Chapter 33: Transactions and positions between residents and non-residents

(moved upwards, revised title)

(OLD Chapter 26: The rest of the world accounts and links to the balance of payments)

Please note that the details on economic territory and residency have been moved to Chapter 5 of the 2025 SNA. These re-allocations have not been highlighted in the form of track changes.

A. Introduction

33.1 This chapter is about the relationship between the rest of the world sector in the SNA and the international accounts as described in ~~BPM6~~BPM7. It shows that the two manuals use the same macroeconomic framework, with the international accounts providing additional detail on aspects of particular relevance in international transactions or positions.

1. The rest of the world ~~account~~accounts in the SNA

33.2 The international accounts, as described in BPM7, are compiled from the domestic economy perspective, which can be thought of as the sum of the transactions and positions with non-residents for each of the institutional sectors in the compiling economy. In the SNA, transactions between a resident unit and the rest of the world are recorded as if the units in the rest of the world were another sector of the economy~~.~~

~~33.2~~33.3 The production and generation of earned income accounts relate only to transactions within the national economy but flows in all other accounts potentially have an entry for the rest of the world. These entries are necessary to balance each row of the sequence of economic accounts but they do not enter the aggregate balancing items. For example, the difference between GDP and GNI derives from transactions for both ~~uses~~expenditures and ~~resources~~revenues recorded in the allocation of ~~primary~~earned income account where the ~~counter-party~~counterparty is a unit in the rest of the world. ~~If the counter-party entries for the rest of the world were also included, there would be no difference between the balancing items.~~

Current accounts

~~33.3~~33.4 Because the rest of the world ~~account is~~accounts are shown in this way, flows to the rest of the world are shown as ~~a use~~an expenditure by the rest of the world and flows from the rest of the world as ~~resources~~revenues. For example, exports are shown as ~~uses~~expenditures of the rest of the world and imports as ~~resources~~revenues from the rest of the world. Entries for imports and exports form part of the goods and services account in the SNA sequence of economic accounts.

~~33.4~~33.5 As well as entries for imports, exports and the items appearing in the allocation of ~~primary~~earned income account, there are potential transactions with the rest of the world to be recorded for all entries in the ~~secondary distribution of~~ income transfers other than social transfers in kind account and for the adjustment item for the net change in pension liabilities appearing in the use of income account.

~~33.5~~33.6 There are no entries for the rest of the world ~~account~~accounts for intermediate or final consumption (or for ~~fixed~~ capital formation) because the use made of the goods and services in another economy is not relevant for the national economy; only the total amount exported is.

~~33.6~~33.7 Although balancing items are not calculated in the SNA for the rest of the world ~~account~~accounts for each individual account, two balancing items relevant to the current accounts are important. The first is the external balance on goods and services, which is the difference between imports and exports. The second is the current external balance which is the sum of all ~~resources~~revenues coming from the rest of the world less all ~~uses~~expenditures going to the rest of the world, including imports and exports. The current external balance thus shows how far residents call on saving by non-residents, or vice-versa.

Accumulation accounts

~~33.7~~33.8 In the rest of the world capital account, there is no entry for (fixed) capital formation, as noted above. It is possible for a transaction to be recorded for a natural resource, for a contract, lease or licence or for goodwill and marketing assets. By their nature, though, and given that land is almost always acquired by a resident unit, such entries will not be common. On the other hand, capital transfers to and from the rest of the world may be quite important.

~~33.8~~33.9 The financial account and balance ~~sheets~~sheet detailing transactions in, and stocks of, financial assets and liabilities where one party is non-resident are viewed as a particularly important part of the rest of the world accounts. Indeed, in ~~*BPM6*~~BPM7 more text is devoted to these items than to the items in the current accounts. In addition, there are possible entries for other changes in the volume of assets and liabilities and revaluation items for both, relevant to the rest of the world account.

2. The international accounts in ~~*BPM6*~~BPM7

~~33.9~~33.10 In the description of the rest of the world accounts above, it was noted that exports, for example, are treated as ~~a use~~an expenditure by the rest of the world and imports as a ~~resource~~revenue from the rest of the world. As its name implies, the rest of the world ~~account is~~accounts are drawn up from the perspective of the rest of the world. ~~*BPM6*~~BPM7 looks at the same stocks and flows from the point of view of the domestic economy. Thus the ~~*BPM6*~~BPM7 entries are the mirror image of the SNA entries relating to the rest of the world. Further, in the context of ~~BPM6~~BPM7, stock levels are usually referred to as positions and the balance sheet accounts for all financial assets and liabilities where one party to the arrangement is non-resident is called the international investment position~~.~~ (IIP).

~~33.10~~33.11 The international accounts for an economy summarize the economic relationships between residents of that economy and the rest of the world. They comprise:

a. the balance of payments, which summarizes the current, capital and financial transactions between residents and non-residents during a specific time period;

b. the international investment position (IIP), which shows at a point in time the value of: financial assets of residents of an economy that are claims on non-~~-~~residents or are gold bullion held as reserve assets; and the liabilities of residents of an economy to non-~~-~~residents; and

c. the other changes in financial assets and liabilities account, a statement that shows other flows, such as valuation changes, which reconcile the balance of payments and IIP for a specific period by showing changes due to economic events other than transactions between residents and non-residents.

These accounts correspond to the transactions, balance sheets and other changes in assets accounts in the SNA, respectively. Note, though, that what appear as assets in the rest of the world ~~account~~accounts appear as liabilities in the international accounts and vice versa.

3. The structure of the chapter

~~33.11~~33.12 Section B of the chapter discusses the accounting rules of the international accounts. These are consistent with the SNA accounting rules and agreement has been reached on when the SNA and when ~~BPM6~~BPM7 takes the lead in defining the rules to be applied in both contexts. Residence is a case in point where the SNA follows BPM7, and this topic is discussed in Chapter 5. The structure of the international accounts and their relation to similar SNA accounts is the subject of section C.A feature of the financial accounts and IIP of the international accounts is the introduction of functional categories that describe the main purpose of financial investment abroad. This is the subject of section D. Section E touches on some considerations of particular importance to the international accounts; global imbalances, exceptional financing, debt reorganization, currency unions and currency conversions.

