

1993 SNA Rev 1 – Preliminary draft

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General Notes to the Readers of the Preliminary Draft Chapters

The preliminary draft of chapters of the 1993 Rev1 are posted on the UN web site at <http://unstats.un.org/unsd/sna1993/draftingPhase/ChapterIssueMatrix.asp> for a period of 60 days during which comments from anyone interested in the SNA are welcome. It is hoped that members of the Advisory Expert Group (AEG) and national accounts staff in countries will be particularly willing and eager to offer comments. The preliminary draft will be revised in light of these comments to form the final draft. Because of the tight time table to produce the final draft, readers are informed that deadlines for comments cannot be extended. The deadline for each chapter is given on the page specific to each chapter

A comparison between each draft chapter and the corresponding chapter (if it existed) of the 1993 SNA is available. See the second section of this web page entitled "Reference text of the 1993 SNA"

In the draft chapters, definitions of national accounting concepts and terms are in bold italics. These definitions will also be extracted to form a glossary of key terms.

References to other chapters and other paragraphs in the updated *1993 SNA* are highlighted in yellow ***but have not yet been updated***. Final cross references will be inserted when the paragraph numbers have been finalized.. References to other manuals are highlighted in turquoise. If there are other citations that would be useful, please submit these suggestions along with comments. .

The tables in the text have been reformatted. They appear inset into portrait pages. Most tables appear on successive left- and right-hand side pages. Within each chapter, a table may appear in several places with alternative detail in each appearance to draw attention to the section currently being discussed in the text. The full detail of each table will appear in an annex and this annex will be available electronically in Excel format so that users can see the embedded formula used to derive the tables.

The code numbers for transactions, flows, sectors, etc. have been suppressed in both the text and the tables for the moment. Discussions continue about changes to the existing codes for the 1993 SNA and until this is settled it is difficult to envisage the format of codes for a somewhat amended hierarchy. They will be inserted at a later stage.

The data values in the tables are being reviewed. Where new entries have been added, at present the entries are usually blank but this needs to be rectified. In general, (excepting this case) a blank entry signifies that no entry is possible. A possible entry appears as a zero. The occurrence of blanks and zeroes is being verified also.

Editor's note: Chapter 4

Section A:

As with other introduction sections, I have picked up and copied key definitions into section A so the concepts are clear before moving on.

It was agreed to change residence slightly by introducing "predominant" before economic interest. Because this is principally a BOP term, I have picked up the discussion from BPM6 and replaced the SNA text by this.

I have incorporated the agreed decision tree of sectoring.

Section B

In 1993 SNA this is called "institutional units in the form of economic and social units" but it doesn't cover units of government which are part of this class. I have split it into two sections, one discussing corporations and one NPIs. I think this will make the index more helpful and well as being more accurate.

In the new section B on corporations, I have introduced a distinction between legal corporations and statistical ones. The existing text says the term "corporations" includes quasi-corporations but then often says corporations and quasi-corporations, as if not persuaded the previous note is sufficient. The text also says that limited liability partnerships and cooperatives are included (but never brings these in again later as it does quasi-corporations). It does not quite bring in foreign branches except via quasi-corporations. So I have a note that in the system "corporations" includes all of these and thereafter use corporations only.

I have brought in material from chapter 21 (public sector) on control of corporations by government and control of NPIs by government and replaced existing text by these.

I have reordered the material on corporations to discuss all the varieties first and control second.

The expression "ancillary corporation" was used in chapter 4 for a particular type of unit that provided services only to other units in a group of enterprise in order to then explain that it was NOT treated as a separate institutional unit in the System. Given the decision to recognise some units performing only ancillary activities as a genuine and possibly recognised ancillary unit, I have used the term "artificial subsidiary" for the type of unit referred to in chapter 4

Section D (was C) Non-financial corporations

We agreed to bring in NPIs as another type of sub-sector. We can hardly call the others "non-non-profit institutions" so I have called them "for profit institutions" FPIs.

Section E Financial corporations

NPIs need to be brought in here also, as well as the breakdown by control and the new sub-sectors as previously circulated with chapter 26.

Section F General government.

The 1993 SNA, GFSM and draft chapter 21 all explain the role of social security funds rather differently. In consultation with the IMF, I have tried to come up with something that tries to reach middle ground.

Sector G Households

The existing text contains a description of those household activities included and those that are not; this is the discussion of the production boundary that should and does take place in chapter 6.

The 1993 text contains some material touching on informal (as well as the annex). Given we will have a separate chapter on that, and in any case it is not really about sectors but about production, I have removed this from chapter 4 also.

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May 21 2007

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Chapter 4: INSTITUTIONAL UNITS AND SECTORS

A. Introduction

- 4.1 This chapter is concerned with the definition and description of institutional units and the way in which they are grouped to make up the sectors and sub-sectors of the System. The various sectors and sub-sectors of an economy are composed of institutional units that are resident in the economy, the total economy consisting of the entire set of resident institutional units.
1. **Institutional units**
- 4.2 *An institutional unit is an economic entity that is capable, in its own right, of owning assets, incurring liabilities and engaging in economic activities and in transactions with other entities.* The main attributes of institutional units may be described as follows:
- (a) An institutional unit is entitled to own goods or assets in its own right; it is therefore able to exchange the ownership of goods or assets in transactions with other institutional units;
 - (b) It is able to take economic decisions and engage in economic activities for which it is itself held to be directly responsible and accountable at law;
 - (c) It is able to incur liabilities on its own behalf, to take on other obligations or future commitments and to enter into contracts;
 - (d) Either a complete set of accounts, including a balance sheet of assets and liabilities, exists for the unit, or it would be possible and meaningful, from both an economic and legal viewpoint, to compile a complete set of accounts if they were to be required.
- 4.3 There are two main types of units in the real world that may qualify as institutional units, namely persons or groups of persons in the form of households, and legal or social entities.
- 4.4 For purposes of the System, *a household is a group of persons who share the same living accommodation, who pool some, or all, of their income and wealth and who consume certain types of goods and services collectively, mainly housing and food.* Institutional households comprise groups of persons staying in hospitals, retirement homes, convents, prisons, etc. for long periods of time.
- 4.5 The individual members of multi-person households are not treated as separate institutional units. Many assets are owned, or liabilities incurred, jointly by two or more members of the same household while some or all of the income received by individual members of the same household may be pooled for the benefit of all members. Moreover, many expenditure decisions, especially those relating to the consumption of food, or housing, may be made collectively for the household as a whole. It may be impossible, therefore, to draw up meaningful balance sheets or other accounts for members of the household on an individual basis. For these reasons, the household as a whole rather than the individual persons in it must be treated as the institutional unit.
- 4.6 *A legal or social entity is one whose existence is recognized by law or society independently of the persons, or other entities, that may own or control it.* The second type of institutional unit is a legal or social entity that engages in economic activities and transactions in its own right, such as a corporation, non-profit institution (NPI) or government unit. Such units are responsible and accountable for the economic decisions or actions they take,

although their autonomy may be constrained to some extent by other institutional units; for example, corporations are ultimately controlled by their shareholders. Some unincorporated enterprises belonging to households or government units may behave in much the same way as corporations, and such enterprises are treated as quasi-corporations when they have complete sets of accounts.

- 4.7 In the legal sense, corporations may be described by different names: corporations, incorporated enterprises, public limited companies, public corporations, private companies, joint-stock companies, limited liability companies, limited liability partnerships, and so on. Conversely, some legal entities that are non-profit institutions may sometimes be described as “corporations”. The status of an institutional unit cannot always be inferred from its name, and it is necessary to examine its objectives and functions. In the System, ***the term corporation covers legally constituted corporations and also cooperatives, limited liability partnerships, notional resident units and quasi-corporations.*** The description of these various institutional units is given in section B.
- 4.8 ***Non-profit institutions (NPIs) are legal or social entities created for the purpose of producing goods and services but whose status does not permit them to be a source of income, profit or other financial gain for the units that establish, control or finance them.*** In practice, their productive activities are bound to generate either surpluses or deficits but any surpluses they happen to make cannot be appropriated by other institutional units. The articles of association by which they are established are drawn up in such a way that the institutional units that control or manage them are not entitled to a share in any profits or other income they generate. For this reason, they are frequently exempted from various kinds of taxes. A description of the treatment of NPIs within the System is given in section C.
- 4.9 ***Government units are legal entities established by political processes that have legislative, judicial or executive authority over other institutional units within a given area.*** Viewed as institutional units, the principal functions of government are to assume responsibility for the provision of goods and services to the

community or to individual households and to finance their provision out of taxation or other incomes; to redistribute income and wealth by means of transfers; and to engage in non-market production.

2. Residence

- 4.10 ***The residence of each institutional unit is the economic territory with which it has the strongest connection, in other words, its centre of predominant economic interest.*** Each institutional unit is a resident of one and only one economic territory determined by its center of predominant economic interest.
- 4.11 Economic interests include current production, consumption, acquisition of assets and incurrence of liabilities, asset holding, place of incorporation or registration, and the origin of applicable taxation and regulation. In contrast, some non-economic connections are citizenship and plans for future location. Since some institutional units have economic interest in two or more economies, there is a need to choose between alternative aspects of economic interest. As a starting point, location is used. An institutional unit has a center of predominant economic interest in an economic territory when there exists, within the economic territory, some location, dwelling, place of production, or other premises on which or from which the unit engages and intends to continue engaging, either indefinitely or over a finite but long period of time, in economic activities and transactions on a significant scale. The location need not be fixed so long as it remains within the economic territory. Actual or intended location for one year or more is used as an operational definition; while the choice of one year as a specific period is somewhat arbitrary, it is adopted to avoid uncertainty and facilitate international consistency.
- 4.12 The concept of residence in the System is exactly the same as in *BPM6*. Further elaboration of borderline cases is given in **chapter 24 and in *BPM6*.**
- ## 3. Sectoring and economic behaviour
- 4.13 The institutional sectors of the System group together similar kinds of institutional units. Corporations, NPIs, government units and households are intrinsically different from each

other in that their economic objectives, functions and behaviour are different.

- 4.14 Institutional units are allocated to sector according to the nature of the economic activity they undertake and the characteristics of their owners. The three basic economic activities recorded in the System are production of goods and services, consumption to satisfy human wants or needs and accumulation of various forms of capital. Corporations undertake either production or accumulation (or both) but do not undertake (final) consumption. Government undertakes production (but mainly of a different type from corporations), accumulation and final consumption on behalf of the population. All households undertake consumption on their own behalf and may also engage in production and accumulation. NPIs are diverse in nature. Some behave like corporations, some are effectively part of government and some undertake activities similar to government but independently of it.
- 4.15 Fundamental to the distinction between corporations and government is the basis on which production is undertaken. Corporations produce for the market and aim to sell their products at economically significant prices. They determine the type of products, the quantities and prices all in response to market forces with the aim of making a profit.
- 4.16 The economic objectives, functions and behaviour of government units are quite distinct. They organize and finance the provision of goods and services, to individual households and the community at large on the basis of political decisions. They may produce most of these goods and services themselves but the products are either provided free or at prices determined by considerations other than purely market forces. Such prices are considered not to be economically significant. Government units are also concerned with distribution and redistribution of income and wealth through taxation and other transfers. Government units include social security funds.
- 4.17 The economic objectives, functions and behaviour of households are different again. Although primarily consumer units, they can also engage in production. Often this production activity is relatively small scale and includes informal and subsistence activities.

