are mainly financed by government are assigned to the general government sector and those mainly financed by market sales at economically significant prices are assigned to the corporations sector.

This division may have seemed unproblematic given SNA's assumptions that "[t]he majority of NPIs in most countries are non-market rather than market producers" (SNA para. 4.60), and that they are mainly financed either by membership dues (SNA para. 4.65) or by donations and transfers (SNA para 4.67). Under these assumptions, it was reasonable to expect that only a relative handful of NPIs would be allocated to either the general government or corporations sector under 1993 SNA's sectoring guidelines, leaving most clearly visible through the special NPISH sector.

In fact, however, recent research has shown that these assumptions were far from the mark. According to data on 34 countries assembled by the Johns Hopkins Comparative Nonprofit Sector Project, for example, 53 percent of NPI income, on average, comes from fees and charges and 34 percent from government, much of this in the form of purchases (Salamon and Sokolowski, 2004:3). As a consequence, the 1993 SNA sectoring rules have operated in practice to allocate much of the economic activity of NPIs to the corporations or general government sectors, where it loses its identity as NPI activity and becomes virtually invisible.

Both of these allocations raise conceptual as well as practical problems, however, as the recent work of the Task Force on Harmonisation of Public Sector Accounting has acknowledged. In particular:

a) Government NPIs

The 1993 SNA assigns NPIs to the general government sector if the NPIs are "controlled and mainly financed by government" (SNA 4.62). Because of the ambiguity and difficulty of applying the "controlled by" portion of this guideline, however, statistical agencies have tended to allocate NPIs to the general government sector chiefly on the basis of whether a government unit is their principal source of income. This can be highly misleading, however, since we know from principal-agent economic theory that finance does not automatically translate into control because of the costs that principals face in monitoring their agents' performance. What is more, NPIs often receive their public sector support from multiple public sector sources, including different "levels" of government, ensuring them a significant degree of autonomy even in the presence of substantial public sector funding. For these and other reasons, the allocation of NPIs to the general government sector on the basis of the fact that they are "mainly financed by government" is often highly inappropriate.

The scale of the potential distortion of the true scale of the NPI sector can be huge, however, given the enormous extent of government support to NPIs. In Western Europe, for example, public sector funding accounts on average for 50-70 percent of overall NPI revenue (Salamon and Sokolowski 2004), and these are also the countries in which the economic weight of the NPI sector exceeds that of many major industries, such as transport, communication, and finance. Yet this economic activity is nowhere associated with NPIs in national accounts data. Rather, at least where the government support reaches NPIs in the form of transfers as opposed to government purchases, it is attributed to the general government sector. Included here are entities such as Germany's religiously affiliated "free welfare associations" (e.g., Caritas), which are heavily supported by public subsidies yet remain private institutions. Allocating these entities to the general government sector on grounds that they are "mainly financed by government" obscures their true character and makes them essentially invisible as NPIs. It also overstates substantially the true size of the public sector.

b) Market NPIs

Similar problems arise with 1993 SNA's allocation of NPIs to the corporations sectors. The 1993 SNA assigns NPIs to the corporations sectors if they are "market producers," i.e., if most of their output is sold at economically significant prices. (1993 SNA, para. 4.58) and they receive sales revenue that covers a majority of their costs. While it may be true, as 1993 SNA assumed, that most NPIs in most countries are non-market producers, however, most NPI output is decidedly not. To the contrary, most of the largest and most important NPIs in most countries—universities, hospitals, social service agencies, day care centers, etc.— receive significant amounts of their income from fees and charges. Under the 1993 SNA sector rules, however, these entities are allocated to the corporations sector and disappear from view as NPIs, obliterating the important distinctions between NPIs and corporations identified in 1993 SNA, para. 4.54. The scale of the resulting under-representation of NPIs, moreover, can be enormous. For example, work recently completed by the National Bank of Belgium in implementing the UN *NPI Handbook* revealed that the output of Belgian NPIs as of 2001 was actually almost 600 percent higher than that visible through NPISH once the NPIs allocated to the corporations sector were taken into account (National Accounts Institute, National Bank of Belgium, *Satellite account of non-profit institutions 2000-2001*, February 2004, p. 17.).