B. Accounting principles

1. Comparison with SNA accounting principles

~~33.12~~33.13 Although the SNA works with a quadruple-entry accounting system, the balance of payments has only a double-entry system. When a transaction is undertaken between two resident units, four entries are necessary, for example two showing the exchange of a good and two the exchange of a means of payment. However, when a resident unit carries out a transaction with a non-resident unit, national compilers are unable to verify independently the counterpart entries in the rest of the world account. As a result, although in principle the balance of payments is balanced, in practice, there may be an imbalance due to shortcomings in source data and compilation so that there is a mismatch between financial transactions and their counterparts within the domestic economy. This imbalance, a usual feature of published balance of payments data, is labelled ~~net errors and omissions.~~statistical discrepancy. The balance of payments manuals have traditionally discussed this item, to emphasize that it should be published explicitly, rather than included indistinguishably in other items and that it should be used to indicate possible sources of mismeasurement.

~~33.13~~33.14 However, there has been increasing interest in estimates that are derived from counterpart reporting that has better coverage, valuation, etc. As well, there has been much work done on reconciling data from the view of both parties (for example, exports of one country, with the counterpart imports recorded by the partner country) and global totals. Counterparty data are also necessary to prepare consolidated data for a currency or economic union from the data of individual member countries. In effect, all this work is built on the fact that balance of payments statistics effectively become a quadruple-entry system when used at the bilateral or global level.

Valuation

~~33.14~~33.15 Valuation principles are the same in the SNA and the international accounts. In both cases, market values are used, with nominal values used for some positions in instruments where market prices are not observable. In the international accounts, the valuation of exports and imports of goods is a special case where a uniform valuation point is used, namely the value at the customs frontier of the exporting economy, that is, the FOB-type valuation (free on board). This treatment brings about consistent valuation between exporter and importer and provides for a consistent basis for measurement in circumstances where the parties may have a wide range of different contractual arrangements, from "ex-works" at one extreme (where the importer is responsible for arranging all transport and insurance) to "delivered duty paid" at the other (where the exporter is responsible for arranging all transport, insurance and any import duties). In international transactions, there may be motivations for under- or over-invoicing in order to evade taxes or exchange controls, so ~~BPM6~~BPM7 provides guidance on how to develop market-equivalent prices when these cases are identified, and how to make the necessary adjustments needed to other items affected. Invoice values may become the new approach for valuing exports and imports in the future; see paragraphs 4.183 to 4.189 for a more detailed discussion. There is also further discussion on the recording of imports and exports in chapters ~~14~~15 and ~~28~~36.

Time of recording and change of ownership

~~33.15~~33.16 Time of recording and ownership principles are the same in the SNA and the international accounts. In practice, the change of economic ownership of goods is often taken to be when the goods are recorded in customs data. To the extent that there are differences between customs data and actual changes in ownership, such as for items with large values or goods sent on consignment (that is, dispatched before they are sold), adjustments are made.

~~33.16~~33.17 There are no longer any exceptions to the recording basis of the change of economic ownership. However, there is a different presentation in the case of merchanting; that is, where an owner buys and resells goods in the same condition without the goods passing through the territory of the owner. In that case, the acquisition of the goods is identified as a change of ownership~~,~~ but shown as a negative export rather than an import on acquisition of the goods and as a positive export on disposal. If the goods are acquired in one period and not disposed of until a subsequent period, they will appear in changes in inventories of the merchant even though these inventories are held abroad. A consequence of this ~~change in~~ treatment is that in the international accounts, merchanting ~~now~~ appears as transactions in goods ~~where previously it was recorded as a transaction in services~~.

~~33.17~~33.18 The principle of recording imports and exports when change of ownership takes place applies also to items such as high-value capital goods where change of ownership is recorded as work is put in place. (See paragraphs 10.53 and 10.55.)

Netting

~~33.18~~33.19 The same rules on netting are applied in ~~*BPM6*~~*BPM7* as in the SNA. In general, netting is not advised except in the special case of recording transactions in financial assets and liabilities. However, only acquisitions and disposals of the same type of asset (or incurrence and redemption of the same type of liability) are netted. There is no netting of assets against liabilities, even of the same sort of instrument and no netting across different sorts of instruments. Greater detail about netting in respect of financial instruments appears in chapter ~~3 of *BPM6*, paragraphs 3.109 to 3.121~~8 of *BPM7*.

2. Units

~~33.19~~33.20 The international accounts and the SNA are built on the same definitions of institutional units and residence. Because the international accounts focus on economic relationships between residents and non-residents, more elaboration of borderline cases is provided in ~~*BPM6*.~~*BPM7*. For a detailed discussion of economic territory and the residence of institutional units, see Chapter 5, Section 2.

C. A comparison between the international accounts and the SNA rest of the world accounts

~~33.20~~33.21 Like the SNA, the international accounts cover accounts for current transactions, accumulation accounts and balance sheets. The transaction accounts are collectively called the balance of payments. An overview of the international accounts presentation (using the SNA numerical example) is given in tables ~~26~~33.3. The three current accounts are the goods and services account, the ~~primary~~earned income account and the ~~secondary~~transfer income account. The ~~primary~~earned income account corresponds to the allocation of ~~primary~~ earned income accounts in the SNA, the ~~secondary~~transfer income account to the ~~secondary distribution of~~ income transfers other than social transfers in kind account in the SNA. The income accounts in ~~BPM6 do not use distribution and redistribution in their titles, since they do not show distribution and redistribution from one party to another, but~~BPM7 just ~~show~~ the income transactions from the point of view of one party. Because there is no account corresponding to use of income in the international accounts, the adjustment for the change in pension entitlements term appears as a single item after the ~~secondary~~ income transfers other than social transfers in kind account~~. (Cross~~ (cross-border pensions are ~~currently~~relatively minor for most economies~~.)~~).