When the production units of households are not legal entities (and cannot be treated as such) they are described as unincorporated enterprises. They remain part of the same institutional unit as the household to which they belong.

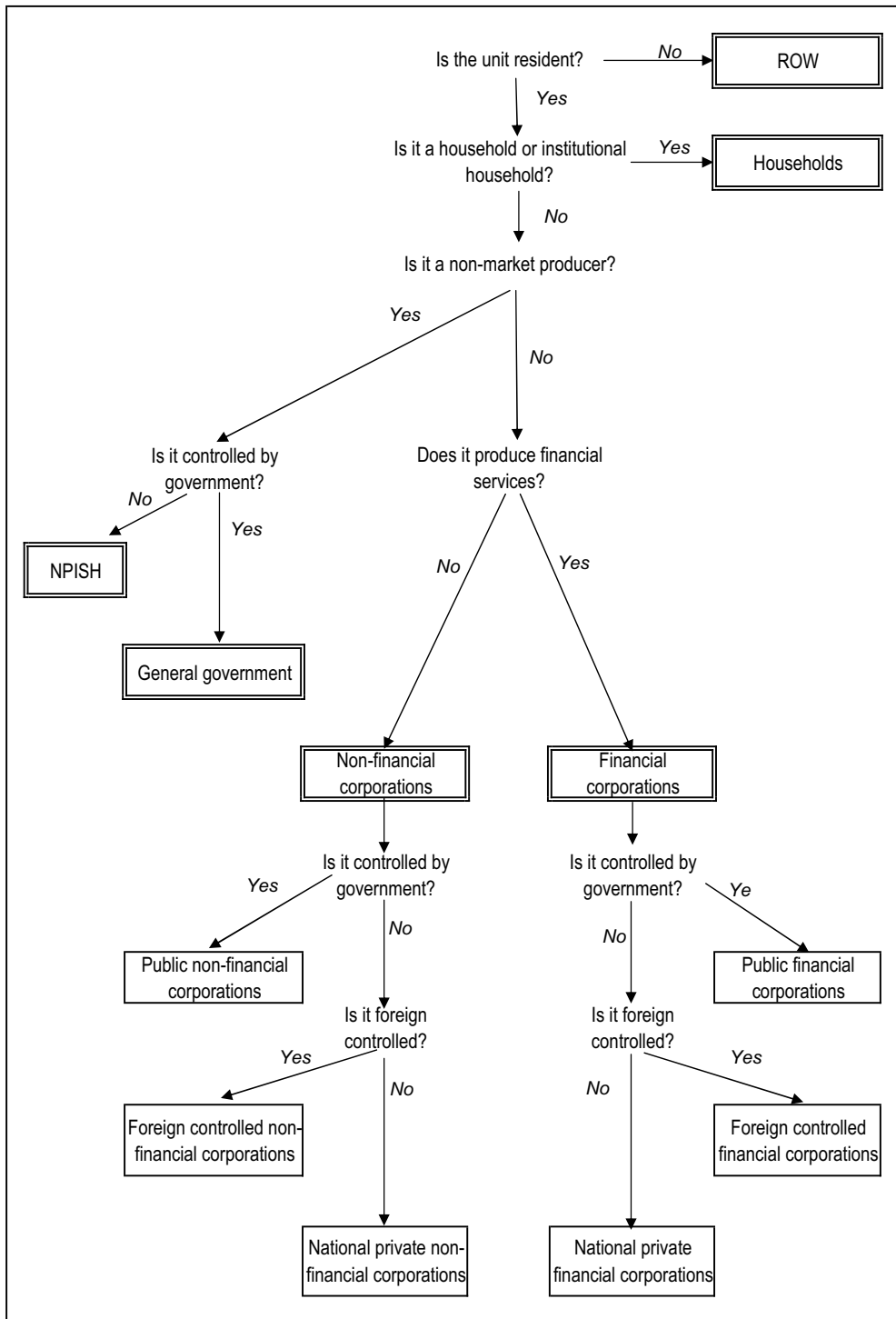
- 4.18 NPIs are institutional units created for the purpose of producing or distributing goods or services but not for the purpose of generating any income or profit for the units that control or finance them. Nevertheless, some NPIs deliver goods and services to customers at economically significant prices and, when they do, these NPIs are treated in the same way as corporations in the System. Other NPIs that are controlled by government are treated as government units. The remaining NPIs, those that produce goods and services but do not sell them at economically significant prices and are not controlled by government, are treated as a special group of units called non-profit institutions serving households (NPISHs). They are in effect non-governmental social institutions.

4. An overview of institutional sectors

- 4.19 *The total economy is defined as the entire set of resident institutional units.* The resident institutional units that make up the total economy are grouped into five mutually exclusive institutional sectors. Sectors are groups of institutional units, and the whole of each institutional unit must be classified to one or other sector of the System. The full sequence of accounts of the System may be constructed for a single institutional unit or a group of units. The attributes of an institutional unit described earlier explain why it is not possible to compile a full set of accounts for only part of a unit. However, it is possible, useful and common practice to compile some accounts for subdivisions of corporations, discriminating on the basis of the type of production the parts undertake. This is the subject of chapter 5. For the present chapter attention focuses on the allocation of complete units to one sector or another.
- 4.20 All resident institutional units are allocated to one and only one of the following five institutional sectors:

The non-financial corporations sector;

Figure 4.1 Illustrative allocation of units to institutional sectors



The financial corporations sector;

The general government sector;

The non-profit institutions serving households sector;

The households sector.

- 4.21 The conceptual basis for the allocation of a unit to the appropriate sector can be seen in figure 4.1. The sectors of the total economy, plus a box for the rest of the world, appear with double borders. Once non-resident units and households are set aside, only resident legal and social entities remain. Three questions determine the sectoral allocation of all such units. The first is whether the unit is a market or non-market producer. This depends on whether the majority of the unit's production is offered at economically significant prices or not. There is more extensive discussion of the definition of economically significant prices and the meaning of market and non-market production in chapter 6.
- 4.22 All non-market units, including non-market NPIs are allocated either to general government or to the NPISHs sector. The determining factor is whether the unit is part of, or controlled by, government. The criteria to establish control are discussed in section C below.
- 4.23 All market units are allocated to either the non-financial corporations sector or the financial corporations sector. In the context of sectors, the term "corporation" is used to encompass more units than those strictly meeting the definition of corporation given above. A distinction is made between non-financial and financial corporations because of the special role that financial corporations play in the economy.
- 4.24 All resident non-financial corporations are included in the non-financial corporations sector and make up most of the sector in practice. In addition, the sector includes non-profit institutions (NPIs) engaged in the market production of goods and non-financial services: for example, hospitals, schools or colleges that charge fees that enable them to recover their current production costs, or trade associations financed by subscriptions from non-financial

corporate or unincorporated enterprises whose role is to promote and serve the interests of those enterprises.

- 4.25 The financial corporations sector includes all resident corporations whose principal activity is financial intermediation or auxiliary activities that facilitate financial intermediation. In addition, the sector includes NPIs engaged in market production of a financial nature such as those financed by subscriptions from financial enterprises whose role is to promote and serve the interests of those enterprises.
- 4.26 The general government sector consists mainly of central, state and local government units together with social security funds imposed and controlled by those units. In addition, it includes NPIs engaged in non-market production that are controlled by government units or social security funds.
- 4.27 The non-profit institutions serving households sector consists of all resident NPIs, except those controlled and mainly financed by government, that provide non-market goods or services to households or to the community at large.
- 4.28 The households sector consists of all resident households. These include institutional households made up of persons staying in hospitals, retirement homes, convents, prisons, etc. for long periods of time. As already noted, an unincorporated enterprise owned by a household is treated as an integral part of the latter and not as a separate institutional unit.

5. Sub-sectors

- 4.29 Each of the five institutional sectors listed above may be divided into sub-sectors. No single method of sub-sectoring may be optimal for all purposes or all countries, so that alternative methods of sub-sectoring are recommended for certain sectors. Dividing the total economy into sectors enhances the usefulness of the accounts for purposes of economic analysis by grouping together institutional units with similar objectives and types of behaviour. Sectors and sub-sectors are also needed in order to be able to target or monitor particular groups of institutional units for policy purposes. For example, the household sector has to be divided into sub-sectors in order to be able to observe how

different sections of the community are affected by, or benefit from, the process of economic development or government economic and social policy measures. Similarly, it may be important to treat corporations subject to control by non-residents as sub-sectors of the financial and non-financial corporate sectors not only because they are liable to behave differently from domestically controlled corporations but because governments may wish to be able to identify and observe those parts of the economy that are subject to influence from abroad. The division of sectors into sub-sectors depends upon the type of analysis to be undertaken, the needs of policy makers, the availability of data and the economic circumstances and institutional arrangements within a country.

Public and foreign control

- 4.30 One common sub-sectoring is to identify those non-financial and financial corporations that are controlled by the government, called public corporations, and those that are controlled from abroad. The remaining corporations form the national private corporations in an economy. The criteria for determining control by government and from abroad are discussed in section B. Figure 4.1 includes this type of sub-sectoring for both groups of corporations.

Non-profit institutions

- 4.31 As described above, the System assigns NPIs to different sectors according to the type of

B. Corporations in the System

1. Types of corporations

- 4.34 In the System, the term corporation is used more broadly than in just the legal sense. In general, all entities that are

capable of generating a profit or other financial gain for their owners²

are recognized at law as separate legal entities from their owners who enjoy limited liability³

are set up for purposes of engaging in market production.

production they carry out⁴ regardless of motivation, status of employees or nature of the production. However, there is increasing interest in considering the full set of NPIs as evidence of “civil society” so it is recommended that NPIs within the corporate and government sectors be identified in distinct sub-sectors so that supplementary tables summarising all NPI activities can be derived as and when required in a straightforward manner.

Other sub-sectoring

- 4.32 The question of sub-sectoring is included in the more extensive consideration of each institutional sector in following sections. Particular sub-sectors are suggested for general government, financial corporations and households.

6. The rest of the world

- 4.33 On occasion it is convenient to refer to non-resident households or corporations as units that are resident in the rest of the world. Whenever accounts are drawn up for institutional sectors, as well as an account for the total economy, a further account is shown showing the relationship with the rest of the world. In effect, therefore transactions with the rest of the world are recorded as if the rest of the world is a de facto sixth sector.

are treated as corporations in the System, however they may describe themselves or whatever they may be called. As well as legally constituted corporations the term corporations⁵ is used to include cooperatives, limited liability partnerships, notional resident units and quasi-corporations. Whenever the term corporation is used, the broader coverage rather than the narrow legal definition is intended unless otherwise stated. Each of the main components of the broader coverage is discussed in turn below.