For a variety of reasons, this allocation of NPIs to the corporations sector seems inappropriate:

i) In the first place, there is considerable ambiguity within the 1993 SNA about the share of output that must be covered by sales in order to classify an economic unit as a "market producer" and countries have used a variety of standards. The European System of National Accounts (ESA 95), for example, uses a 50 percent cut-off but 1993 SNA speaks more generally about "the majority" of a producer's costs. This means that countries can apply a wide assortment of standards to allocate what is now a far from trivial component of their economies, undermining the comparability of national accounts data.

ii) The concept of *"economically significant prices,"* which is widely acknowledged to be a far from perfect standard under the best of circumstances, is particularly difficult to apply to NPIs. This is so because of the types of markets in which NPIs operate (they are often "public goods" markets in which prices may not fully reflect costs), the extent of non-market output NPIs produce, and the complex cross-subsidization of these non-market outputs that often occurs (e.g., tuition fees help to cover the costs of libraries that are crucial to the non-market research functions of non-profit universities). Determining whether an NPI is selling its output at economically significant prices thus comes to involve especially complex judgment calls.

iii) Even when they cover "the majority" of their costs through market sales, NPIs often do not cover all of the costs that would be associated with such output if for-profit corporations were involved. As a result, their apparent cost of production may be lowered, thus artificially boosting their ratio of sales to production costs and leading to their mis-classification as market producers. Among the *foregone costs of production* that NPIs may benefit from are these:

- The unpaid labor of volunteers (our research shows that volunteers comprise, on average, 45 percent of the full-time equivalent labor force of NPIs);
- Foregone wages of employees motivated by the mission of the organization and therefore willing to accept lower wages than they could command in for-profit businesses;
- Production expenses covered in whole or in part by transfers (e.g., university classroom facilities or libraries financed by alumni gifts).

iv) Some "customers" of NPIs may willingly pay *premium fees* for the services they receive because they know the excess goes to subsidize socially valuable activity (e.g., scholarships for disadvantaged students, special concert performances for students, free access to museums for disadvantaged youth, advocacy activity on the part of human service providers). This, too, has the effect of boosting the apparent ratio of sales to costs for NPIs and shifting more NPIs into the "market producer" category.

v) The inclusion of *government contracts* as “sales” in the calculation of the ratio of sales to output and hence the identification of NPIs as “market producers” causes additional problems. This is so because NPI contract work for government is often designed to serve a public purpose for which no private market exists—e.g., providing health care to the aged or the indigent, offering training to the unemployed, conducting research for which there is no commercial market. Often, NPIs are virtually the only providers operating in these “markets” aside from government agencies. Treating these “sales” as equivalent to market sales to households or corporations can thus be inappropriate.

   What is more, this usage opens the definition of market NPIs to another source of ambiguity since it is often unclear whether a government payment to an NPI is a “contract,” and therefore a market purchase, or a “grant,” and therefore a transfer. Governments may define these instruments in very different terms, causing a lack of uniformity in the treatment of NPIs and resulting gross aberrations in the estimates of the corporations and NPISH sectors. Further, governments often shift the form of assistance in response to administrative considerations that have little to do with market vs. non-market relations (e.g. a desire to enforce performance measures).

   Since NPIs often receive much of their apparent “sales” revenue from government, this can cause especially difficult problems. Well over 60 percent of the revenue of NPIs in Belgium originates with the public sector, for example. However, because this funding reaches the NPIs in what the Bank of Belgium has considered to be purchases of services rather than grants, most of the huge Belgian NPI sector is allocated to the corporations sector in the Belgian accounts, leaving only one-sixth of this sector visible in NPISH.