~~33.21~~33.22 There are no exact parallels in the international accounts for the production account, the generation of income account and use of income account because the international accounts do not describe production, consumption (or capital formation). Products imported and exported are treated as simple transactions in all cases; whether the products will eventually be used for intermediate consumption, final consumption, capital formation, or will be re-exported is unknown in the context of ~~the~~ international ~~transaction~~transactions. The use made of products is ~~entirely~~ domestic in nature.

~~33.22~~33.23 Table ~~26~~33.3 also shows the restricted form of the capital account in the international accounts ~~and~~as well as the financial account using the functional classification of financial transactions rather than the instrument classification used in the SNA. Because the functional classification is a grouping of instruments, the two forms of presentation are strictly consistent. The functional classification is described below in section D~~. (The~~, along with. the explanation of the shaded cell for reserves liabilities ~~is explained in section D also.)~~.

1. Goods and services account

~~33.23~~33.24 The goods and services account consists only of imports and exports of goods and services because these are the only transactions in goods and services with a cross-border dimension. Goods and services are recorded when there is a change of economic ownership from a unit in one economy to a unit in another country. Although there is usually a physical movement of goods when there is a change of ownership, this is not necessarily the case. In the case of merchanting, goods may change ownership and not change location until they are resold to a third party.

Table 26.3: Overview of the balance of payments

~~33.1 Goods that change location from one economy to another but do not change economic ownership do not appear in imports and exports. Thus goods sent abroad for processing, or returned after processing, do not appear as imports and exports of goods; only the fee agreed for processing appears as a service.~~

~~33.24~~33.25 The balance of payments gives emphasis to the distinction between goods and services. This distinction reflects policy interests, in that there are separate international treaties covering goods and services. It also reflects data issues, in that data on goods are usually obtained from customs sources, while data on services are usually obtained from surveys, payments records ~~or surveys~~and other administrative sources.

Goods

33.26 The main source of data for goods is international merchandise trade statistics. International standards are given in *International Merchandise Trade Statistics: Concepts and Definitions (IMTS)* (United Nations, 1998). ~~*BPM6*~~Goods are presented at an aggregate level in the balance of payments, whereas more detailed commodity breakdowns can be obtained from IMTS data.

~~33.25~~33.27 *BPM7* identifies some sources of difference that may occur in some or all countries. It also recommends a standard reconciliation table to assist users in understanding these differences. One major source of difference is that the standards for IMTS use a CIF-type (cost, insurance and freight) valuation for imports, while the balance of payments use a uniform FOB valuation for both exports and imports. It is therefore necessary to exclude freight and insurance costs incurred between the customs frontier of the exporter and the customs frontier of the importer. Because of variations between the FOB-type valuation and actual contractual arrangements, some freight and insurance costs need to be rerouted. Further details are provided in chapter 15.

33.28 The change of ownership basis used for the balance of payments means that goods entries will have a time of reporting consistent with the corresponding financial ~~flows~~transactions. In ~~*BPM6*~~*BPM7*, there are no ~~longer~~ exceptions to the change of ownership principle. In contrast, IMTS follow the timing of customs processing. While this timing is often an acceptable approximation, adjustments may be needed in some cases, such as goods sent on consignment.

33.29 Goods that change location from one economy to another but do not change economic ownership, while part of merchandise trade, do not appear in imports and exports in the balance of payments or SNA. Thus, goods sent abroad for processing, and returned after processing, do not appear as imports and exports of goods; only the fee agreed for processing appears as a service. In the case of goods sent abroad for processing with no change of ownership, the values of goods movements are included in IMTS, but changes in ownership are the primary presentation in the balance of payments. ~~(~~However, the values of goods movements are recommended as supplementary items to understand the nature of these arrangements~~.)~~. Further details of the recording of these processing arrangements are given in chapter 23 (see paragraphs 23.21~~-~~ to 23.27).

~~33.26~~33.30 Other adjustments to IMTS may be needed to bring estimates into line with the change of economic ownership of goods, either generally or because of the particular coverage of each country. Possible examples include merchanting, inverse merchanting, non~~-~~-monetary gold, goods entering or leaving the territory illegally, goods procured in ports by carriers, and goods moving physically but where there has been no change of ownership.

Merchanting

33.31 Merchanting involves the purchase of goods by a resident (of the compiling economy) from a non-resident and the subsequent resale of the goods to another non-resident. Under such arrangements, the goods do not cross the border of the compiling economy, at any point, but the goods change ownership. The purchase is recorded as negative exports and the subsequent sale as positive exports, with the difference representing the trade margin of the merchant. Further details of the recording of merchanting are given in chapter 23 (see paragraphs 23.12 to 23.20).

Factoryless goods arrangements

33.32 International sales of final goods under factoryless goods producer (FGP) arrangements are recorded under goods (general merchandise) and not under merchanting. The activity of the FGP is manufacturing. Further details of the recording of this activity are given in chapter 23 (see paragraphs 23.28 to 23.32).

Re-exports

~~33.27~~33.33 Re-exports are foreign goods (goods produced in other economies and previously imported with a change of economic ownership) that are exported with no substantial transformation from the state in which they were previously imported. Because re-exported goods are not produced in the economy concerned, they have less connection to the economy than other exports. Economies that are major trans-shipment points and locations of wholesalers often have large values of re-exports. Re-exports increase the figures for both imports and exports; and~~,~~ when re-exporting is significant, the proportions of imports and exports to economic aggregates ~~are increased also~~increase . It is therefore useful to show re-exports separately. Goods that have been imported and are waiting to be re-exported are recorded in inventories of the resident economic owner.