Legally constituted corporations

4.35 Legally constituted corporations may be described by different names: corporations, incorporated enterprises, public limited companies, public corporations, private companies, joint-stock companies, limited liability companies, limited liability partnerships, and so on. ***A legally constituted corporation is a legal entity, created for the purpose of producing goods or services for the market, that may be a source of profit or other financial gain to its owner(s); it is collectively owned by shareholders who have the authority to appoint directors responsible for its general management.***

4.36 The laws governing the creation, management and operations of legally constituted corporations may vary from country to country so that it is not feasible to provide a precise, legal definition of a corporation that would be universally valid. It is possible, however, to indicate in more detail the typical features of corporations that are most relevant from the point of view of the System. They may be summarized as follows:

- (a) A corporation is an entity created by process of law whose existence is recognized independently of the other institutional units that may own shares in its equity. The existence, name and address of a corporation are usually recorded in a special register kept for this purpose. A corporation may normally be expected to have a centre of predominant economic interest (that is, to be resident) in the country in which it is created and registered.
- (b) A corporation that is created for the purpose of producing goods or services for sale on the market does so at prices that are economically significant. This implies that it is a market producer. (A description of economically significant prices and the difference between market and non-market production is given in chapter 6.)
- (c) A corporation is fully responsible and accountable at law for its own actions, obligations and contracts, this being an essential attribute of an institutional unit

in the System. A corporation is liable to pay taxes on its productive activities, income or assets.

- (d) Ownership of a corporation is vested in the shareholders collectively. The amount of income actually distributed to shareholders as dividends in any single accounting period is decided by the directors of the corporation. Income is usually distributed to shareholders in proportion to the value, or amounts, of the shares or other capital participations they own. There may be different kinds of shares in the same corporation carrying different entitlements.
- (e) In the event of a corporation being wound up, or liquidated, the shareholders are similarly entitled to a share in the net worth of the corporation remaining after all assets have been sold and all liabilities paid. If a corporation is declared bankrupt because its liabilities exceed the value of its assets, the shareholders are not liable to repay the excess liabilities.
- (f) Control of a corporation is ultimately exercised by the shareholders collectively. A corporation has a board of directors that is responsible for the corporation's policy and appoints the senior management of the corporation. The board of directors is usually appointed by the collective vote of the shareholders;
- (g) In practice, however, some shareholders may exert much more influence or control over the policies and operations of a corporation than others:
 - (i) The voting rights of shareholders may not be equal. Some types of shares may carry no voting rights, while others may carry exceptional rights, such as the right to make specific appointments to the board of directors or the right to veto other appointments made on a majority vote. Such exceptional rights may be held by the government when it is a shareholder in a corporation;
 - (ii) Many shareholders with voting rights do not choose to exercise them, so that a small, organized minority of active shareholders may be in a position to

control the policy and operations of a corporation.

Cooperatives, limited liability partnerships, etc.

- 4.37 Cooperatives are set up by producers for purposes of marketing their collective output. The profits of such cooperatives are distributed in accordance with their agreed rules and not necessarily in proportion to shares held, but effectively they operate like corporations. Similarly, partnerships whose members enjoy limited liability are separate legal entities that behave like corporations. In effect, the partners are at the same time both shareholders and managers.

Notional resident units

- 4.38 Immovable assets such as land and other natural resources, and buildings and structures are usually treated as being owned by resident units. If the legal owner is actually non-resident, an artificial unit, called a notional resident unit, is created in the System. The notional resident unit is recorded as owning the asset and receiving the rent or rentals that accrue to the asset. The legal owner owns the equity in the notional resident unit and then receives income from the notional resident unit in the form of property income paid abroad. The only exception is made for land and buildings in extraterritorial enclaves of foreign governments (such as embassies, consulates and military bases) that are subject to the laws of the home territory and not those of the territory where they are physically situated

Quasi-corporations

- 4.39 Some unincorporated enterprises function in all (or almost all) respects as if they were incorporated. These are termed quasi-corporations in the System and are included with corporations in the non-financial and financial corporations sectors. ***A quasi-corporation is:***

either an unincorporated enterprise owned by a resident institutional unit that is operated as if it were a separate corporation and whose de facto relationship to its owner is that of a corporation to its shareholders: such an

enterprise must, of course, keep a complete set of accounts

or an unincorporated enterprise owned by a non-resident institutional unit that is deemed to be a resident institutional unit because it engages in a significant amount of production in the economic territory over a long or indefinite period of time.

- 4.40 Three main kinds of quasi-corporations are recognized in the System:

- (a) Unincorporated enterprises owned by government units that are engaged in market production and that are operated in a similar way to publicly owned corporations;
- (b) Unincorporated enterprises, including unincorporated partnerships, owned by households which are operated as if they were privately owned corporations;
- (c) Unincorporated enterprises that belong to institutional units resident abroad: these consist of the permanent branches, or offices of foreign corporate or unincorporated enterprises, or of production units belonging to foreign enterprises that engage in significant amounts of production within the economic territory over long, or indefinite, periods of time; e.g., units engaged in the construction of bridges, dams or other large structures. Unincorporated enterprises of non-resident units are referred to as branches.

- 4.41 The intent behind the concept of a quasi-corporation is clear: namely, to separate from their owners those unincorporated enterprises that are sufficiently self-contained and independent that they behave in the same way as corporations. If they function like corporations, they must keep complete sets of accounts. Indeed, the existence of a complete set of accounts, including balance sheets, for the enterprise is a necessary condition for it to be treated as a quasi-corporation. Otherwise, it would not be feasible from an accounting point of view to distinguish the quasi-corporation from its owner.

- 4.42 As a quasi-corporation is treated as a separate institutional unit from its owner, it must have its own value added, saving, assets, liabilities, etc.

It must be possible to identify and record any flows of income and capital that are deemed to take place between the quasi-corporation and its owner. The amount of income withdrawn from a quasi-corporation during a given accounting period is decided by the owner, such a withdrawal being equivalent to the payment of a dividend by a corporation to its shareholder(s). Given the amount of the income withdrawn, the saving of the quasi-corporation (i.e., the amount of earnings retained within the quasi-corporation) is determined. A balance sheet is also needed for the quasi-corporation showing the values of its non-financial assets used in production and also the financial assets and liabilities owned or incurred in the name of the enterprise.

- 4.43 Experience has shown that countries have difficulty distinguishing quasi-corporations owned by households. However, it is not useful to introduce additional criteria, such as size, into the definition of quasi-corporations owned by households; if an enterprise is not in fact operated like a corporation and does not have a complete set of accounts of its own, it cannot and should not be treated as a quasi-corporation however large it may be.

2. Special cases

Groups of corporations

- 4.44 Large groups of corporations, or conglomerates, may be created whereby a parent corporation controls several subsidiaries, some of which may control subsidiaries of their own, etc. For certain purposes, it may be desirable to have information relating to a group of corporations as a whole. However, each individual corporation should be treated as a separate institutional unit, whether or not it forms part of a group. Even subsidiaries that are wholly owned by other corporations are separate legal entities that are required by law and the tax authorities to produce complete sets of accounts, including balance sheets. Although the management of a subsidiary corporation may be subject to the control of another corporation, it remains responsible and accountable for the conduct of its own production activities.

- 4.45 Another reason for not treating groups of corporations as single institutional units is that groups are not always well defined, stable or easily identified in practice. It may be difficult to obtain data for groups whose activities are not closely integrated. Moreover, many conglomerates are much too large and heterogeneous for them to be treated as single units, and their size and composition may be continually shifting over time as a result of mergers and takeovers.

Holding companies

- 4.46 Two quite different types of units exist that are both referred to as holding companies. The first is the head office that exercises some aspects of managerial control over its subsidiaries. These may sometimes have noticeably fewer employees, and more at a senior level, than its subsidiaries but it is actively engaged in production. These types of activities are described in ISIC rev 4 in section M class 7010 as follows:

This class includes the overseeing and managing of other units of the company or enterprise; undertaking the strategic or organizational planning and decision making role of the company or enterprise; exercising operational control and manage the day-to-day operations of their related units.

Such units are allocated to the non-financial corporations sector unless all or most of their subsidiaries are financial corporations, in which case they are treated by convention as financial auxiliaries in the financial corporations sector.

- 4.47 The other type of holding company is a unit that holds the assets of subsidiary corporations but does not undertake any management activities. They are described in ISIC rev 4 in section K class 6420 as follows:

This class includes the activities of holding companies, i.e. units that hold the assets (owning controlling-levels of equity) of a group of subsidiary corporations and whose principal activity is owning the group. The holding companies in this class do not provide any other service to the businesses in which the equity is held, i.e. they do not

administer or manage other units.

Such units are always allocated to the financial corporations sector even if all the subsidiary corporations are non-financial corporations.

Institutional units with no employees and little production activity

- 4.48 A holding company that simply owns the assets of subsidiaries is one example of a unit that is not primarily established to carry out production. Other examples include investment funds and pension funds and units known variously as special purpose entities (SPEs) or special purpose vehicles. There is no common definition of an SPE but some purposes that such structures are used for are holding and managing wealth for individuals or families, holding assets for securitization, issuing debt securities on behalf of related companies (such a company may be called a conduit), securitization vehicles and to carry out other financial functions.
- 4.49 These units typically have no employees and no non-financial assets. They may have little physical presence beyond a “brass plate” confirming their place of registration. They are always related to another corporation, often as a subsidiary, and SPEs in particular are often resident in a territory other than the territory of residence of the related corporations.
- 4.50 The units are managed by employees of another corporation which may or may not be a related one. The unit pays fees for services rendered to it and in turn charges its parent or other related corporation a fee to cover these costs. This is the only production the unit is involved in though it will often incur liabilities on behalf of its owner and will usually receive investment income and holding gains on the assets held.
- 4.51 These units are distinct from the artificial units discussed below and are treated as institutional units, all of which are classified in the financial corporations sector.

Artificial subsidiaries

- 4.52 A subsidiary corporation, wholly owned by a parent corporation, may be created to provide

services to the parent corporation, or other corporations in the same group, in order to avoid taxes, to minimize liabilities in the event of bankruptcy, or to secure other technical advantages under the tax or corporation legislation in force in a particular country. For example, the parent may create a subsidiary to which ownership of its land, buildings or equipment is transferred and whose sole function is to lease them back again to the parent corporation; the subsidiary may be the nominal employer of all the staff who are then contracted to other corporations in the group, or the subsidiary may keep the accounts and records of the parent on a separate computer installation; and so on. In some cases, corporations may create “dormant” subsidiaries that are not actually engaged in any production but which may be activated at the convenience of the parent corporation

- 4.53 These sorts of corporations are not treated as separate institutional units in the System but should be treated as an integral part of the parent and their accounts consolidated with those of the parent.
- 4.54 Artificial subsidiaries are to be distinguished from units conducting ancillary activities as described in chapter 5.