vi) Quite apart from these practical difficulties of applying the existing sector rules, the basic character of NPIs as defined in 1993 SNA makes the current practice of effectively allocating the majority of NPI economic activity to the corporations sector in most countries rather misleading. Even when a majority of the output of these units is covered by market sales, the units still differ significantly from the for-profit corporations with which they are grouped in the SNA institutional sector accounts. By definition, they are not fundamentally profit-seeking enterprises. They thus have a different “production function” and different governance structures, legal statuses, human resource arrangements, and often tax obligations than the other occupants of the corporations sectors. In addition, because NPIs can raise funds through donations, a source not available to for-profit corporations, the implications of operating deficits are different for them than for regular corporations. Taken together, these differences suggest that whatever their apparent similarities in production behavior, NPIs and for-profit firms are likely to have differences that will be reflected in transactions recorded elsewhere in the sequence of accounts. Including these NPIs in the corporate sector thus causes distortions not only to the picture that SNA provides of NPIs, but also to the picture it presents of the corporations sector.

Taken together, these considerations suggest the need to clarify and refine the guidelines for determining which NPIs truly share sufficient features with for-profit corporations to warrant allocating them to the corporations sectors.

c) Treatment of Volunteer Labor

A third problem that 1993 SNA poses for the accurate portrayal of the economic activity of NPIs relates to the treatment of volunteer labor. Research conducted through the Johns Hopkins Comparative Nonprofit Sector Project reveals that volunteer labor represents, on average, 45 percent of the labor input of NPIs around the world, with considerably higher proportions in the Scandinavian countries and in Africa. In Canada, recent data generated by Statistics Canada indicates that the contribution to GDP provided by such volunteers exceeds that provided by Canada's agriculture sector (Statistics Canada, *Satellite Account of Nonprofit Institutions and Volunteering*, 2004, pp. 6, 9).

1993 SNA makes no provision to capture this economic activity, considering it to be outside the "production boundary" of the economy. However, 1993 SNA paras. 1.20 and 1.22 define the "production boundary" to include not only "all production actually destined for the market," but also "all goods or services provided free to individual households or collectively to the community by government *or NPISHs."* This would seem to include goods or services produced by volunteers working in and through NPIs, but the value of these labor services is not now captured.

The UN *NPI Handbook* incorporates this volunteer activity in the NPI "satellite account," and recommends a "replacement cost" approach to valuing it. This approach has now been applied in a number of countries, such as Canada, Australia, and Belgium, and found to be workable within the context of SNA.

II. Recommendations

Fortunately, the Task Force on Harmonisation of Public Sector Accounting (TFHPSA) formed as part of the SNA updating process has advanced a set of recommendations that go a considerable distance toward resolving at least some of these issues in the 1993 SNA treatment of NPIs. In addition, some of the underlying principles of the TFHPSA recommendations could usefully be extended to apply more explicitly to NPIs. We understand that the treatment of NPIs was not the principal focus of the TFHPSA and that the extensions suggested here may lie outside its scope of work. However, the TFHPSA's comments on the delineation between public sector units and NPIs, and between market and non-market NPIs, have put these issues on the update agenda and therefore made them ripe for resolution. Our comments are designed to suggest potentially effective ways to resolve them consistent with some of the central concepts advanced by the TFHPSA.

More specifically, we outline six recommendations for refinements to 1993 SNA to provide a more accurate and meaningful picture of NPIs. With regard to three of them, our suggestions either incorporate TFHPSA recommendations or build on them. Accordingly, we first outline the TFHPSA recommendations and then offer our own recommendations relating to them. We then outline three additional changes that flow from these earlier suggestions or from experience to date with the *NPI Handbook.*

Recommendation 1: Accept the TFHPSA's suggested clarifications of the definition of NPIs "controlled by" government

In an effort to clarify the 1993 SNA definition of a public sector economic unit and bring it into better alignment with the concept of a public sector unit in prevailing accounting standards, the TFHPSA has recommended a clarification of the types of corporations and NPIs that properly belong in the public sector. This has involved clarifying the 1993 SNA's definition of what constitutes "control" of an economic unit by government.