~~33.2~~33.1 ~~Goods are presented at an aggregate level in the balance of payments. More detailed commodity breakdowns can be obtained from IMTS data.~~

~~Detail~~Services

33.34 Standards for services trade are shown in the *Manual on Statistics of International Trade in Services (MSITS)* (United Nations, European Commission, International Monetary Fund, Organisation for Economic Co-operation and Development, United Nations Conference on Trade and Development and the World Trade Organization, 2010), which is fully harmonized with the international accounts.

33.35 As noted above, goods sent abroad for processing, and returned after processing, do not involve a change of ownership, and are thus not recorded as imports and exports of goods. Instead, the fees for processing appear as either imports of services (payments for processing) or exports of services (receipts from processing), and are included in item (a) below.

~~33.28~~33.36 Trade in services detail is produced for the following ~~12~~16 standard components of services:

a. Manufacturing services on physical inputs owned by others;

b. Maintenance and repair services n.i.e.;

c. Transport;

d. Travel;

e. Construction;

f. Insurance and pension services;

g. Financial services;

h. Charges for the use of intellectual property n.i.e.;

i. Telecommunications~~, computer~~ services

~~i.~~j. Computer and information services;

~~j.~~k. Research and developments services

~~k.~~l. Professional and management consulting services

~~l.~~m. Trade-related services

~~m.~~n. Operating lease services

~~n.~~o. Technical and other business services;

~~o.~~p. Personal, cultural and recreational services; and

~~p.~~q. Government goods and services n.i.e.

~~33.29~~33.37 ~~Three~~Most components of trade in services are product-based, derived from the more detailed classes of CPC 2.1. However, three of the standard components are transactor-based items, that is, they relate to the acquirer or provider, rather than the product itself. These categories are travel, construction and government goods and services n.i.e.

~~33.30~~33.38 Travel covers all goods or services acquired by non- residents during visits whether for own use or to give away. Travel includes goods, local transport, accommodation, meals and other services. Construction covers both the total value of the product delivered by the contractor and any goods and services sourced locally by the contractor that are not recorded in imports and exports of goods. Government goods and services n.i.e. cover a range of items that cannot be allocated to more specific headings.

~~33.31 Besides the three transactor-based items, the remaining components are product-based, built from the more detailed classes of the *CPC 2*. Additional standards for services trade are shown in the *Manual on Statistics of International Trade in Services (MSITS)* (United Nations, European Commission, International Monetary Fund, Organisation for Economic Co-operation and Development, United Nations Conference on Trade and Development and the World Trade Organization, 2002), which is fully harmonized with the international accounts.~~

2. The ~~primary~~earned income account

~~33.32~~33.39 The entries in ~~the primary income~~this account are concerned with ~~compensation~~remuneration of employees and property income, exactly as in the allocation of ~~primary~~earned income account in the SNA. Payments of taxes on production by residents and receipts of subsidies by residents from the domestic government are recorded in the generation of income account, an account that does not form part of the balance of payments. Any payments of taxes on production payable by a resident to another government as well as any subsidy receivable by a resident from another government are recorded in the ~~primary~~earned income account of the balance of payments. The matching entries for the domestic government are shown in the SNA in the allocation of ~~primary~~earned income account and for foreign governments in the rest of the world column of that account and in the ~~primary~~earned income account of the balance of payments.

~~33.33~~33.40 Rent relates to the income receivable by the owner of a non-produced non-financial asset (the lessor or landlord) for putting the asset at the disposal of another institutional unit (a lessee or tenant) for use in production. Examples concern payments related to the use of marketing assets, land and other non-produced natural resources. Rent on land and other natural resources may arise in cross-border situations, but rarely, because all land and other natural resources are deemed to be owned by residents, if necessary by creating a notional resident unit. An example where rent on natural resources may be recorded in the international accounts may be short-term fishing rights in territorial waters provided to foreign fishing fleets. It is common in the international accounts to use the term investment income meaning property income excluding rent. Investment income therefore reflects income arising from the ownership of financial assets and the disaggregation of investment income matches that of financial assets and liabilities so that rates of return can be calculated.

~~33.34~~33.41 In ~~*BPM6*,~~*BPM7*, flows of interest ~~flows~~ and similar returns are measured on exactly the same basis as in the SNA with ~~FISIM~~implicit financial services on loans and deposits separated and treated as an import or export of financial services.

Income of direct investment enterprises

~~33.35~~33.42 The role of direct investment enterprises is particularly important and reflected in both the flows and positions in the international accounts. There is extended discussion on the identification and role of direct investment enterprises in section D.

~~33.36~~33.43 As explained in paragraphs ~~7.136~~ 8.141 to ~~7.139,~~ 8.144, in the case of a direct investment enterprise, it is assumed that a proportion of the enterprise's retained earnings is distributed to the direct investor as a form of investment income. The proportion corresponds to the direct investor's holding in the enterprise.

~~33.37~~33.44 Retained earnings are equal to the net operating surplus of the enterprise plus all property income earned less all property income payable (before calculating reinvested earnings) plus current transfers receivable less current transfers payable and less the item for the adjustment for the change in pension entitlements. Reinvested earnings accrued from any immediate subsidiaries are included in the property income receivable by the direct investment enterprise.

~~33.38~~33.45 Reinvested earnings may be negative, for example where the enterprise makes a loss or where dividends are distributed from ~~holding gains,~~ accumulated earnings, or in a quarter when an annual dividend is paid. ~~However, if~~ In this respect, it can be noted that payments related to the ~~dividends~~ sales of financial or non-financial assets are ~~disproportionately large relative to recent levels of dividends and earnings, the excess should be recorded~~treated as a withdrawal of ~~owner's~~ equity. The treatment of dividends for foreign direct investment differs from the ~~corporation as explained in paragraph 7.131.~~treatment of those for domestic direct investment; see paragraphs 8.136 and 8.137.

