Towards the 2025 SNA and BPM7

Note with recommendations for resolving minor action points

Peter van de Ven

2008 SNA Update Lead Editor

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Introduction

29 action points derived from assessment of research agenda and master-log of changes:

- For **six action points, separate issues notes** have been drafted (4), or will be drafted in the near future (2)
- **Seven action points will be dealt with while drafting the 2025 SNA**
- **Three action points have already been resolved**, while for one other action point a different procedure has been agreed
- **Twelve action points** (of which two have been combined) **dealt with in the note with recommendations for resolving minor action points**
  - **Two more substantial action points will be presented here**
    - **A.12 (combined with B.11): Work-in-progress, transfer of ownership and capital services**
    - **B.10: Recording of non-life insurance claims in the case of losses of capital assets**
  - **For the other action points**, the AEG and BOPCOM will be requested to provide their opinion via a **written consultation after the meeting**

A.12: Work-in-progress, transfer of ownership and capital services

Two issues:

- Work-in-progress and the ownership transfer of incomplete fixed assets
- Measurement of capital services

A.12: Work-in-progress and transfer of ownership

- Paragraph 10.135 of the 2008 SNA states the following for the recording of work-in-progress:

  > ***Work-in-progress must be recorded for any output that is not complete at the end of the accounting period***. *This is a particular problem for output taking a long time to complete, such as construction. …* ***The only exceptions*** *to recording incomplete work as work-in-progress are for* ***partially completed projects for which the ultimate owner is deemed to have taken ownership, either because the production is for own use or as evidenced by the existence of a contract of sale or purchase***.

A.12: Work-in-progress and transfer of ownership

- However, paragraph 6.140 of the 2008 SNA includes exceptions to this general rule, as follows:

> *When a contract of sale is agreed in advance for the construction of buildings and structures, **but not for other production spreading over several periods**, the **output produced each period is treated as being sold** to the purchaser at the end of each period, that is, as a sale rather than work-in-progress. … It is **recorded as gross fixed capital formation by the purchaser** and not as work-in-progress by the producer. When the contract calls for **stage payments, the value of the output may often be approximated by the value of stage payments** made each period. In the absence of a contract of sale, however, the incomplete output produced each period must be recorded as work-in-progress of the producer*

A.12: Work-in-progress and transfer of ownership

- **Issues at stake:**
  - **Removing the inconsistency in treatment of buildings and structures versus other fixed assets**
  - From a conceptual point of view, **stage payments should not be considered the single criterion for recording a transfer of partially completed assets**, it's about the effective transfer of ownership
  - **Recording of the transfer of uncompleted assets as gross fixed capital formation** in the books of the purchaser
  - **Recording of uncompleted assets produced for own final use as gross fixed capital formation**
- **Theory versus practice**
  - It may not always be that easy to make a **distinction between work-in-process and gross fixed capital formation** (e.g., in the case of R&D)
  - **Effective transfer of ownership not easy to determine**

A.12 WIP: Summary of recommendations

- Rec. 1: Include more generic guidance on the recording of work-in-progress, **not restricting the transfer of ownership to buildings and other structures**
- Rec. 2: Include **guidance on the conceptually preferred recording of work-in-progress** (only record a transfer in the case of an effective transfer of ownership; record partially completed structures as work-in-progress, also after a partial hand-over; record differences between stage payments and the effective transfer of ownership as other accounts payable/receivable)
- Rec. 3: Include **possible exceptions to the conceptually preferred recording**, in view of problems around the practical implementation (use stage payments as a proxy for transfer of ownership; if it is not possible to distinguish between the recording of work-in-progress for partially completed assets versus the recording of gross fixed capital formation for completed assets, record gross fixed capital formation as a default)

A.12: Measurement of capital services

- Paragraph 20.3 of the 2008 SNA:
  - **Capital services** not restricted to fixed assets, but **also related to inventories, natural resources and other non-produced assets used in production**
  - Valuables explicitly excluded, as some of them may also be used in production
- Capital services on inventories
  - Hardly any guidance on the estimation of capital services related to inventories (apart from numerical example on work-in-progress in para. 20.63) => **include more explicit guidance on capital services for inventories**
  - Inventories may also suffer from a decline in value because of some forms of downgrading => part of **"normal wear and tear"**; however, this is (implicitly) recorded as intermediate consumption
  - In the case of **work-in-progress**, stage payments could differ from the actual transfer of ownership => value of non-financial assets ≠ sources of funding needed; however, for practical reasons, it was already recommended to treat transfer of partially completed assets as being equal to stage payments