As part of this delineation, the TFHPSA has advanced three suggestions for clarifying which NPIs should be allocated to the General Government sector (See *TFHPSA Report, Amended Version*, paras. 68, 69, and 71-77):

a) Dropping the phrase "and mainly financed by government" from the definition of a government-controlled NPI;

b) Adding a set of "indicators of control" to provide further guidance on the kinds of factors that should be considered in judging whether government control of an NPI exists (See Attachment A); and

c) Specifying that any NPIs allocated to the general government sector even after these clarifications retain their identity as NPIs in statistical records

Taken together, these suggestions promise to narrow the range of NPIs inappropriately allocated to the general government sector by making clear that being "mainly financed by government" does not necessarily translate into control by government. Although "degree of financing by government" (Indicator 4) and "existence of contractual agreements" between government and NPIs (Indicator 3) are among the five indicators suggested for use in determining whether an NPI is "controlled by" government, the TFHPSA recommendation specifies that neither the existence of a contractual relationship with government nor a preponderance of government funding is sufficient to establish government control. "[S]o long as the NPI is ultimately able to determine its policy or programme to a significant extent," then it "would not be considered controlled by government" (*TFHPSA Report, Amended Version,* paras.73 and 74). Properly applied, this clarification should leave a larger portion of NPIs in the NPISH sector and avoid the assignment of NPIs to the government sector merely because they are heavily "financed by" government.

We endorse TFHPSA's recommendations for modification of SNA 1993 paragraph 4.62 to clarify the definition of an NPI "controlled by" government and therefore assigned to the general government sector. We also endorse its call to identify separately any NPIs that remain in the General Government sector even after the implementation of this recommended clarification.

Recommendation 2: Extend and adapt to NPIs major features of the TFHPSA's recommendations for differentiating market from non-market public sector units.

In addition to clarifying the division between NPIs and government, the TFHPSA also made a number of recommendations for clarifying the distinction between market and non-market producers in 1993 SNA. Although the TFHPSA recommendations here apply only to public sector producers, several of its key principles could usefully be applied to NPIs. These include:

- The need for additional guidance beyond that currently available to clarify the meaning of "economically significant price" and more clearly delineate market producers (*TFHPSA Report, Amended Version,* para 83);

- The rejection of a single numerical standard such as the European System of National Accounts' "50 percent rule" to specify the share of costs that must be covered by sales in order to identify a unit as a "market producer."

- The idea that a useful indicator of whether a unit is a market producer is "which units are the consumers of its goods and services" (*TFHPSA Report, Amended Version,* para. 87). The notion here is that sales to corporations and households are a more reliable indicator that an economic unit is a "market producer" than are sales to government (*TFHPSA Report, Amended Version,* para. 87). This is consistent with the TFHPSA's earlier comments that "classifying government payments to NPIs" remains a problem within 1993 SNA and "needs further guidelines" (*TFHPSA Report, Amended Version,* para. 79); and

- The idea that the degree of competition, particularly from private corporations, is a useful indicator of whether a unit producing for a government purchaser is a market producer. As the TFHPSA puts it: If a producer "is the only supplier, it is treated as a non-market unit unless it competes with a private producer in tendering for a contract to government on normally accepted commercial terms." (*TFHPSA Report, Amended Version,* para. 90).

- The recommendation that "[a]ny NPIs allocated to the corporate sectors should retain their identity as NPIs in statistical records to facilitate analysis of the complete set of NPIs" (*TFHPSA Report, Amended Version,* para. 85).

We believe that applying these principles to NPIs could usefully clarify the treatment of NPIs in the core SNA, thereby reducing or eliminating the inappropriate allocation of NPIs to the corporations sectors. More specifically, in view of the distinctive production function, governance structure, revenue structure, legal status, tax status, and access to gifts of time and money characteristic of NPIs as outlined above, we recommend modifying para. 4.58 of the 1993 SNA by inserting the following additional guidance for the identification of market NPIs.

Identifying market NPIs

a) Trade associations and other NPIs directly serving business are presumed to be market producers and are assigned to one of the corporations sectors.

b) NPIs whose sales exceed their costs of production are presumed to be operating under market conditions and are assigned to one of the corporations sectors.

c) NPIs whose sales are less than their costs of production are presumed to have non-market production and are assigned to the NPI sector

d) NPI receipts from government should not be considered to be part of market sales for purposes of assigning NPIs to sectors unless they take the form of contract payments for which there is active competition from for-profit market producers.