~~33.39~~33.46 For a direct investment enterprise that is 100 per cent owned by a non-resident, reinvested earnings are equal to retained earnings and the net saving of the enterprise is exactly zero.

3. ~~Secondary~~Transfer income account

~~33.40~~33.47 The entries in ~~the secondary income~~ this account are current transfers. The range of entries corresponds exactly to those in the ~~secondary distribution of~~ income transfers other than transfers in kind account in the SNA. Several of these are particularly important in the international accounts, especially current international cooperation and remittances sent to their home countries by individuals working abroad.

~~33.41~~33.48 Cross-border personal transfers are household-to-household transfers and are of interest because they are an important source of international funding for some countries that provide large numbers of long-term workers abroad. Personal transfers include remittances by long-term workers, that is, those who have changed their economy of residence.

~~33.42~~33.49 Other workers, such as border and seasonal workers do not change their economy of residence from the home economy. Instead of transfers, the international transactions of these workers include ~~compensation~~remuneration of employees, taxes and travel costs. A supplementary presentation of personal remittances brings together personal transfers with these related items. Personal remittances include personal transfers, ~~compensation~~remuneration of employees less taxes and travel, and capital transfers between households. For further details, see Appendix ~~5~~x Remittances in ~~*BPM6*~~*BPM7*.

~~33.43~~33.50 Insurance flows, especially flows relating to reinsurance, can be important internationally. These flows are recorded in the same way as in the SNA, both as regards the separation of a financial service charge and the treatment of direct insurance and reinsurance flows separately and not on a consolidated basis. Detailed information on this separation is given in part 1 of chapter ~~17~~24.

4. Balancing items in the current accounts of the international accounts

~~33.44~~33.51 The structure of the balancing items in the balance of payments is somewhat different from that in the SNA, in that each account has its own balancing item and another that carries down to the next account. To illustrate, the ~~primary~~earned income account has its own balancing item (balance on ~~primary~~earned income) and a cumulative balance (balance on goods, services and ~~primary~~earned income). The external balance on ~~primary~~earned income corresponds to balance of ~~primary incomes~~this account and is the item feeding into GNI. The current external balance corresponds to saving by the rest of the world relative to the domestic economy. The balancing items in the ~~*BPM6*~~*BPM7* structure of accounts are shown in table ~~16~~19.3, reproduced here for convenience as table ~~26~~33.4.

5. The capital account

~~33.45~~33.52 The elements of the capital account subject to international transactions are more restricted than those covered in the SNA. ~~The entries~~Transactions in produced assets are not recorded in the capital account~~ cover~~, because, as explained earlier, they are recorded as exports and imports of goods (and possibly services). Therefore, the capital account only includes acquisitions and disposals of non-produced non-financial assets and capital transfers~~. There are no transactions recorded as capital formation of produced assets because, as explained earlier, the ultimate use~~, including unusually large non-life insurance claims and other major compensatory payments, capital taxes, investment grants, debt forgiveness and one-off guarantees and other types of ~~exports is not a concern for the national economy.~~debt assumption.

~~33.46~~33.53 Like the SNA, net lending or net borrowing is the balancing item for the sum of the current and capital accounts and for the financial account. As in the SNA, it covers all instruments used for providing or acquiring funding, not just lending and borrowing. Conceptually, it has the same value as the national accounts item for the total economy, and the same as the national accounts item for the rest of the world but with the sign reversed.

6. The financial account and ~~IIP~~international investment position

~~33.47~~33.54 The financial account of the balance of payments and the ~~IIP~~international investment position (IIP) are of particular importance because they provide an understanding of international financing as well as of international liquidity and vulnerability. The ***integrated IIP statement***~~, including~~ parallels the accumulation accounts in the SNA, as shown in Table 33.5. It combines the opening and closing balance sheet positions of the IIP ~~and associated~~with the financial ~~and~~ transactions, the other changes ~~accounts, is shown in Table 26.5. The primary classification is based on functional categories, with additional data on instruments~~in volume of assets and labilities, and ~~institutional sectors.~~revaluations..

~~33.48~~33.55 Financial transactions and positions with non-residents are presented in the SNA on an asset and liability basis, by instrument. However, the primary classification of the international accounts is based on functional categories. The functional categories, described in section D, convey more information about the motivation and relationship between the parties, which are of ~~particular~~ interest ~~to~~for international economic analysis. ~~Data by~~The functional ~~category~~categories are further subdivided by instrument and institutional sector, which makes it possible to link them to the corresponding SNA and monetary and financial statistics items. The institutional sector classification is the same as in the SNA, although it is usually abbreviated (to five sectors in the standard components). In addition, a supplementary subsector is used for monetary authorities, which is a functional subsector linked to reserve assets. It covers the central bank and any parts of general government or financial corporations other than the central bank that hold reserve assets, so it is relevant for countries where some or all reserves are held outside the central bank.

Table ~~26~~33.4: Balancing items in the international accounts in relation to the SNA sequence of economic accounts

~~33.49~~33.56 The part of the balance sheets covered in the international accounts is called the IIP. The terminology highlights the specific components of the national balance sheet which are included. The IIP covers only financial assets and liabilities because, to be included in the IIP, there must be a cross-~~-~~border element. In the case of financial claims, the cross-~~-~~border element arises when one party is a resident and the other party is a non-resident. In addition, while gold bullion is an asset that has no counterpart liability, it is included in the IIP when held as a reserve asset, because of its role as a means of international payments. However, non-financial assets are excluded as they do not have a counterpart liability or other international aspect.

~~33.50~~33.57 The balancing item on the IIP is the net IIP. The net IIP plus non-financial assets in the national balance sheet equal national net worth, ~~because~~with all resident-to-resident financial claims ~~net to zero~~accounted for in the national balance sheet.