3. Ownership and control of corporations

- 4.55 The ownership of a corporation is diffused among the institutional units that own its shares in proportion to the shareholdings. It is possible for one single institutional unit; (whether another corporation, a household or a government unit); to own all the equity or shares in a corporation but, in general, ownership is diffused among several, possibly very many, institutional units.
- 4.56 A single institutional unit owning more than a half of the shares, or equity, of a corporation is able to control its policy and operations by outvoting all other shareholders, if necessary. Similarly, a small, organized group of shareholders whose combined ownership of shares exceeds 50 per cent of the total is able to control the corporation by acting in concert. There may be exceptional cases in which certain shareholders enjoy privileged voting rights, such as a “golden share” giving a right of veto, but in general an individual institutional unit or group of units owning more than half the voting shares

of a corporation can exercise complete control by appointing directors of its own choice. The degree of autonomy exercised by the directors and managers of a corporation is, therefore, likely to vary considerably, depending upon the extent to which the ownership of its shares is concentrated in the hands of a small number of other institutional units, whether these are other corporations, households or government units. In general, institutional units do not have to be autonomous but they do have to be responsible, and accountable, for the decisions and actions they take.

4.57 Because many shareholders do not exercise their voting rights, a single shareholder, or small number of shareholders acting together, may be able to secure control over a corporation, even though they may hold considerably less than half of the total shares. When ownership of shares is widely diffused among a large number of shareholders, control may be secured by owning 20 per cent or less of the total shares.

4.58 However, it is not possible to stipulate a minimum shareholding below 50 per cent that will guarantee control in all cases. The minimum must vary depending upon the total number of shareholders, the distribution of shares among them, and the extent to which small shareholders take an active interest, etc.

Subsidiary and associate corporations

4.59 It is common for corporations to own shares in other corporations, and certain inter-relationships between corporations need to be specified for purposes of the System.

Subsidiary corporations

4.60 Corporation B is said to be a subsidiary of corporation A when:

- (a) Either corporation A controls more than half of the shareholders' voting power in corporation B; or
- (b) Corporation A is a shareholder in corporation B with the right to appoint or remove a majority of the directors of corporation B.

4.61 Corporation A may be described as the parent corporation in this situation. As the relationship of a parent corporation to a subsidiary is defined in terms of control rather than ownership, the relationship must be transitive: that is, if C is a subsidiary of B and B is a subsidiary of A, then C must also be a subsidiary of A. If A has a majority shareholding in B while B has a majority shareholding in C, A cannot also have a majority shareholding in C. Nevertheless, A must be able to control C if it controls B. By analogy with families of persons, corporation B can be described as a first generation subsidiary of corporation A, and corporation C as a second generation subsidiary of A. Evidently, large families of corporations may be built up with any number of subsidiaries at each level or generation and also any number of generations. Very large families of corporations, described as conglomerates, are encountered in some countries. Conglomerates may include corporations resident in different countries, in which case the parent corporation is usually described as a multinational corporation.

Associate corporations

4.62 Corporation B is said to be an associate of corporation A when corporation A and its subsidiaries control between 10 per cent and 50 per cent of the shareholders' voting power in B so that A has some influence over the corporate policy and management of B.

4.63 By definition, a corporation is able to exert less influence over an associate corporation than over a subsidiary. Although some corporations may be able to exert considerable influence over their associates, this cannot be guaranteed. The relationship between associates is weaker than that between parent and subsidiary corporations, and groups of associates may not be well defined.

Government control of corporations

4.64 A corporation is a public corporation if a government unit, another public corporation, or some combination of government units and public corporations controls the entity, where control is defined as the ability to determine the general corporate policy of the corporation. The expression "general corporate policy" as used here is understood in a broad sense to mean the key financial and operating policies relating to

the corporation's strategic objectives as a market producer.

- 4.65 Because governments exercise sovereign powers through legislation, regulations, orders and the like, care needs to be applied in determining whether the exercise of such powers amounts to a determination of the general corporate policy of a particular corporation and therefore control of the corporation. Laws and regulations applicable to all units as a class or to a particular industry should not be viewed as amounting to control of these units.
- 4.66 The ability to determine the general corporate policy does not necessarily include the direct control of the day-to-day activities or operations of a particular corporation. The officers of such corporations would normally be expected to manage these in a manner consistent with and in support of the overall objectives of the particular corporation.
- 4.67 Nor does the ability to determine the general corporate policy of a corporation include the direct control over any professional, technical or scientific judgments, as these would normally be viewed as part of the core competence of the corporation itself. For example, the professional or technical judgments exercised by a corporation set up to certify aircraft airworthiness would not be considered controlled in respect of individual approvals and disapprovals, though its broader operating and financial policies, including the airworthiness criteria, may well be determined by a government unit as part of the corporation's corporate policy.
- 4.68 Determining the general corporate policy of a corporation while acting as a fiduciary would not imply control. This is because the trustee, in executing its fiduciary obligations, would be obliged to act strictly in accordance with the trust deed. The trustee would act in the interests of the beneficiaries and not at the behest of its controlling entity. Two examples where this may apply relate to autonomous government employee pension funds and public trustees.
- 4.69 Because the arrangements for the control of corporations can vary considerably, it is neither desirable nor feasible to prescribe a

definitive list of factors to be taken into account. The following eight indicators, however, will normally be the most important and likely factors to consider:

- *Ownership of the majority of the voting interest.* Owning a majority of shares will normally constitute control when decisions are made on a one-share one-vote basis. The shares may be held directly or indirectly, and the shares owned by all other public entities should be aggregated. If decisions are not made on a one-share one-vote basis, the classification should be based on whether the shares owned by other public entities provide a majority voice.
- *Control of the board or other governing body.* The ability to appoint or remove a majority of the board or other governing body as a result of existing legislation, regulation, contractual, or other arrangements will likely constitute control. Even the right to veto proposed appointments can be seen as a form of control if it influences the choices that can be made. If another body is responsible for appointing the directors, it is necessary to examine its composition for public influence. If a government appoints the first set of directors but does not control the appointment of replacement directors, the body would then be part of the public sector until the initial appointments had expired.
- *Control of the appointment and removal of key personnel.* If control of the board or other governing body is weak, the appointment of key executives, such as the chief executive, chairperson, and finance director, may be decisive. Non-executive directors may also be relevant if they sit on key committees such as the remuneration committee determining the pay of senior staff.
- *Control of key committees of the entity.* Sub-committees of the board or other governing body could determine the key operating and financial policies of the entity. Majority public sector membership on these sub-committees could constitute control. Such membership can be established under the constitution or other enabling instrument of the corporation.

- *Golden shares and options.* A government may own a “golden share,” particularly in a corporation that has been privatized. In some cases, this share gives the government some residual rights to protect the interests of the public by, for example, preventing the company selling off some categories of assets or appointing a special director who has strong powers in certain circumstances. A golden share is not of itself indicative of control. If, however, the powers covered by the golden share do confer on the government the ability to determine the general corporate policy of the entity in particular circumstances, and those circumstances currently existed, then the entity should be in the public sector from the date in question. The existence of a share purchase option available to a government unit or a public corporation in certain circumstances may also be similar in concept to the golden share arrangement discussed above. It is necessary to consider whether the circumstance in which the option may be exercised currently exists, the volume of shares that may be purchased under the option and the consequences of such exercise means that the government currently has “the ability to determine the general corporate policy of the entity” by exercising that option. An entity’s status in general should be based on the government’s existing ability to determine corporate policy exercised under normal conditions rather than in exceptional economic or other circumstances such as wars, civil disorders or natural disasters.
- *Regulation and control.* The borderline between regulation that applies to all entities within a class or industry group and the control of an individual corporation can be difficult to judge. There are many examples of government involvement through regulation, particularly in areas such as monopolies and privatized utilities. It is possible for regulatory involvement to exist in important areas, such as in price setting, without the entity ceding control of its general corporate policy. Choosing to enter into or continue to operate in a highly regulated environment suggests that the entity is not subject to control. When regulation is so tight as to effectively dictate how the entity performs its business,

then it could be a form of control. If an entity retains unilateral discretion as to whether it will take funding from, interact commercially with, or otherwise deal with a public sector entity, the entity has the ultimate ability to determine its own corporate policy and is not controlled by the public sector entity.

- *Control by a dominant customer.* If all of the sales of a corporation are to a single public sector customer or a group of public sector customers, there is clear scope for dominant influence. The presence of a minority private sector customer usually implies an element of independent decision-making by the corporation so that the entity would not be considered controlled. In general, if there is clear evidence that the corporation could not choose to deal with non-public sector clients because of the public sector influence, then public control is implied.
- *Control attached to borrowing from the government.* Lenders often impose controls as conditions of making loans. If the government imposed controls through lending or issuing guarantees that are more than would be typical when a healthy private sector entity borrows from a bank, control may be indicated. Similarly, control may be implied if only the government was prepared to lend.

4.70 Although a single indicator could be sufficient to establish control, in other cases, a number of separate indicators may collectively indicate control. A decision based on the totality of all indicators must necessarily be judgmental in nature but clearly similar judgements must be made in similar cases.

Control by a non-resident unit

4.71 A non-resident unit controls a resident corporation if the non-resident unit owns more than ~~fifty~~⁵⁰ per cent of the equity of the corporation. Branches of non-resident corporations are by their nature always under foreign control. However, control may also be possible with a holding of less than half the equity if the non-resident unit can exercise some of the powers just described as indicating possible control by government, for example the control of the board or other governing body,

control of the appointment and removal of key personnel, control of key committees of the corporations and so on.

- 4.72 Within the balance of payments, a distinction is made between corporations where over ~~fifty~~ per cent of the equity is held by non-resident and those corporations where between 10 and 50 per cent of the equity is held abroad. All corporations with foreign holdings of 10 per cent or more are described as foreign direct

investment enterprises and special treatment of their earnings is applied. Further details on this are given in **chapters 7 and 24**. It is important to note, however, that while all foreign controlled corporations are foreign direct investment enterprises, the reverse is not true. For example even a publicly controlled corporation may be a foreign direct enterprise if, in addition to government controlling half of the equity, a further 10 per cent is owned by a non-resident.

C. Non-profit institutions

- 4.73 Non-profit institutions are legal or social entities created for the purpose of producing goods and services whose status does not permit them to be a source of income, profit or other financial gain for the units that establish, control or finance them. In practice, their productive activities are bound to generate either surpluses or deficits but any surpluses they happen to make cannot be appropriated by other institutional units. The articles of association by which they are established are drawn up in such a way that the institutional units that control or manage them are not entitled to a share in any profits or other income they receive. For this reason, they are frequently exempted from various kinds of taxes.