This guidance will help clarify which NPIs to allocate to the corporations sector. It retains as market producers those NPIs that are primarily serving business and that are truly market producers in the sense that they normally cover their costs of production through their sales, while eliminating the ambiguity and awkwardness of allocating to the corporations sector huge numbers of NPIs whose production function, mission, and non-market output set them apart behaviorally from regular for-profit corporations. This guidance also takes account of the non-commercial character of much NPI sales to government, as acknowledged by the TFHPSA and noted above.

One consequence of the changes that result from this guidance may be to raise estimates of GDP by the amount of the non-market output of some current market NPIs, since this output is not now valued in SNA. However, experience with the UN *NPI Handbook* to date suggests that this should not pose a serious problem since it will add only marginally to GDP. For example, in Belgium, the estimated value of the non-market output of NPIs allocated to the corporations sector amounted to only 0.16 percent of overall GDP, and Belgium is a country with an unusually large NPI sector.

Recommendation 3: Clarify the coverage of the NPISH sector in the institutional sector accounts by changing the name of this sector to "Non-profit Institutions (NPIs)."

The basic thrust of the TFHPSA's recommendations on "government controlled" NPIs and our recommendations regarding "market NPIs" is to reduce the inappropriate assignment of NPIs to other sectors in the SNA institutional sector accounts. This will create a place in these accounts where NPIs as defined in the 1993 SNA can be viewed more fully and accurately. Consistent with this, it seems sensible to drop the qualifier "serving households" from the name of the resulting institutional sector. No comparable designation of the entities being served is used to characterize the general government or business sector. Calling this the "NPI sector" would thus make the language symmetrical with that used for the General Government, Financial Corporations, and Non-financial Corporations sectors, all of which are characterized in terms of the major types of entities that comprise them rather than the beneficiaries of their activities.

Recommendation 4: Establish NPI subsectors for any NPIs that remain in the general government or corporations sectors after the application of the foregoing recommendations.

Even if the recommendations advanced above are adopted, some NPIs may still be appropriately allocated to the general government or corporations sectors. The TFHPSA report recommends the separate identification of any such NPIs in their respective sectors (*TFHPSA Report, Amended Version*, paras. 69 and 86).

We endorse these suggestions and recommend that this be done by designating explicit NPI subsectors in these sectors, as is now done with public sector entities within the corporations sector. It should be noted that the information needed to create these subsectors will have been developed in the process of implementing the NPI sector account. Carrying out this recommendation should therefore not involve significant additional burdens.

Recommendation 5: Separately identify the share of NPI sales revenue that originates with government.

1993 SNA lumps sales to government together with other sales revenue for NPIs and other economic units. As the TFHPSA notes, however, "which units are the consumers of [a unit's] goods and services" can be important in determining the character of the transaction (*TFHPSA Report, Amended Version,* para. 87). This is particularly true of purchases by governments and especially so for purchases from NPIs for the reasons noted earlier: NPI sales to government are often indistinguishable from grants even though a contract instrument is used. Such sales are frequently in markets where only nonprofits operate and in which normally accepted commercial terms do not apply. What is more, it is extremely important for policy reasons to know what share of total revenue originates from government, regardless of whether this revenue reaches NPIs through grants (and is therefore recorded as transfers) or through contracts (and is therefore buried in overall sales revenue).

Both the TFHPSA recommendations for delineating public sector market producers and recommendation 2 above for delineating NPI market producers require that the government share of sales revenue be identified as part of the decision process for determining which NPIs and public sector entities are market producers. The present recommendation suggests that this information be retained and reported separately so that the full amount of government support—both transfers and contract purchases-- can subsequently be aggregated.

Recommendation 6: Develop procedures to capture the value of volunteer inputs to NPIs either (a) as part of the core SNA, (b) through a continuation of the NPI "satellite account," (c) through issuance of an NPI "compilation guide," or (d) through some other means.

One of the distinguishing features of NPIs is their extensive use of volunteer labor. As noted earlier, recent research indicates that 45 percent of the labor effort utilized by NPIs takes this form. This naturally lends an important special character to NPI production, as SNA has traditionally acknowledged in recognizing that NPIs constitute a distinctive class of economic units.