A.12: Measurement of capital services

- Chapter 20 of the 2008 SNA already addresses the concept of capital services for **land and other natural resources**; see paragraphs 20.41 – 20.48 => **needs to be updated In view of the new guidance for natural resources**
- Funds locked in by **working capital** in the form of liquidity to run an enterprise, which may also give rise to capital services? => **not recommended to extend the concept of capital services**, as one may assume that these liquid funds, especially the ones without any income in the form of interest, will be limited to the extent possible
- **Choice of rate of return**:
  - The 2008 SNA contains a rather generic discussion, including options for either an exogenous or an endogenous rate
  - Although more prescriptive guidance may not be warranted, it is recommended that the 2025 SNA includes **more guidance on the choice of an exogenous rate of return**, in line with Guidance Note WS.10 (i.e., the use of yields on long-term government bonds as a default for discounting future resource rents)

A.12 Capital services: Summary of recommendations

- Rec. 4: Include **more explicit guidance on capital services for inventories**
- Rec. 5: **Update the guidance on the measurement of capital services for natural resources**, in line with the recommendations of Guidance Notes WS.6, WS.8, WS.10 and WS.11
- Rec. 6: Include **additional discussion on the rate of return**, and also on the use of **discount rates**, in line with Guidance Note WS.10

B.10: Recording of non-life insurance claims in the case of losses of capital assets

- At its 7th meeting, held on 23 – 25 April 2012, the AEG discussed the issue of **recording non-life insurance claims, as capital transfers, in the case of catastrophic events**
- The discussion mainly focussed on what constitutes a catastrophic event, but the AEG also noted that "***further clarification is needed on whether capital transfers should only be recognised for claims related to the loss of capital assets in the event of a catastrophe***, *and requested the ISWGNA to investigate the issue*"
- Paragraph 17.40 of the 2008 SNA states that **it makes sense to record claims arising from catastrophic events as capital transfers**, using the rationale "*that many of the claims will relate to destruction or serious damage to assets such dwellings, buildings and structures*"
- However, it is also noted that "*damage corresponding to* ***a normal level of claims is covered by, for example, consumption of fixed capital or losses from inventories***". In these cases, losses due to normal or recurrent accidental damage are included as cost elements, and therefore "*captured as current expenditure elsewhere in the system*"

B.10: Recording of non-life insurance claims in the case of losses of capital assets

Items for discussion

- The 2008 SNA only refers to "*assets such as dwellings, buildings and structures*", but **what about losses of fixed assets other than dwellings, buildings and structures; inventories; non-produced non-financial assets, and also valuables?** It is considered logical to also record claims related to the losses of these assets from catastrophic events as capital transfers
- **What about reinsurance?**
  - **An exceptional event for national insurers may be business-as-usual for a large worldwide operating reinsurance company**; however, recording direct non-life insurance claims as capital transfers and reinsurance claims as income transfers would lead to **counterintuitive results**
  - Need for **alignment on a case by case basis**, also cross-border; a relatively strict delineation of catastrophic events would definitely support such efforts

B.10: Recording of non-life insurance claims in the case of losses of capital assets

- Claims arising from damages to **consumer durables**
  - **Should one record relevant claims as capital transfers, although no assets have been recognised?**
  - **Consumer durables are not only a special case when it comes to claims due to catastrophic events, but also for claims which are not related to catastrophic events**; while normal losses of fixed assets and inventories are covered by consumption of fixed capital and losses from inventories, this does not hold for consumer durables
  - Importantly, expenditures related to replacing the relevant losses are recorded as final consumption. Consequently, a recording of claims as capital transfers would lead to an inconsistency between disposable income and final consumption expenditure, while **a recording as current transfer would at least not affect saving of households**
  - **What about claims due to catastrophic events? Current transfers as well?** It may not be feasible to separate claims related to consumer durables
  - Unless such information is available, it is recommended to **treat all claims arising from catastrophic events as capital transfers as the default option**

Summary of recommendations

- Rec. 1: **Not to change the current guidance for recording non-life insurance claims, apart from extending the recording of capital transfers in the case of catastrophic events to claims related to inventories and non-financial assets other than dwellings, building and structures**
- Rec. 2: **Add clarifications on** the recording of **reinsurance claims** which are related to catastrophic events
- Rec. 3: **Add clarifications on** the recording of claims in the case of damage to **consumer durables**, whether or not these are arising from catastrophic events
- Rec. 4: To arrive at a consistent recording of non-life insurance claims due to catastrophic events, also in view of avoiding inconsistencies in international transfers, **apply a relatively strict delineation of major catastrophic events**
- Rec. 5: If needed, add more details on the treatment of non-life insurance in the context of **distributional national accounts** in Chapters 32 and/or 34

Thank you for your attention!