- 4.74 NPIs may be created by households, corporations, or government but the motives leading to their creation are varied. For example, NPIs may be created to provide services for the benefit of the households or corporations who control or finance them; or they may be created for charitable, philanthropic or welfare reasons to provide goods or services to other persons in need; or they may be intended to provide health or education services for a fee, but not for profit; or they may be intended to promote the interests of pressure groups in business or politics; etc. Although they may provide services to groups of persons or institutional units, by convention they are deemed to produce only individual services and not collective services.

1. The characteristics of NPIs

- 4.75 The main features of NPIs may be summarized as follows:

- (a) Most NPIs are legal entities created by process of law whose existence is recognized independently of the persons, corporations or government units that establish, finance, control or manage them. The purpose of the NPI is usually stated in the articles of association or similar document drawn up at the time of its establishment. In some countries, especially developing countries, an NPI may be an informal entity whose existence is recognized by society but not have any formal legal status; such NPIs may be created for the purpose of producing non-market goods or services for the benefit of individual households or groups of households.
- (b) Many NPIs are controlled by associations whose members have equal rights, including equal votes on all major decisions affecting the affairs of the NPI. Members enjoy limited liability with respect to the NPI's operations.
- (c) There are no shareholders with a claim on the profits or equity of the NPI. The members are not entitled to a share in any profits, or surplus, generated by the productive activities of the NPI, such profits being retained within the NPI.
- (d) The direction of an NPI is usually vested in a group of officers, executive committee or

similar body elected by a simple majority vote of all the members. These officers are the counterpart of the board of directors of a corporation and are responsible for appointing any paid managers.

- (e) The term “non-profit institution” derives from the fact that the members of the association controlling the NPI are not permitted to gain financially from its operations and cannot appropriate any surplus that it may make. It does not imply that an NPI cannot make an operating surplus on its production.

4.76 As in the case of producer units owned by government units, it is important to distinguish between NPIs engaged in market and non-market production as this affects the sector of the economy to which an NPI is allocated. NPIs do not necessarily engage in non-market production.

4.77 In some countries, NPIs are subject to preferential tax treatment, possibly to exemption from income tax, but this is not necessarily so and is not a determining factor in the identification of an NPI.

2. NPIs engaged in market production

4.78 Market producers are producers that sell most or all of their output at prices that are economically significant, that is, at prices that have a significant influence on the amounts the producers are willing to supply and on the amounts purchasers wish to buy. Schools, colleges, universities, clinics, hospitals, etc. constituted as NPIs are market producers when they charge fees that are based on their production costs and that are sufficiently high to have a significant influence on the demand for their services. Their production activities must generate an operating surplus or loss. Any surpluses they make must be retained within the institutions as their status prevents them from distributing them to others. On the other hand, because of their status as “non-profit institutions” they are also able to raise additional funds by appealing for donations from persons, corporations or government. In this way, they may be able to acquire assets that generate significant property income in addition to their revenues from fees, thereby

enabling them to charge fees below average costs. However, they must continue to be treated as market producers so long as their fees are determined mainly by their costs of production and are high enough to have a significant impact on demand. Such NPIs are not charities, their real objective often being to provide educational, health or other services of a very high quality using their incomes from endowments merely to keep down somewhat the high fees they have to charge.

Market NPIs serving businesses

4.79 As well as offering goods and services for sale to the economy at large, some market NPIs restrict their activities to serving a particular sub-set of other market producers. Most market NPIs serving businesses are created by associations of the businesses whose interests they are designed to promote. They consist of chambers of commerce, agricultural, manufacturing or trade associations, employers’ organizations, research or testing laboratories or other organizations or institutes that engage in activities that are of mutual interest or benefit to the group of businesses that control and finance them. The NPIs often engage in publicity on behalf of the group, lobby politicians or provide advice or assistance to individual members in difficulty for one reason or another. The NPIs are usually financed by contributions or subscriptions from the group of businesses concerned. The subscriptions are treated not as transfers but as payments for services rendered and these NPIs are, therefore, classed as market producers. However, as explained below, when chambers of commerce or similar organizations intended for the benefit of businesses are controlled by government units, they are classified as non-market NPIs and allocated to the general government sector.

3. NPIs engaged in non-market production

4.80 The majority of NPIs in most countries are non-market rather than market producers. Non-market producers are producers that provide most of their output to others free or at prices that are not economically significant. Thus, NPIs engaged mainly in non-market production may be distinguished not only by the fact that they are incapable of providing financial gain to the units that control or manage them, but also by the fact that they must rely principally on

funds other than receipts from sales to cover their costs of production or other activities. Their principal source of finance may be regular subscriptions paid by the members of the association that controls them or transfers or donations from third parties, including government.

4.81 NPIs engaged mainly in non-market production are divided into two groups: those NPIs controlled by government and those NPIs that provide goods and services to households at prices that are not economically significant and that are financed mainly by transfers from non-governmental sources in the national economy or from non-residents. The latter are described as “non-profit institutions serving households” (NPISHs) and constitute a separate sector in the System.

Government control of non-profit institutions

4.82 Control of an NPI is defined as the ability to determine the general policy or programme of the NPI. All 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. To determine if an NPI is controlled by the government, the following five indicators of control should be considered:

- *The appointment of officers.* The government may have the right to appoint the officers managing the NPI either under the NPI’s constitution, its articles of association or other enabling instrument.
- *Other provisions of enabling instrument.* The enabling instrument may contain provisions other than the appointment of officers that effectively allow the government to determine significant aspects of the general policy or programme of the NPI. For example, the enabling instrument may specify 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 enabling instrument may also give the government the right to remove key personnel or veto proposed appointments, require prior approval of budgets or financial arrangements by the

government, or prevent the NPI from changing its constitution, dissolving itself, or terminating its relationship with government without government approval.

- *Contractual agreements.* The existence of a contractual agreement between a government and an NPI may allow the government to determine key aspects of the NPI’s general policy or programme. As long as the NPI is ultimately able to determine its policy or programme to a significant extent, such as by being able to renege on the contractual agreement and accept the consequences, by being able to change its constitution or dissolve itself without requiring government approval other than that required under the general regulations, then it would not be considered controlled by government.
- *Degree of financing.* An NPI that is mainly financed by government may be controlled by that government. Generally, if the NPI remains able to determine its policy or programme to a significant extent along the lines mentioned in the previous indicator, then it would not be considered controlled by government.
- *Risk exposure.* 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 constitutes control. The criteria are the same as in the previous two indicators.

4.83 A single indicator could be sufficient to establish control in some cases, but in other cases, a number of separate indicators may collectively indicate control. A decision based on the totality of all indicators will necessarily be judgmental in nature.

NPIs serving households (NPISHs)

4.84 *Non-profit institutions serving households (NPISHs) consist of NPIs that provide goods or services to households free or at prices that are not economically significant.* Two main types of NPISHs may be distinguished.

4.85 The first type consists of NPISHs that are created by associations of persons to provide goods or, more often, services primarily for the benefit of the members themselves. The services are

usually provided free, being financed by regular membership subscriptions or dues. They include NPISHs such as professional or learned societies, political parties, trade unions, consumers' associations, churches or religious societies, and social, cultural, recreational or sports clubs. They do not include bodies serving similar functions that are controlled by government units. Religious institutions are treated as NPISHs even when mainly financed by government units if this majority financing is not seen as empowering control by government. Political parties in countries with one-party political systems that are controlled by government units by means of providing the necessary finance are included in the general government sector.

4.86 In some communities, NPISHs may be found that do not possess any legal status or formal articles of association. They should be treated as NPISHs when they perform the same kinds of functions as the societies, parties, unions, etc., described above, even if they are not

legally constituted as NPISHs. However, when groups of households collaborate on communal construction projects (such as construction of buildings, roads, bridges, ditches, dykes, etc.), they should be treated as informal partnerships engaged on own-account construction rather than NPISHs. NPISHs should normally have a continuing role to play and not be deemed to be created for single projects of limited duration.

4.87 The second type of NPISH consists of charities, relief or aid agencies that are created for philanthropic purposes and not to serve the interests of the members of the association controlling the NPISH. Such NPISHs provide goods or services on a non-market basis to households in need, including households affected by natural disasters or war. The resources of such NPISHs are provided mainly by donations in cash or in kind from the general public, corporations or governments. They may also be provided by transfers from non-residents, including similar kinds of NPISHs resident in other countries.

D. The non-financial corporations sector and its sub-sectors

4.88 *Non-financial corporations are corporations whose principal activity is the production of market goods or non-financial services.* The non-financial corporations sector is composed of the following set of resident institutional units:

- (a) All resident non-financial corporations (understood in the statistical sense of corporations and not just restricted to legally constituted corporations), regardless of the residence of their shareholders;
- (b) The branches of non-resident non-financial enterprises that are engaged in significant amounts of production on the economic territory on a long-term basis;
- (c) All resident NPIs that are market producers of goods or non-financial services.

4.89 Two classification criteria are used to sub-sector the non-financial corporations sector. One criterion is to show NPIs separately from other units in the sector. For convenience these may be described as for profit institutions (FPIs). The second criterion is that of control to show those that are publicly controlled, those that are national private institutions and those that are foreign controlled. The criteria for the second level of sub-sectoring, by control, are given above in the sections on corporations and NPIs.

4.90 ~~In full~~ the sub-sectoring of the non-financial corporations sector can be seen as a two-way table as shown in table 4.1. The exact form of presentation of the sub-sectors will depend on both analytical and statistical considerations. It may be that the number of NPIs is such that some control categories are empty or sufficiently sparse that the detail cannot be shown for reasons of confidentiality.

Table 4.1: Sub-sectors of the non-financial corporations sector

Non-financial corporations	NPIs	FPIs
Public non-financial corporations	Public non-financial NPIs	Public non-financial FPIs
National private non-financial corporations	National private non-financial NPIs	National private non-financial FPIs
Foreign controlled non-financial corporations	Foreign controlled non-financial NPIs	Foreign controlled non-financial FPIs
Non-financial corporations	Non-financial NPIs	Non-financial FPIs

E. The financial corporations sector and its sub-sectors

4.91 *Financial corporations consist of all resident corporations that are principally engaged in providing financial services, including insurance and pension funding services, to other institutional units.* Institutional units with no employees and little production set up to hold financial assets are included. The production of financial services is the result of financial intermediation, financial risk management, liquidity transformation or auxiliary financial activities. Because the provision of financial services is typically subject to strict regulation, it is usually the case that units providing financial services do not produce other goods and services and financial services are not provided as secondary production.

4.92 Financial corporations can be divided into three broad classes namely, financial intermediaries, financial auxiliaries and other financial corporations. Financial intermediaries are institutional units that incur liabilities on their own account for the purpose of acquiring financial assets by engaging in financial transactions on the market. Financial auxiliary activities are institutional units principally engaged in serving financial markets, but do not take ownership of the financial assets and liabilities they handle. Other financial corporations are institutional

units providing financial services, where most of their assets or liabilities are not available on open financial markets.