~~33.51~~33.58 The same level of detail is used for investment income and the IIP. As a result, average rates of return can be calculated. Rates of return can be compared over time and for different instruments and maturities. For example, the trends in return on direct investment can be analysed, or the return can be compared with other instruments.

7. The other changes in assets accounts

~~33.52~~33.59 International assets and liabilities may be subject to all the possible types of other changes in the volume of assets and liabilities and to revaluation changes. For example, entries are made in the other changes in volume of assets and liabilities account for monetization and de-monetization of gold, or for the unilateral cancellation of a claim by a debtor. Because instruments are often denominated in foreign currencies and analysis of the effect of exchange rate movements is particularly important, ~~there is a~~the breakdown of revaluations into exchange rate changes and other factors is essential for analysis.

D. International accounts functional categories

~~33.53~~33.60 The international accounts functional categories are the primary classification used for each of investment income, financial transactions and positions in the international accounts. The following five categories are identified:

a. direct investment;

b. portfolio investment;

c. financial derivatives (other than reserves) and employee stock options;

d. other investment; and

e. reserve assets.

Table ~~26~~33.5: Overview of Integrated International Investment Position Statement

~~33.54~~33.61 Detailed definitions are given later in this section. The functional categories are built on the classification of financial instruments discussed in chapters ~~11~~12 and ~~13~~14, but with an additional dimension that takes into account some aspects of the relationship between the parties and the motivation for investment. As a result, the different categories exhibit different patterns of behaviour. For example, there is a different type of relationship between the parties for direct investors compared to portfolio investors holding equity. Direct investment is related to control or a significant degree of influence, and tends to be associated with a lasting relationship although it may be short-term. In addition to financial resources, direct investors often supply additional factors such as know-how, technology, management and marketing. As well, related companies are more likely to trade with and lend to each other. In contrast, portfolio investors typically have a smaller role in the decision-making of the enterprise, with potentially important implications for future flows, and for the volatility of the price and volume of positions. Portfolio investment differs from other investment in that it provides a direct way to access financial markets, and so can provide liquidity and flexibility.

~~33.55~~33.62 Reserve assets include a range of instruments that are shown under other categories when not owned by monetary authorities or other units authorized by the monetary authorities and sometimes even when held by monetary authorities. However, as reserve assets they are identified as being available to meet international payments financing needs and undertake market intervention to influence the exchange rate.

~~33.56~~33.63 The instrument classification alone does not fully reflect these behavioural differences. For example, a loan can appear under direct investment or other investment, but the different nature of the relationship between the parties means that the risks and motivations behind the transaction tend to differ. A direct investment loan is more likely to be provided and generally involves less vulnerability on the part of the borrowing economy because of the relationship between the parties. Table ~~26~~33.6 shows the relationship between instruments and functional categories.

Table ~~26~~33.6: Link between Financial Assets Classification and Functional Categories

Footnote 1: SDR assets are reserve assets; SDR liabilities are other investment;

X shows applicable functional categories; x shows cases that are considered to be relatively uncommon.

1. Direct investment

~~33.57~~33.64 ***Direct investment is a category of cross-border investment associated with a resident in one economy having control or a significant degree of influence on the management of an enterprise that is resident in another economy***. As well as the equity that gives rise to control or influence, direct investment also includes associated debt (except debt between affiliated financial intermediaries).

~~33.58~~33.65 Control is determined to exist if the direct investor owns more than 50 per cent of the voting power in the direct investment enterprise. Such an enterprise is called a subsidiary. A significant degree of influence is determined to exist if the direct investor owns from 10 to 50 percent of the voting power in the direct investment enterprise. Such an enterprise is called an associate. In order to achieve bilateral consistency and avoid subjective decisions about actual control or influence, these operational definitions should be used in all cases.

~~33.59~~33.66 As well as immediate direct investment relationships, there may be indirect direct investment relationships, as a result of a chain of ownership. In addition, fellow enterprises may be an important part of direct investment. (Fellow enterprises are enterprises that have less than ten per cent equity in each other but which are under the control or influence of the same investor who is a foreign direct investor in at least one of the fellows.) Reverse investment arises when direct investment enterprises invest in their own direct investors but have less than ten per cent of the voting power in the direct investor.

~~33.60~~33.67 Direct investment includes debt between the parties as well as equity except in the case of debt positions between related financial institutions~~.~~ (e.g., insurance companies and pension funds). Such debt between related companies may be called inter-company lending. One of the features of a group of direct investment enterprises is that its members are more likely to extend loans and trade credit to each other than are unrelated enterprises.

~~33.61~~33.68 Because of the relationship of control or influence, the direct investor's share of retained earnings of a subsidiary or associate is imputed as first being paid out as an income flow and then reinvested as a financial transaction. The income item is called reinvested earnings; the corresponding equal entry in the financial account is called reinvestment of earnings. Reinvested earnings are defined as the direct investor's share in the retained earnings of the enterprise, and so are consistent with the corresponding SNA items. A consequence is that there will be no net saving by an enterprise that is 100 per cent foreign owned, because all saving will be attributed to its direct investor.

~~33.62~~33.69 Those direct investment enterprises that are controlled by non-residents correspond to the SNA subsectors of foreign- controlled enterprises. However direct investment enterprises include those not subject to control from abroad but still subject to a significant degree of influence. The SNA's foreign-controlled enterprises are limited to inward direct investment, while the international accounts are also concerned with outward direct investment.

Reinvested earnings on foreign direct investment in the SNA have the same scope as in the balance of payments (although "foreign" is not used because it is redundant in the context of the international accounts).

