

**Fourth meeting of the Advisory Expert Group on National Accounts
30 January – 8 February 2006, Frankfurt**

Issue 30
Definition of economic assets

DEFINITION OF ECONOMIC ASSETS

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AEG Issue number 30: Definition of economic assets

Paper for discussion at the AEG meeting Jan 30 —Feb 8 2006

Issue description: The SNA should provide a clear definition of what constitutes an asset which is consistent with where the asset boundary falls in respect of currently known entities, as well as providing guidance for determining whether entities which appear in the future fall within the asset boundary. It should be accompanied by guidance on how assets should be valued.

Introduction

The definition of an asset in the 1993 SNA in para 10.2 is as follows:

The assets recorded in the balance sheets of the System are economic assets. These are defined as entities:

- (a) over which ownership rights are enforced by institutional units , individually or collectively; and*
- (b) from which economic benefits may be derived by their owners by holding them, or using them, over a period of time.*

Neither of the concepts of ownership or benefits¹ is defined. This is an omission which needs correcting and it should probably be done as early as chapter 3.

What follows is suggested text, but the AEG is asked to concentrate on the logical sequence of the argument and the substance of it, reserving purely wording changes for written exchange. An earlier version of this text was distributed in Bangkok at the AEG, asking for comments. It was discussed in the Canberra II Group meeting in September and comments from that meeting and some others received from the BPM staff have been taken into account in this version.

Benefits

The heart of the System describes how labour, capital and natural resources including land are used to produce goods and services. These goods and services are used for the three economic activities recognised in the System, production, consumption and accumulation. Benefits are defined as follows.

Benefits are the means of acquiring goods and services for production, consumption or accumulation in the current period or in future periods.

Sometimes the immediate benefit is in terms of goods and services directly, for example own account production or wages and salaries in kind. More often a benefit is in the form of the medium of exchange (money) for example as wages and salaries. Consumption is an activity which takes place in the current

¹ My personal preference would be to use "rewards" in place of benefits to avoid confusion with "social benefits" but there has been little support for this and a clear expression to remain with "benefits" made.

period only but may be financed from past benefits. Production and accumulation involve benefits postponed to future periods. Thus means of allowing benefits to be moved from one accounting period to another have to be recognised. These take the form of financial assets where a benefit in one period is converted to a benefit in one or more future periods. Similarly goods and services, or current benefits, may be acquired by committing future benefits in the form of financial liabilities.

Ownership

Two types of ownership can be distinguished, legal ownership and economic ownership.

The legal owner of entities such as goods and services, natural resources, financial assets and liabilities is the institutional unit entitled in law and sustainable under the law to claim the benefits associated with the entities.

Sometimes government may claim legal ownership of an entity on behalf of the community at large. No entity which does not have a legal owner, either on an individual or collective basis is recognised in the System.

The acts of production, consumption and accumulation, involve varying degrees of risk. Two main forms of risk can be identified. The first sort refers to production. These arise because of such uncertainties as the demand for goods and services once produced, developments in the economy in general and technical innovation which affects the benefits to be earned from capital and natural resources. The consequence is that benefits from capital, natural resources and labour in the form of operating surplus and income from employment, are not wholly predictable in advance, but embody a degree of risk.

The second type of risk refers to the process of transferring benefits between time periods. It arises because of uncertainty over interest rates in future periods, which in turn affects the comparative performance of different types of benefits.

When economic agents make decision about consumption or accumulation, they have to make a judgement about the relative advantages of benefits being converted to goods and services in the current period as against conversion in a later period. Thus all economic activity involves both benefits and risks. Transferring benefits between time periods inevitably involves transferring risks also. An agent may opt for a lower but more certain benefit in future rather than a benefit which might be higher but is less certain. Of particular interest is the case when an agent swaps benefits and risks associated with production with those associated with financial assets and liabilities.

The economic owner of an entity such as goods and services, natural resources, financial assets and liabilities is the institutional unit which is entitled to claim the benefits associated with the use of entity in the course of an economic activity by virtue of accepting the associated risks.

Every entity has both a legal owner and an economic owner, though in many cases, the economic owner and the legal owner of an entity are the same. Where they are not, the legal owner has handed responsibility for the risk involved in using the entity in an economic activity to the economic owner along with associated benefits. In return the legal owner accepts another package of risks and benefits from the economic owner.

When government claims legal ownership of an entity on behalf of the community at large, the benefits also accrue to the government on behalf of the community at large. Thus government is both the legal and economic owner of these entities.

The benefits inherent in financial assets and liabilities are seldom transferred from a legal owner to an economic owner in exactly the same state. They are usually transformed to new forms of financial assets and liabilities by the intermediation of a financial institution which assumes some of the risk and benefits while passing the balance on to other units.

The definition of an asset

Leading on from the above it is possible to rephrase the definition of an asset, but not the substance of the definition.

An asset is an entity from which the economic owner can derive a benefit or series of benefits in future accounting periods by holding or using the entity over a period of time, or from which the economic owner has derived a benefit in past periods and is still receiving a benefit in the current period. Because it represents a stock of future benefits, an asset can be regarded as a store of value.