4.93 The financial corporations sector can be divided into nine sub-sectors according to its activity in the market and the liquidity of its liabilities. These nine sub-sectors are shown in table 4.2 and are each described later in this section. Sub-sector 6 corresponds to financial auxiliaries; sub-sector 7 corresponds to other financial corporations. All the other sub-sectors are financial intermediaries of one sort or another.

4.94 As well as being sub-sectored according to the nature of the financial activity being undertaken, the financial corporations sector can also be sub-sectored in the same manner as the non-financial corporations sector to show the difference between NPIs and FPIs and to show which units are subject to public control, which are national private corporations and which are foreign controlled. Thus in principle each of the rows in table 4.2 may be further disaggregated in the manner of table 4.1 though it is unlikely that all possible cross-classifications exist and a compressed sub-sectored based on local circumstance and particular analytical interest may be sufficient.

Table 4.2 Sub-sectors of the financial corporations sector

1. Central Bank
2. Deposit-taking corporations except the Central Bank
3. Money market funds (MMF)
4. Non-MMF investment funds
5. Other financial intermediaries except insurance corporations and pension funds (ICPF)
6. Financial auxiliaries
7. Captive financial institutions and money lenders
8. Insurance companies (IC)
9. Pension funds (PF)

1. Central bank

4.95 *The central bank is the national financial institution that exercises control over key aspects of the financial system.*

4.96 In general, the following financial intermediaries are classified in this sub-sector:

- (a) ~~The national central bank, including where it is part of a system of central banks; and~~
- (b) Central monetary agencies of essentially public origin (for example, agencies managing foreign exchange or issuing banknotes and coin) that keep a complete set of accounts but are not classified as part of central government. Supervisory authorities that are separate institutional units are not included with the central bank but are included with financial auxiliaries.

2. Deposit-taking corporations except the central bank

4.97 *Deposit-taking corporations except the central bank have financial intermediation as their principal activity. To this end, they have liabilities in the form of deposits or financial instruments (such as short-term certificates of deposit) that are close substitutes for deposits. The liabilities of deposit-taking corporations are typically included in measures of money broadly defined.*

4.98 In general, the following financial intermediaries are classified in this sub-sector:

- (a) Commercial banks, ‘universal’ banks, ‘all-purpose’ banks;
- (b) Savings banks (including trustee savings banks and savings and loan associations);
- (c) Post office giro institutions, post banks, giro banks;
- (d) Rural credit banks, agricultural credit banks;
- (e) Co-operative credit banks, credit unions; and
- (f) Specialized banks or other financial corporations if they take deposits or issue close substitutes for deposits.

3. Money market funds (MMFs)

4.99 *MMFs are collective investment schemes that raise funds by issuing shares or units to the public. The proceeds are invested primarily in money market instruments, MMF shares/units, transferable debt instruments with a residual maturity of less than one year, bank deposits and instruments that pursue a rate of return that approaches the interest rates of money market instruments. MMF shares can be transferred by cheque or other means of direct third-party payment. Because*



of the nature of the instruments the schemes invest in, their shares or units may be regarded as close substitutes for deposits.

4. Non-MMF investment funds

4.100 *Non-MMF investment funds are collective investment schemes that raise funds by issuing shares or units to the public. The proceeds are invested predominantly in long-term financial assets and non-financial assets (usually real estate).* Investment fund shares or units are generally not close substitutes for deposits. They are not transferable by means of cheque or third-party payments.

5. Other financial intermediaries, except insurance corporations and pension funds (ICPFs)

4.101 *Other financial intermediaries except insurance corporations and pension funds consist of financial corporations that are engaged in providing financial services by incurring liabilities, in forms other than currency, deposits or close substitutes for deposits, on their own account for the purpose of acquiring financial assets by engaging in financial transactions on the market.* It is a feature of a financial intermediary that transactions on both sides of the balance sheet are carried out in open markets.

4.102 In general, the following financial intermediaries are classified in this sub-sector:

- (a) Financial corporations engaged in the securitization of assets;
- (b) Security and derivative dealers (on own account);
- (c) Financial corporations engaged in lending, including the finance associated of retailers, who may be responsible for financial leasing and both personal or commercial finance;
- (d) Specialized financial corporations that provide:
 - Short-term financing for corporate mergers and takeovers;

Export/import finance;

Factoring companies;

Venture capital and development capital firms.

6. Financial auxiliaries

4.103 *Financial auxiliaries consist of financial corporations that are principally engaged in activities associated with transactions in financial assets and liabilities or with providing the regulatory context for these transactions but in circumstances that do not involve the auxiliary taking ownership of the financial assets and liabilities being transacted.*

4.104 In general, the following financial auxiliaries are classified in this sub-sector:

- (a) Insurance brokers, salvage and claims adjusters (whether employed by the insurance company, an independent adjuster or a public adjuster employed by the policy holder), insurance and pension consultants;
- (b) Loan brokers, securities brokers, investment advisers, etc.;
- (c) Flotation corporations that manage the issue of securities;
- (d) Corporations whose principal function is to guarantee, by endorsement, bills and similar instruments;
- (e) Corporations that arrange derivative and hedging instruments, such as swaps, options and futures (without issuing them);
- (f) Corporations providing infrastructure for financial markets;
- (g) Managers of pension funds, mutual funds, etc. (but not the funds they manage);
- (h) Corporations providing stock exchange and insurance exchange;

- (i) Foreign exchange bureaux;
- (j) Credit insurance corporations and guarantee banks to the extent that they do not have differentiated pools of reserves to meet claims; if they do they are classified in insurance corporations;
- (k) Non-profit institutions recognized as independent legal entities serving financial corporations, but are not themselves providing financial or auxiliary financial services;
- (l) Central supervisory authorities of financial intermediaries and financial markets when they are separate institutional units.

corporations but that do not themselves conduct the business of financial corporations.

Financial corporations such as SPEs or conduits that raise funds in open markets to be used by their parent corporation.

Units which provide financial services exclusively with own funds, or funds provided by a sponsor to a range of clients and incur the financial risk of the debtor defaulting, including

Moneylenders.

Corporations engaged in lending (e.g. student loans, import/export loans) from funds received from a sponsor such as a government unit or non-profit institution.

7. Captive financial institutions and money lenders

4.105 *Captive financial institutions and money lenders consist of institutional units providing financial services, where most of either their assets or liabilities are not transacted on open financial markets.* It includes entities transacting within only a limited group of units such as with subsidiaries or subsidiaries of the same holding corporation or entities that provide loans from own funds provided by only one sponsor.

Pawnshops that predominantly engage in lending.

4.106 In general, the following financial corporations are classified in this sub-sector:

Units which are legal entities such as, trusts, estates, agencies accounts or brass plate companies.

Holding corporations that only hold the assets (owning controlling-levels of equity) of a group of subsidiary corporations and whose principal activity is owning the group without providing any other service to the businesses in which the equity is held, that is, they do not administer or manage other units.

Financial holding corporations, entities principally engaged in controlling (head office services) financial corporations or groups of financial

8. Insurance corporations (ICs)

4.107 *Insurance corporations consist of incorporated, mutual and other entities whose principal function is to provide life, accident, sickness, fire or other forms of insurance to individual institutional units or groups of units or reinsurance services to other insurance corporations.*

9. Pension funds (PFs)

4.108 Pension liabilities arise when an employer or government obliges or encourages members of households to participate in a social insurance scheme that will provide income in retirement. The social insurance schemes may be organised by employers or by government, they may be organised by insurance corporations on behalf of employees or separate institutional units may be established to hold and manage the assets to be used to meet the pensions and to distribute the pensions. *The pension fund sub-sector consists of only those social insurance pension funds that are institutional units separate from the units that create them.*

10. Secondary financial activities

4.109 One form of financial innovation has been a substantial growth in activity of a kind traditionally carried out by, or through, financial corporations but that may also be done directly by non-financial enterprises themselves. For example, there is a tendency in some countries for producers or retailers of goods to provide consumer credit directly to their customers. Another example is the tendency for non-financial enterprises in some countries to raise funds themselves by selling their own obligations directly on the money or capital markets. However, the enterprise as a whole must continue to be classified as non-financial provided that:

- (a) A non-financial enterprise does not create a new institutional unit, such as a

subsidiary corporation, to carry out the financial activity; and

- (b) The financial activity remains secondary to the principal activity of the enterprise.

4.110 The same principle applies to the sub-sectoring of financial corporations. For example, many central banks also engage in some commercial banking. However, as a single institutional unit, the central bank as a whole, including its commercial banking activities, is classified in the sub-sector "central banks". For the same reason, central bank or monetary authority-type functions carried out by agencies within the central government that are not separate institutional units from government are not allocated to the central bank sub-sector. (This is discussed further in the following section and in chapter 21.)

F. The general government sector and its sub-sectors

1. Government units as institutional units

4.111 *Government units are unique kinds of legal entities established by political processes that have legislative, judicial or executive authority over other institutional units within a given area.* Viewed as institutional units, the principal functions of government are to assume responsibility for the provision of goods and services to the community or to individual households and to finance their provision out of taxation or other incomes; to redistribute income and wealth by means of transfers; and to engage in non-market production. In general terms:

- (a) A government unit usually has the authority to raise funds by collecting taxes or compulsory transfers from other institutional units. In order to satisfy the basic requirements of an institutional unit in the System, a government unit, whether at the level of the nation, a region or a locality, must have funds of its own either raised by taxing other units or received as transfers from other government units and the authority to disburse some, or all, of such funds in the pursuit of its policy

objectives. It must also be able to borrow funds on its own account;

- (b) Government units typically make three different kinds of final outlays:
 - (i) The first group consists of actual or imputed expenditures on the free provision to the community of collective services such as public administration, defence, law enforcement, public health, etc. that, as a result of market failure, have to be organized collectively by government and financed out of general taxation or other income;
 - (ii) The second group consists of expenditures on the provision of goods or services free, or at prices that are not economically significant, to individual households. These expenditures are deliberately incurred and financed out of taxation or other income by government in the pursuit of its social or political objectives, even though individuals could be charged according to their usage;

(iii) The third group consists of transfers paid to other institutional units, mostly households, in order to redistribute income or wealth.

4.112 Within a single territory there may be many separate government units when there are different levels of government, specifically central, state or local government. In addition, social security funds also constitute government units. These different kinds of government units are described later when the sub-sectoring of the general government sector is explained.

Government units as producers

4.113 The fact that governments choose to supply not only collective services but also many goods and individual services free, or at prices that are not economically significant, to households or other units does not require that they produce them themselves. Even in the case of most collective services, or so-called “public goods”, for which there is market failure, governments are obliged only to assume responsibility for organizing and financing their production. They are not obliged to produce them. However, government units do usually engage in a wide range of productive activities in practice, covering not only collective services but also many other goods and individual services. Because it is largely a matter of political choice, the range of goods and services produced by government units varies greatly from one country to another. Apart from some collective services such as public administration and defence, it is therefore difficult to categorize certain types of production, such as the production of education or health services, as intrinsically governmental, even though they are often produced by government units.