~~33.63~~33.70 In addition to the statistics on the international financial flows associated with direct investment, information on foreign-controlled enterprises is provided through statistics on the Activities of Multinational Enterprises (AMNE statistics) and the closely related Foreign AffiliaTes Statistics (FATS). These cover items such as exports, imports, domestic sales and domestic purchases of goods and services~~.~~, labour input and value added. They therefore provide a wider picture of the operations of multinational enterprises. Additional information is available in *Recommendations Manual on the Production of Foreign AffiliaTes Statistics*, the *Handbook on Economic Globalisation Indicators* and *MSITS*.

2. Portfolio investment

~~33.64~~33.71 ***Portfolio investment is defined as cross-border transactions and positions involving debt or equity securities, other than those included in direct investment or reserve assets***. Securities are instruments designed for convenient negotiability between parties, such as shares, bonds, notes and money market instruments. The negotiability of securities is a way of facilitating trading, allowing them to be held by different parties during their lives. Negotiability allows investors to diversify their portfolios and to withdraw their investment readily.

~~33.65~~33.72 Portfolio investment typically depends on organized financial markets and associated bodies such as dealers, exchanges and regulators. In contrast, the parties to direct and other investment instruments usually deal directly with each other. The negotiability of portfolio investment transactions makes them a convenient and flexible investment channel, but also may be associated with volatility.

3. Financial derivatives (other than reserves) and employee stock options

~~33.66~~33.73 The definition of the functional category financial derivatives (other than reserves) and employee stock options largely coincides with the corresponding financial instrument class, discussed in chapters ~~11~~12, 14 and ~~13~~25. The difference in coverage between the functional category and the financial instrument is that financial derivatives associated with reserve asset management are excluded from the functional category and included in reserve assets. This category is identified separately because it relates to risk transfer, rather than supply of funds or other resources.

4. Other investment

~~33.67~~33.74 ***Other investment is a residual category that includes positions and transactions other than those included in direct investment, portfolio investment, financial derivatives and employee stock options and reserve assets***. It includes the remainder of the following financial instruments:

a. other equity;

b. currency and deposits;

c. loans (including use of IMF credit and loans from the IMF);

d. non-life insurance technical reserves, life insurance and annuities entitlements, pension entitlements and provisions for calls under standardized guarantees;

e. trade credit and advances;

f. other accounts receivable/payable; and

g. SDR allocations (SDR holdings are included in reserve assets).

5. Reserve assets

~~33.68~~33.75 ***Reserve assets are those external assets that are readily available to and controlled by monetary***

authorities for meeting balance of payments financing needs, for intervention in exchange markets to affect the currency exchange rate and for other related purposes (such as maintaining confidence in the currency and the economy, and serving as a basis for foreign borrowing). Reserve assets must be denominated and settled in foreign currency. Underlying the concept of reserve assets are the notions of "control" and "availability for use" by the monetary authorities. The standardized statistical definition of net international reserves is reserve assets less short-term net foreign currency claims.

~~33.69~~33.76 In general, only external claims actually owned by the monetary authorities can be classified as reserve assets. Nonetheless, ownership is not the only condition that confers control. In cases where institutional units (other than the monetary authorities) in the reporting economy hold legal title to external foreign currency assets and are permitted to do so only on terms specified by the monetary authorities or only with their express approval, such assets can be considered reserve assets. This is because such assets are under the direct and effective control of the monetary authorities.

~~33.70~~33.77 Reserve assets must be readily available in the most unconditional form. A reserve asset is liquid in that the asset can be bought, sold and liquidated for foreign currency (cash) with minimum cost and time, and without unduly affecting the value of the asset. This concept refers to both non-marketable assets, such as demand deposits, and marketable assets, such as securities where there are ready and willing sellers and buyers. In order to be readily available to the authorities to meet balance of payments financing needs and other related purposes under adverse circumstances, reserve assets generally should be of high quality.

~~33.71~~33.78 Reserve assets are limited to assets, but a memorandum item is provided for reserve-related liabilities that are included in other functional categories, mainly portfolio and other investment. (This is why the liabilities cell for reserves in table 26.3 is shaded.)

E. Special international accounts considerations

1. Global imbalances

~~33.72~~33.79 In recent years, the IMF has done extensive work on global statistical imbalances. By summing data on transactions (goods, services, transfers, etc.) and (changes in) financial stocks between residents and non-residents for all economies, global totals can be derived. (Although as a functional category, reserve assets have no counterpart liability, the constituent instruments can be allocated to their counterpart liabilities for an exercise of the type described here.) The extent of actual inconsistency has been used to identify systematic biases that can indicate reporting problems, for example, that services credits have higher coverage than services debits.

2. Exceptional financing

~~33.73~~33.80 Exceptional financing brings together financial arrangements made by the authorities to meet balance of payments needs. Exceptional financing therefore identifies transactions according to their motivation. In addition, the incurrence of arrears is included in exceptional financing. Although it is not a transaction, it is an action the monetary authorities may take to manage their payments requirements.

~~33.74~~33.81 Exceptional financing is presented in the "analytic" presentation of the balance of payments, as published in the Balance of Payments Statistics Yearbook (International Monetary Fund, annual). In this presentation, entries relating to reserves, IMF credit and exceptional financing are presented "below-the-line" while all the other entries, which will require funding, are shown above-the-line. This presentation facilitates analysis of the monetary authorities' international liquidity.

~~33.75~~33.82 There is more discussion on exceptional financing in appendix 1 of ~~*BPM6*~~*BPM7*.

3. Debt instruments

~~33.76~~33.83 It is useful to group the different types of debt instruments, because debt instruments have particular implications for international liquidity and risk. Debt instruments are those instruments that require the payment of principal or interest or both at some point(s) in the future. Debt instruments comprise special drawing rights, currency and deposits, debt securities, loans, insurance technical reserves and provision for calls under standardized guarantees, and other accounts receivable/payable. Financial derivatives are not debt instruments, but an overdue obligation on a financial derivative contract is classified as an account payable and thus is included as a debt instrument.