While the cash transfers and subsidies to NPIs are acknowledged and counted in 1993 SNA, however, the contributions of time are not even though SNA's own definition of the "production boundary" of the economy seems to encompass such voluntary effort. This has the effect of understating the output and economic contribution of these economic units, and doing so by a substantial margin. In fact, recent research indicates that the giving of time that volunteerism represents, even valued conservatively, outdistances the giving of cash by a factor of 3:1.

As noted earlier, the UN *NPI Handbook* addresses this issue by recommending that countries include the value of volunteer labor channeled through NPIs in the NPI satellite account, using a simplified replacement cost method to estimate the value of this labor, and a number of countries—among them Canada, Australia, and Belgium—have already successfully applied this approach. Consistent with the UN Trial International Classification for Time Use Statistics, this approach strategically defines volunteer work as work outside an individual's household. Only that portion of volunteer effort that is utilized by entities that are clearly within the production boundary of the economy—i.e. NPIs—are therefore included. A number of statistical offices, among them Canada's, Australia's, and the National Bank of Belgium, have now applied these procedures successfully and reported the results.

If the recommendations outlined above are incorporated in the updated 1993 SNA, however, there is a possibility that countries will cease completing the satellite account recommended in the *NPI Handbook.* To the extent this occurs, the important volunteer component of NPI work may again be lost from view within the SNA context. To avoid this, we recommend that SNA re-examine its position on the volunteer labor utilized by NPIs and consider several alternative ways for capturing this activity in the SNA structure.

Our preferred option here is to incorporate the volunteer labor contributed to NPIs into the core SNA (Option a above). It offers the clearest way to provide an accurate picture of the economic activity of NPIs and to portray the economic reality that volunteering represents, something that has become a matter of considerable policy interest as reflected in the recent UN Year of the Volunteer and the July 18, 2005, Follow-Up Report of the UN Secretary General on this subject.

In the event Option (a) proves unworkable, serious attention needs to be directed to one of the other options noted.

Conclusions

Nonprofit institutions have become increasingly central to policy debates about the promotion of democracy, the proper role of government, and the optimal solutions to problems as diverse as poverty alleviation and environmental protection. SNA wisely anticipated this development in 1968 by acknowledging the existence of a definable set of "non-profit institutions" in the national accounts framework and providing a reasonable way to define and identify them. Unfortunately, however, the institutional sector guidelines adopted as part of the 1993 SNA have had the effect of obscuring the true size and role of the set of institutions so defined. This is so because those guidelines put a heavy emphasis on the source of revenue as the basis for assigning economic units to institutional sectors, and NPIs turn out to have revenue structures very different from what the originators of the sector guidelines may have assumed.

Now that we have a better handle on the true economic scale and operations of NPIs, it seems sensible to clarify their treatment within the SNA. Fortunately, the work of the Task Force on Harmonization of Public Sector Accounting, which mirrors positions advanced in the UN *NPI Handbook,* points the way towards achieving this by clarifying what constitutes a public sector unit and what constitutes a market producer. These TFHPSA recommendations deserve support.

The suggestions outlined here build on these TFHPSA recommendations in order to clarify the treatment of NPIs in SNA even further. If adopted, they would produce a much clearer and more complete picture of the world's NPIs than the 1993 SNA now permits, and they would usefully clarify the true scale of the corporations and general government sectors in the process.

As you may know, we have already conveyed the major thrust of these suggestions to the author of the TFHPSA report and have been pleased to find many of them incorporated into a revised version of that report. We would very much appreciate your bringing them to the attention as well of the Advisory Expert Group that is considering this and other reports. We are convinced that clarifying the treatment of NPIs in the core SNA as suggested here will further enhance the utility of the national accounts system both for policymakers and for other potential users. We understand that implementing these suggestions may require further deliberations. Given the work that has already been done in the course of developing the UN *NPI Handbook*, we believe that such deliberations can be carried out within the time-frame of the 2007 SNA update and we are more than willing to assist in that process. We look forward to hearing from you and the AEG on this and thank you in advance for your willingness to entertain these comments.