4.114 When a government unit wishes to intervene in the sphere of production it has three options:

- (a) it may create a public corporation whose corporate policy, including pricing and investment, it is able to control;
- (b) it may create an NPI that it controls;
- (c) it may produce the goods or services itself in an establishment that it owns but that does not exist as a separate legal entity from the government unit itself.

4.115 However, a government establishment, or group of establishments engaged on the same kind of production under common management, should be treated as a quasi-corporation if the following three criteria hold:

- (a) the unit charges prices for its outputs that are economically significant;
- (b) the unit is operated and managed in a similar way to a corporation; and
- (c) the unit has a complete set of accounts that enable its operating surpluses, savings, assets and liabilities to be separately identified and measured.

Such quasi-corporations are market producers that are treated as separate institutional units from the government units that own them. They are classified, sectored and sub-sectored in the same way as public corporations.

4.116 In order to be treated as a quasi-corporation the government must allow the management of the enterprise considerable discretion not only with respect to the management of the production process but also the use of funds. Government quasi-corporations must be able to maintain their own working balances and business credit and be able to finance some or all of their capital formation out of their own savings, depreciation reserves or borrowing. The ability to distinguish flows of income and capital between quasi-corporations and government implies that their operating and financing activities are not fully integrated with government revenue or finance statistics in practice, despite the fact that they are not separate legal entities.

4.117 Producer units of government that cannot be treated as quasi-corporations, like all unincorporated enterprises that cannot be separated from their owners, remain in the same institutional unit as the owner, in this case within the general government sector. They are likely to consist largely, or entirely, of non-market producers: that is, producers most or all of whose output is supplied to other units free, or at prices that are not economically significant. In addition to providing non-market goods or services to the general public, such units may include government producers supplying non-market goods or services to other

government units for purposes of intermediate consumption or gross fixed capital formation: for example, munitions factories, government printing offices, transport agencies, computer or communications agencies, etc. However, it is possible for an unincorporated enterprise within a government to be a market producer. The example often quoted is that of a bookshop within a museum.

Social security funds

- 4.118 Social security schemes cover a wide variety of programmes, providing benefits in cash or in kind for old age, invalidity or death, survivors, sickness and maternity, work injury, unemployment, family allowance, health care, etc. There is usually no direct link between the amount of the contribution paid by an individual and the risk to which that individual is exposed.
- 4.119 Social security funds may be separately organized from the other activities of government units and hold their assets and liabilities separately from the latter and engage in financial transactions on their own account. However, institutional arrangements in respect of social security differ from country to country and in some countries they may become so closely integrated with the other finances of government as to bring into question whether they should be treated as separate institutional units. The amounts raised, and paid out, in social security contributions and benefits may be deliberately varied in order to achieve objectives of government policy that have no direct connection with the concept of social security as a scheme to provide social benefits to members of the community. They may be raised or lowered in order to influence the level of aggregate demand in the economy, for example.

2. The general government sector

- 4.120 The general government sector consists of the following groups of resident institutional units:
- (a) All units of central, state or local government;
 - (b) All non-market NPIs that are controlled by government units.

The sector also includes social security funds, either as separate institutional units or as part of central, state or local government. The sector does not include public corporations, even when all the equity of such corporations is owned by government units. Nor does it include quasi-corporations that are owned and controlled by government units. However, unincorporated enterprises owned by government units that are not quasi-corporations remain integral parts of those units and, therefore, must be included in the general government sector.

3. Sub-sectors of the general government sector

- 4.121 A full sub-sectoring of the general government would allow for both NPIs and social security funds to be distinguished for each of central, state and local government. In practice though it is usual to show all social security units together as one sub-sector or to merge them all with their appropriate level of government and not show social security units by level of government separately. Further, NPIs may be shown as an “of which” item for general government as a whole or for central, state and local government individually.
- 4.122 Thus the first method of sub-sectoring general government is as follows:
- (a) Central government;
 - (b) State government;
 - (c) Local government;
 - (d) Social security funds;

where it is understood that each of the sub-sectors a, b and c include NPIs but exclude social security funds at that level of government.

- 4.123 The second method of sub-sectoring general government is as follows:
- (a) Central government;
 - (b) State government;
 - (c) Local government

where it is understood that each of the sub-sectors a, b and c include both NPIs and social security funds at that level of government.

- 4.124 Under either method of sub-sectoring, NPIs should be shown as “of which” heading under the appropriate level of government.
- 4.125 The choice between the two methods of sub-sectoring depends mainly on the size, or importance, of social security funds within a country and on the way in which they are managed.
- 4.126 In some countries there may not exist a proper intermediate level of government between central and local government, in which case the sub-sector “state government” is not distinguished. In others there may be more than two levels of government below the central government. In that case, the lower levels should be aggregated with state or local government as appropriate.

Central government

- 4.127 The central government sub-sector consists of the institutional unit or units making up the central government plus those non-market NPIs that are controlled by central government.
- 4.128 The political authority of central government extends over the entire territory of the country. Central government has therefore the authority to impose taxes on all resident and non-resident units engaged in economic activities within the country. Its political responsibilities include national defence and relations with foreign governments and it also seeks to ensure the efficient working of the social and economic system by means of appropriate legislation and regulation and also the maintenance of law and order. In addition it may incur expenditures on the provision of services, such as education or health, primarily for the benefit of individual households. Finally, it may make transfers to other institutional units, namely to households, NPIs, corporations and other levels of government.
- 4.129 Central government is a large and complex sub-sector in most countries. It is generally composed of a central group of departments or ministries that make up a single institutional unit plus, in many countries, other institutional

units. The departments may be responsible for considerable amounts of expenditure within the framework of the government’s overall budget, but they are nevertheless not separate institutional units. Each department is not capable of owning assets, incurring liabilities, engaging in transactions, etc., in its own right, that is to say independently of central government as a whole. It would not be possible to compile meaningful, or analytically useful, income and accumulation accounts or balance sheets for each separate department as if it were a single legal entity.

- 4.130 The departments of central government are often deliberately dispersed geographically and located in different parts of the country, but they nevertheless remain parts of a single institutional unit. Similarly, if the central government maintains branch offices or agencies in different parts of the country to meet local needs, including military bases or installations that serve national defence purposes, these must also be counted as parts of a single institutional unit for central government.
- 4.131 In addition to government departments and ministries, there may be agencies of central government with separate legal identity and substantial autonomy; they may have discretion over the volume and composition of their expenditures and may have a direct source of revenue such as earmarked (“hypothecated”) taxes. Such agencies are often established to carry out specific functions such as road construction or the non-market production of health or education services. These should be treated as separate institutional units if they maintain full sets of accounts but are part of the central government sub-sector if the services they produce are non-market and if they are controlled by central government.
- 4.132 In some countries, the central government may include units that engage in financial transactions that in other countries would be performed by central banks. In particular, units of central government may be responsible for the issue of currency, the maintenance of international reserves and the operation of exchange stabilization funds, and also transactions with the International Monetary Fund (IMF). When the units in question remain financially integrated with central government

and under the direct control and supervision of central government, they cannot be treated as separate institutional units. Moreover, whatever monetary authority functions are carried out by central government are recorded in the government sector and not the corporate financial sector. However, because of the analytical importance that is attached to obtaining accounts covering the monetary authorities as a whole, and in order to provide links with other statistical systems, such as the *Balance of Payments Manual*, the *Government Finance Statistics Manual* and the *Monetary and Financial Statistics Manual* of the IMF, it is recommended that the transactions of central government agencies carrying out monetary authority and deposit-taking functions should be separately identified, so that they can be combined with those of the central bank and other depository corporations in special tabulations if desired.

State government

- 4.133 The state government sub-sector consists of state governments that are separate institutional units plus those non-market NPIs that are controlled by state governments.
- 4.134 State governments are institutional units exercising some of the functions of government at a level below that of central government and above that of the governmental institutional units existing at a local level. They are institutional units whose fiscal, legislative and executive authority extends only over the individual “states” into which the country as a whole may be divided. Such “states” may be described by different terms in different countries. In some countries, especially small countries, individual states and state governments may not exist. However, in large countries, especially those that have federal constitutions, considerable powers and responsibilities may be assigned to state governments.
- 4.135 A state government usually has the fiscal authority to levy taxes on institutional units that are resident in, or engage in economic activities or transactions within, its area of competence (but not other areas). In order to be recognized as an institutional unit it must be able to own assets, raise funds and incur liabilities on its own account. It must also be entitled to spend

or allocate some, or possibly all, of the taxes or other income that it receives according to its own policies, within the general rules of law of the country, although some of the transfers it receives from central government may be tied to certain specified purposes. It should also be able to appoint its own officers, independently of external administrative control. On the other hand, if a regional unit is entirely dependent on funds from central government, and if the central government also dictates the ways in which those funds are to be spent at the regional level, it should be treated as an agency of central government rather than as a separate institutional unit.

- 4.136 State governments, when they exist, are distinguished by the fact that their fiscal authority extends over the largest geographical areas into which the country as a whole may be divided for political or administrative purposes. In a few countries more than one level of government exists between the central government and the smallest governmental institutional units at a local level; in such cases, for purposes of sectoring within the System, these intermediate levels of government are grouped together with the level of government, either state or local, with which they are most closely associated.
- 4.137 State governments may own, or control, corporations in the same way as central government. Similarly, they may have units that engage in market production, in which case the relevant producer units should be treated as quasi-corporations whenever their operations and accounting records justify this.

Local government

- 4.138 The local government sub-sector consists of local governments that are separate institutional units plus those non-market NPIs that are controlled by local governments. In principle, local government units are institutional units whose fiscal, legislative and executive authority extends over the smallest geographical areas distinguished for administrative and political purposes. The scope of their authority is generally much less than that of central government or state governments, and they may, or may not, be entitled to levy taxes on institutional units resident in their areas. They are often heavily dependent on grants or

transfers from higher levels of government, and they may also act as agents of central or regional governments to some extent. However, in order to be treated as institutional units they must be entitled to own assets, raise funds and incur liabilities by borrowing on their own account; similarly, they must have some discretion over how such funds are spent. They should also be able to appoint their own officers, independently of external administrative control. The fact that they may also act as agents of central or state governments to some extent does not prevent them from being treated as separate institutional units provided they are also able to raise and spend some funds on their own initiative and own responsibility.

- 4.139 As they are the government units that are in closest contact with the institutional units resident in their localities, they typically provide a wide range of services to local residents, some of which may be financed out of transfers from higher levels of government. The same rules govern the treatment of the production of goods and services by local government units as are applied to central and state governments. Units such as municipal theatres, museums, swimming pools, etc., that supply goods or services on a market basis should be treated as quasi-corporations whenever the appropriate accounting information is available. Other units supplying goods and services on a market basis are treated as unincorporated enterprises within local government. Units supplying services such as education or health on a non-market basis remain an integral part of the local government unit to which they belong.