~~33.77~~33.84 Debt instruments can be contrasted with equity and investment shares in the nature of the liability and risk. While equity gives a residual claim on the assets of the entity, a debt instrument involves an obligation to pay an amount of principal or interest or both usually according to a predefined formula, which means that the creditor has a more limited risk exposure. In contrast, the return on equity is largely dependent on the economic performance of the issuer, so the holders bear more of the risk. Additional information is provided in the External Debt Guide.

~~33.78~~33.85 Debt instrument flows and positions are shown divided between long-term and short-term. Primarily, this split is according to their original maturity, that is, the period from issue until contractually scheduled final payment. In addition, because of the international accounts concern with international liquidity issues, liability data can also be prepared on the basis of remaining maturity, that is, the period from the reference date until contractually scheduled final payment, on a supplementary basis.

4. Debt reorganization

~~33.79~~33.86 ***Debt reorganization (also referred as debt restructuring) is defined as arrangements involving both the creditor and the debtor (and sometimes third parties) that alter the terms established for servicing an existing debt***. Governments are often involved in debt reorganization, as a debtor, or a creditor or a guarantor, but debt reorganization can also involve the private sector, such as through debt exchanges. Debt reorganization involves a range of different types of transactions as well as valuation and timing issues.

~~33.80~~33.87 The four main types of debt reorganization are:

a. Debt forgiveness; a reduction in the amount of, or the extinguishing of, a debt obligation by the creditor via a contractual arrangement with the debtor;

b. Debt rescheduling or refinancing; a change in the terms and conditions of the amount owed, which may or may not result in a reduction in burden in present value terms;

c. Debt conversion; the creditor exchanges the debt claim for something of economic value, other than another debt claim on the same debtor, such as debt-for-equity swaps, debt-for-real-estate swaps, debt-for- development swaps, debt-for-nature swaps, and for debt prepayments, debt-for-cash; and

d. Debt assumption and debt payments on behalf of others when a third party is also involved.

Debt forgiveness across economies often involves government and there is further guidance on the treatments of these arrangements in chapter 22, ~~*BPM6*~~*BPM7* and specialized manuals such as the *External Debt Guide*.

~~33.81~~33.88 Debt repudiation, write-offs and write-downs of debt on a unilateral basis are not treated as transactions in either the SNA or ~~*BPM6*~~*BPM7* and so are not considered part of debt reorganization.

5. Regional arrangements, including currency unions

~~33.82~~33.89 Regional arrangements include:

a. monetary and currency unions, which provide for a single monetary policy across an area. Some of the same issues apply when one economy unilaterally adopts the currency of another economy, such as with "dollarization";

b. economic unions, which harmonize certain economic policies to foster greater economic integration; and

c. customs unions, which have common tariff and other trade policies with non-member economies.

~~33.83~~33.90 ~~*BPM6*~~*BPM7* gives detailed guidance on the treatments of these arrangements. Among the issues that are dealt with are the production of consolidated data for a union as a whole, the treatment of regional organizations, including the central bank, treatment of bank notes in a currency union, and revenue-sharing arrangements in a customs union. The existence of a currency union central bank (common currency and single monetary policy) does not preclude the existence of country central bank institutional units within the union. The country's central bank institutional units are deemed to be resident institutional units in the economies where they are located. However, the residence of the currency union central bank is the region to which the union applies.

6. Currency conversion, including multiple exchange rates

~~33.84~~33.91 Exchange rates must be considered carefully when measuring international transactions and positions, as changes can distort measurement. Flows denominated in a foreign currency are converted to their value in the domestic currency at the rate prevailing when the flows take place, and positions are converted at the rate prevailing on the balance sheet date. The midpoint between the buying and selling rates should be used at the time of transaction (for transactions) and at the close of business on the reference date for positions. The difference between buying/selling prices and midpoint prices represents a service charge and should be recorded as such.

~~33.85~~33.92 In principle, the actual exchange rate applicable to each transaction should be used for currency conversion. The use of a daily average exchange rate for daily transactions usually provides a very good approximation. If daily rates cannot be applied, average rates for the shortest period should be used. Some transactions occur on a continuous basis, such as the accrual of interest, over a period of time. For such flows, therefore, an average exchange rate for the period in which the flows occur should be used for currency conversion.

~~33.86~~33.93 Under a multiple exchange rate regime, two or more exchange rates are applicable to different categories of transactions; the rates favour some categories and discourage others. Such rates incorporate elements similar to taxes or subsidies. Because the multiple rates influence the values and the undertaking of transactions expressed in domestic currency, net proceeds implicitly accruing to authorities as a result of these transactions are calculated as implicit taxes or subsidies. The amount of the implicit tax or subsidy for each transaction can be calculated as the difference between the value of the transaction in domestic currency at the actual exchange rate applicable and the value of the transaction at a unitary rate that is calculated as a weighted average of all official rates used for external transactions. For conversion of positions of external financial assets and liabilities in a multiple rate system, the actual exchange rate applicable to specific assets or liabilities at the beginning or end of the accounting period is used.

33.94 Parallel (unofficial) or black market rates cannot be ignored in the context of a multiple rate regime and can be treated in different ways. For instance, if there is one official rate and a parallel market rate, the two should be handled separately. Transactions in parallel markets should be converted using the exchange rate applicable in that market. If there are multiple official rates and a parallel rate, the official rates and the parallel rate should be treated as distinct markets in any calculation of a unitary rate. Transactions effected at the parallel rate usually should be separately converted at that rate. However, in some instances, parallel markets may be considered effectively integrated with the official exchange rate regime. Such is the case when most or all transactions in the parallel market are sanctioned by the authorities or when the authorities actively intervene in the market to affect the parallel rate, or do both. In this instance, the calculation of the unitary rate should include both the official and parallel market rates. If only limited transactions in the parallel market are sanctioned by the authorities, the parallel rate should not be included in the calculation of a unitary rate.