Yours truly,

Lester M. Salamon　　　　Helen Stone Tice

Cc: Paul Cheung
Rob Edwards
Carol Carson
Lucie Laliberté
Graham Jenkinson
NPI Handbook Experts Committee and Implementers

Attachment A: *TFHPSA Report, Amended Version*

Government Control of Non-market NPIs

Background and Current definition

67. NPIs controlled and mainly financed by government are allocated to the general government sector. In this context, control is defined 'as the ability to determine the general policy or programme of the NPI by having the right to appoint the officers managing the NPI' [SNA 4.62].

Proposed revised definition and supporting text

68. It is proposed that the reference to 'and mainly financed by government' be replaced with the term 'non-market' and that the reference to 'the right to appoint the officers managing the NPI' be repositioned under a new 'indicators of control' sub-heading. The reference to 'mainly financed' is retained as an indicator.

69. The amendment does not change the conceptual basis of the current definition but it does it make it operationally more consistent with that used in the accounting standards. As a result of these changes the paragraph above would read as follows:

> *Non-market NPIs controlled by government are allocated to the general government sector. In this context, control is defined as the ability to determine the general policy or programme of the NPI. (Any NPIs allocated to the general government sector should retain their identity as NPIs in statistical records, to facilitate analysis of the complete set of NPIs.)*

70. In addition, further text could be added in the revised SNA so as to provide guidance on the factors that may indicate control of NPIs. The text in the box below is offered as the basis of this:

Some indicators of control:

Indicator 1 – appointment of officers

71. Under the provisions of the NPIs constitution, articles of association or other enabling instrument, the government may have the right to appoint the officers managing the NPI.

Indicator 2 – other provisions of enabling instrument

72. Even though government may not have the right to appoint the officers managing the NPI, the enabling instrument may contain other provisions that effectively allow the government to determine significant aspects of the general policy or programme of the NPI. For example, the enabling instrument may simply specify and or limit the functions, objectives and other operating aspects of the NPI, thus making the issue of managerial appointments less critical or even irrelevant. The government may retain the right to remove key personnel, veto proposed appointments, require prior approval of budgets or financial arrangements, prevent the NPI from changing its constitution, dissolving itself, terminating its relationship with government, etc.

Indicator 3 – existence of contractual agreements

73. The existence of any contractual agreement between a government and an NPI for, say, the provision of goods or services may contain clauses indicative of the NPI effectively allowing government to determine aspects of its general policy or programme. However, so long as the NPI is ultimately able to determine its policy or programme to a significant extent (for example by being able to renege on the contractual agreement and accepting the consequences, by being able to change its constitution or dissolving itself without requiring government approval other than that required under the general regulations), then it would not be considered controlled by government.

Indicator 4 – degree of financing by government

74. Where an NPI is mainly financed by government, the detail of the arrangement still needs to be examined. This would establish whether the conditions attached to the financing amount to effective control of the entity that is the NPI itself, or whether they amount only to control over the application of the financing made available. Generally, if the NPI remains able to determine its policy or programme to a significant extent along the lines mentioned in indicator 3 above, then it would not be considered an institutional unit which is controlled by government.

Indicator 5 – level of risk exposure

75. If a government openly allows itself to be exposed to all or a large proportion of the financial risks associated with an NPI's activities, then the arrangement may be examined to establish if control of the NPI itself exists or is implied. Again, the rationale in indicators 3 and 4 above could be applied.

Totality of all indicators

76. In many cases, a single indicator alone could be sufficient to establish the existence of

control beyond doubt. In other cases, a number of separate indicators could each be indicative of control, but lack conclusiveness as individual indicators. Other indicators including those listed under the control of corporations may also be relevant. In these instances, the total impact of all such indicators should be taken into account to establish whether overall control effectively exists, even when none of them provide such an indication on their own.

77. A decision based on the totality of all indicators as described here must necessarily be judgmental in nature, rather than one based on the principles of exact science. Of course, there has to be consistency of approach in classification decisions for such judgments to be effective.