All assets in the System are economic assets. Attributes such as reputation or skill which are sometimes described in common parlance as an asset, are not recognised as such in the System because they are not economic in nature in the sense described under ownership.

Financial assets and liabilities

A particularly important mechanism in the economy is the device whereby one economic unit exchanges a particular set of benefits with another economic unit. Benefits are exchanged by means of payments. From this a financial claim can be defined.

A financial liability is established when one unit (the debtor) is obliged, under specific circumstances, to provide a payment or series of payments to another unit (the creditor). The most common circumstance in which a financial liability is established is a legally binding contract which specifies the terms and conditions of the payment(s) to be made and payment according to the contract is unconditional.

In addition, a financial liability may be established not by contract but by long and well-recognised custom which is not easily refuted. In these cases, the creditor has a valid expectation of payment, despite the lack of a legally binding contract. Such liabilities are called constructive liabilities.

Depending on the outcome of the discussion on standardised guarantees, there may be some contingent liabilities included also.

Whenever either of these types of liability exists, there is a corresponding financial claim which the creditor has against the debtor. Like the liabilities, the claims are unconditional. In addition, a financial claim may exist which entitles the creditor to demand payment from the debtor but whereas the payment by the debtor is unconditional if demanded, the demand itself is discretionary on the part of the creditor.

Financial assets consist of all financial claims plus monetary gold², Special Drawing Rights (SDRs) of the International Monetary Fund and shares in corporations. Monetary gold and SDRs are treated as financial assets even though their holders do not have claim over other designated units. Shares are treated as financial assets by convention even though their holders do not have a fixed or predetermined monetary claim on the corporation.

² May need changing depending on the outcome of the discussion on financial gold.

The asset boundary

All entities which meet the definition of an asset given above are included in the asset boundary of the System. All assets appear on the balance sheet of the economy. This, together with the requirement that they entail future benefits, implies that all assets can be represented by a monetary value. This value represents the market's view of the total of the benefits embodied by the asset. Where a direct market view of this value is not available, it must be approximated by other means. (discussed elsewhere)

Classification of assets and entry and exit from the balance sheet

Assets which are not financial assets are non-financial assets. Non-financial assets are further subdivided into those which are produced and those which are non produced. This first level of classification of assets is important since the process by which assets enter and leave the balance sheet differs for the three types of assets.

*Produced non-financial assets come into being via the production process or as imports. Two exceptions exist. Historical monuments are included as produced assets even **though** they may have been constructed long before economic accounts existed. Occasionally a monument may be newly recognised as having value and thus enter the asset boundary as a produced asset other than through a current production process. Similar arguments apply to artefacts treated as valuables. Produced non-financial assets leave the asset boundary by being exhausted or by being sold to resident units which will not continue to use the asset in production as a source of future benefits or by being sold to non-resident units.*

Non produced non-financial assets are of two types, natural resources, and contracts, leases and licences. The borderline for which natural resources are considered assets and which are not depends on a number of factors . (More text to follow along the line of para 10.10 to 10.12 explaining when these assets enter and leave the balance sheet). Contracts, leases and licences may represent an asset to the holder when the agreement restricts the general use or supply of products covered by the agreement and thus enhances the benefits accruing to the party to the agreement beyond what would accrue in the case of unrestricted supply. These assets come into existence when the agreement is made and the enhanced benefits become apparent. They leave the balance sheet when the conditions restricting access are lifted or when there is no longer a benefit to be earned from having restricted access to the asset.

Financial assets and liabilities cease to exist when there is no longer a commitment for one unit to make payments to the other.

Exclusions from the asset boundary

Consumer durables are not regarded as assets in the system because the services they provide are not within the production boundary. Because the information on the stock of durables is of analytical interest, though, it is suggested that this information appear as a memorandum item in the balance sheet but not be integrated into the totals of the table.

Human capital is not treated by the System as an asset. It is difficult to envisage "ownership rights" in connection with people and even if this were side-stepped, the question of valuation is not very tractable.

There are some environmental assets excluded from the SNA asset boundary. These are usually of the same type as those within the boundary but are of no economic value.

Although constructive liabilities are included, contingent financial liabilities, where there is no unconditional obligation for either party to the agreement to make a payment are excluded.

When a decision is made on provisions and on one-off guarantees, there may be more text needed here to explain the position.

The only assets included in the asset boundary of an economy are those whose economic owners are resident in the economy. However, in the case of most natural resources and immobile fixed capital, which physically cannot leave the economy, a notional resident unit is established if the economic owner is technically a non-resident unit. In this way the assets in question do become those with resident economic owners and so are included within the asset boundary and are included on the balance sheet. Portable non-financial assets which are physically situated in an economy but are owned by non-residents are excluded from the balance sheet; those which are physically situated in the rest of the world but owned by residents are included in the asset boundary.

Questions for the AEG

Although draft text is being presented, the intent is that the discussion of the AEG should concentrate on the substance of the proposals presented. Detailed drafting comments would be welcome but should be provided separately to the editor.

Do you agree with the need to define ownership and benefits?

Do you agree with the thrust behind the proposed definitions?

Do you agree with the revised definition of an asset? Do you agree with the exclusions from the balance sheet?

Do you agree that constructive liabilities should be included in the asset boundary?