Social security funds

- 4.140 The social security funds sub-sector consists of the social security funds operating at all levels

G. The households sector and its sub-sectors

1. Households as institutional units

- 4.142 *For the purposes of the System, a household is defined as a group of persons who share the same living accommodation, who pool some, or all, of their income and wealth and who*

of government. As explained above, social security funds are social insurance schemes covering the community as a whole or large sections of the community that are imposed and controlled by government units.

4. The alternative method of sub-sectoring

- 4.141 The alternative method of sub-sectoring the general government sector is to group the social security funds operating at each level of government with the corresponding government units and government controlled and financed NPIs at that level of government. The two alternative methods of sub-sectoring are designed to accommodate different analytical needs. The decision as to which method is more appropriate in a given country cannot be made a priori. It depends on how important social security funds are and on the extent to which they are managed independently of the government units with which they are associated. If the management of social security funds is so closely integrated with the short- or medium-term requirements of the government's general economic policy that contributions and benefits are deliberately adjusted in the interests of overall economic policy, it becomes difficult, at a conceptual level, to draw any clear distinction between the management of social security and the other economic functions of government. Alternatively, in some countries, social security funds may exist in only a very rudimentary form. In either of these circumstances it is difficult to justify treating social security funds as a separate sub-sector on a par with central, state and local government, and it is more appropriate to use the alternative method of sub-sectoring in which they are grouped with the corresponding government units at each level of government. This is the approach generally favoured in the *GFSM 2001*.

consume certain types of goods and services collectively, mainly housing and food In general, each member of a household should have some claim upon the collective resources of the household. At least some decisions affecting consumption or other economic

activities must be taken for the household as a whole.

- 4.143 Households often coincide with families, but members of the same household do not necessarily have to belong to the same family so long as there is some sharing of resources and consumption. Households may be of any size and take a wide variety of different forms in different societies or cultures depending on tradition, religion, education, climate, geography, history and other socio-economic factors. The definition of a household that is adopted by survey statisticians familiar with the socio-economic conditions within a given country is likely to approximate closely to the concept of a household as defined in the System, although survey statisticians may add more precise, or operational, criteria within a particular country.
- 4.144 Domestic staff who live on the same premises as their employer do not form part of their employer's household even though they may be provided with accommodation and meals as remuneration in kind. Paid domestic employees have no claim upon the collective resources of their employers' households and the accommodation and food they consume are not included with their employer's consumption. They should therefore be treated as belonging to separate households from their employers.
- 4.145 Persons living permanently in an institution, or who may be expected to reside in an institution for a very long, or indefinite, period of time are treated as belonging to a single institutional household when they have little or no autonomy of action or decision in economic matters. Some examples of persons belonging to institutional households are the following:
- (a) Members of religious orders living in monasteries, convents or similar institutions;
 - (b) Long-term patients in hospitals, including mental hospitals;
 - (c) Prisoners serving long sentences;
 - (d) Old persons living permanently in retirement homes.

4.146 On the other hand, persons who enter hospitals, clinics, convalescent homes, religious retreats, or similar institutions for short periods, who attend residential schools, colleges or universities, or who serve short prison sentences should be treated as members of the individual households to which they normally belong.

4.147 The residence of individual persons is determined by that of the household of which they form part and not by their place of work. All members of the same household have the same residence as the household itself, even though they may cross borders to work or otherwise spend periods of time abroad. If they work and reside abroad so long that they acquire a centre of economic interest abroad, they cease to be members of their original households.

2. Unincorporated enterprises within households

4.148 As noted in the introduction, households are unlike corporations in that they undertake final consumption. However, like corporations, they may also engage in production. Household unincorporated market enterprises are created for the purpose of producing goods or services for sale or barter on the market. They can be engaged in virtually any kind of productive activity: agriculture, mining, manufacturing, construction, retail distribution or the production of other kinds of services. They can range from single persons working as street traders or shoe cleaners with virtually no capital or premises of their own through to large manufacturing, construction or service enterprises with many employees.

4.149 Household unincorporated market enterprises also include unincorporated partnerships that are engaged in producing goods or services for sale or barter on the market. The partners may belong to different households. When the liability of the partners for the debts of the businesses is unlimited, the partnerships must be treated as unincorporated enterprises and remain within the household sector since all the assets of the household, including the dwelling itself, are at risk if the enterprise goes bankrupt. However, unincorporated partnerships with many partners, such as some large legal, accounting or architectural firms, are likely to behave like corporations and should be treated

as quasi-corporations assuming complete sets of accounts are available for the partnerships. Partnerships whose partners enjoy limited liability are effectively separate legal entities and, as already noted, are treated as corporations.

4.150 An unincorporated enterprise can only be treated as a corporation if it is possible to separate all assets, including financial assets down to the level of cash, into those that belong to the household in its capacity as a consumer from those belonging to the household in its capacity as a producer.

3. The household sector and its sub-sectors

4.151 The household sector consists of all resident households. There are many useful ways in which the households sector may be sub-sectored and statistical agencies are advised to give due consideration to the various possibilities. More than one method may be adopted if there is a demand for different breakdowns of the households sector from different users, analysts or policy-makers.

4.152 The System has to be applied flexibly, not rigidly. In order to implement any of the possible methods of sub-sectoring the households sector suggested below, individual countries are obliged to make their own decisions about what they consider to be the most relevant classification. Thus, the fact that a specific, detailed classification according to a criterion of interest is proposed here should not be interpreted as implying that the characteristics in question are less important for purposes of economic analysis and policy-making.

Sub-sectoring according to income

4.153 Households may be grouped into sub-sectors according to the nature of their largest source of income. For this purpose, the following types of household income need to be distinguished:

(a) Income accruing to the owners of household unincorporated enterprises with paid employees;

(b) Incomes accruing to the owners of household unincorporated enterprises without paid employees;

(c) Compensation of employees;

(d) Property and transfer incomes.

4.154 Households are allocated to sub-sectors according to which of the four categories of income listed above is the largest for the household as a whole, even if it does not always account for more than half of total household income. When more than one income of a given category is received within the same household, for example, because more than one member of the household earns compensation of employees or because more than one property or transfer income is received, the classification should be based on the total household income within each category. The four sub-sectors are described as follows:

(a) Employers;

(b) Own-account workers-;

(c) Employees;

(d) Recipients of property and transfer incomes.

4.155 The fourth sub-sector, households for which property and transfer incomes make up the largest source of income, constitutes a heterogeneous group and it is recommended that it should be divided into three further sub-sectors when possible. These sub-sectors are defined as follows:

Recipients of property incomes;

Recipients of pensions;

Recipients of other transfer incomes.

Sub-sectoring according to characteristics of a reference person

4.156 Other methods of sub-sectoring usually require a reference person to be identified for each household. The reference person is not necessarily the person that other members of the

household regard as the “head of the household”, as the reference person should be decided on grounds of economic importance rather than age or seniority. The reference person should normally be the person with the largest income although the reference person could also be the person who makes the major decisions with regard to the consumption of the household.

4.157 Once a reference person has been identified, it is possible to group households into sub-sectors on the basis of the reference person’s characteristics. For example, sub-sectors may be defined according to:

- (a) Occupation of the reference person;
- (b) Industry, if any, in which the reference person works;
- (c) Educational attainment of the reference person;
- (d) Qualifications or skills possessed by the reference person.

Each of the criteria listed above provides its own possible scheme of sub-sectoring. It would also be possible to group households into sub-

sectors according to the main income of the reference person if, for some reason, it was not possible to group on the basis of the largest income received by the household. For this purpose, the same income categories may be used as those recommended for the household’s largest income.

Sub-sectoring according to household size and location

4.158 Finally, it may be noted that households may be sub-sectored using criteria that apply to the household as a whole. For example, sub-sectors may be defined according to:

- (a) Size of the total income of the household;
- (b) Size of the household as measured by number of persons;
- (c) Type of area in which the household is located.

The last criterion enables households living in agricultural, urban or metropolitan areas to be distinguished from each other, or from households located in different geographical regions.

H. The non-profit institutions serving households sector

4.159 Previous sections have explained that NPIs are allocated to the corporations sectors when they are engaged in market production and to the general government sector if they are engaged in non-market production but subject to government control. The remaining NPIs are termed non-profit institutions serving households (NPISHs)

4.160 The NPISH sector includes the following two main kinds of NPISHs that provide goods or services to their members or to other households without charge or at prices that are not economically significant:

- (a) Trade unions, professional or learned societies, consumers’ associations, political parties (except in single party

states), religious institutions (including those financed by governments), and social, cultural, recreational and sports clubs;

- (b) Charities, relief and aid organizations financed by voluntary transfers in cash or in kind from other institutional units or from non-residents.

4.161 If the number or size of NPISHs funded from abroad is significant, it may be useful to disaggregate NPISHs into those that are primarily funded domestically and those that are funded from abroad.

I. The rest of the world

4.162 For purposes of the System, the rest of the world consists of all non-resident institutional units that enter into transactions with resident units, or have other economic links with resident units. It is not a sector for which complete sets of accounts have to be compiled, although it is often convenient to describe the rest of the world as if it were a sector. The accounts, or tables, for the rest of the world are confined to those that record transactions between residents and non-residents or other economic relationships, such as claims by residents on non-residents, and vice versa. The rest of the world includes certain institutional units that may be physically located within the geographic boundary of a country; for example, foreign enclaves such as embassies, consulates or military bases, and also international organizations.

1. International organizations

4.163 Certain international organizations have all the essential attributes of institutional units. The special characteristics of an "international organization" as this term is used in the System may be summarized as follows:

- (a) The members of an international organization are either national states or other international organizations whose members are national states; they thus derive their authority either directly from the national states that are their members or indirectly from them through other international organizations;
- (b) They are entities established by formal political agreements between their members that have the status of

international treaties; their existence is recognized by law in their member countries;

- (c) Because they are established by international agreement, they are accorded sovereign status; that is, international organizations are not subject to the laws or regulations of the country, or countries, in which they are located; they are not treated as resident institutional units of the countries in which they are located;
- (d) International organizations are created for various purposes including, among others, the following types of activities:
 - (i) The provision of non-market services of a collective nature for the benefit of their members;
 - (ii) Financial intermediation at an international level - that is, channelling funds between lenders and borrowers in different countries; an international organization may also act as a central bank to a group of countries.

4.164 Formal agreements concluded by all the member countries of an international organization may sometimes carry the force of law within those countries. Most international organizations are financed wholly or partly by contributions (transfers) from their member countries, but some organizations may raise funds in other ways such as borrowing on financial markets. For purposes of the System, international organizations are treated as units that are resident in the rest of the world.