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Dear Paul

Comments on 1993 SNA updating issues

This is the UK response to your letter of 19 May requesting comments on the revised version of the SNA. Thank you for extending the deadline to allow a considered response.

Before giving the detailed comments I would like to make some general points:

The UK is fully supportive of the SNA update process. We consider that it should be continued through to its conclusion. Not surprisingly at this stage there remain issues of debate, and we raise some in our comments attached. But we do not consider, as some have suggested, that this implies that the update process should be slowed or curtailed:

- Users want a system which meets the needs of modern global economies. Not responding, risks users turning to other sources for their information and analysis.

- Updating the SNA happens only every 15 years: we should do what we can now or be seen as increasingly out of touch.

- It will be six or more years before SNA is generally implemented. This gives time for new data sources to be developed. An example here is the information needed to measure pension obligations accurately. Following the adoption of related commercial accounting standards and Public Sector Accounting Standards, actuarial estimates are increasingly seen as fit for purpose.

Some have proposed the increased use of supplementary or satellite accounts to present statistics on an experimental basis, alongside alternative estimates in the core accounts. This is potentially confusing for users. They expect the best single measure of these key aggregates in the core accounts. Although we recognise that satellite accounts have a use as an extension of the national accounts system, we believe that key aggregates should not be estimated differently in satellites.

Detailed comments are in the attachment.

Yours sincerely

Karen Dunnell

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1 Repurchase agreements

We agree with the recommendations made by the AEG, including keeping the issue on the research agenda. We support the extension of the text to cover related transactions on gold etc.

2 Employers' pension schemes

This is a major issue for users of the accounts and every effort should be made to resolve it during this update. There are new financial accounting standards, implemented in the UK government departmental resource accounts, which demonstrate that this difficult issue can be addressed. The challenge is to bring some equivalent treatment into the integrated national accounting framework. The accounting developments also mean that data availability and reliability is improving rapidly which will ease the implementation of new requirements. (Some countries have already implemented something similar in their national accounts which demonstrates that the practical problems can be overcome.)

The UK believes that the original package of proposals developed by the IMF taskforce was on the right lines. We support the existing recommendations for private pension schemes. We agree that there are issues to be resolved for some countries for social security and government employer schemes. There may be different estimates for different purposes and we need to make information available for this analysis. However, we should also identify a preferred set of best estimates and ensure that these are in the core accounts. We do not support a set of alternative estimates in supplementary accounts, as this will cause confusion to users.

3 Employee stock options

We agree with all the recommendations made by the AEG.

4a Non-performing loans

We agree with the approach proposed by the AEG but suggest that, in addition to showing the fair value of non performing loans, the nominal value of total NPLs should also be separately recorded - confronting the fair value of NPLS with the nominal value of all loans (performing and non performing) will not be of analytical interest without the additional information. We presume the intention is for these items to be standard for all NPLs on the balance sheets of government and the financial sector, including those "with the rest of the World" - the text of the paper is ambiguous and could be understood as implying that these latter might be supplementary.

4b Valuation of loans and deposits; Write-off and interest accrual on impaired loans

We agree with all the recommendations made by the AEG.

5 Non-life insurance

We agree with all the recommendations made by the AEG.

6a Financial services

We agree with all the recommendations made by the AEG. However, we hold the view that the inclusion of non-intermediary services in output measurement should logically spell the end of FISIM as a term.

6b Allocation of the output of central banks

We accept the AEG's recommendations on the measurement of central bank output, although we do not consider that the pure cost based measure is a second best solution. We support the AEG's call for flexibility in applying different approaches for market and non market services and consider that a measure based on costs is an acceptable solution, particularly when judged on measurement cost/benefit considerations.

7 Taxes on holding gains

We agree with all the recommendations made by the AEG.

8 Interest under high inflation

We agree with all the recommendations made by the AEG.

9 Research and development (R&D)

The United Kingdom is in broad agreement with the recommendations made by the AEG on this issue and we support the moves to refine the definitions of R&D. We support the moves to make adjustments to the Frascati framework to meet the needs of the SNA more closely. We note the AEG recommendation that freely available R&D should not be included as capital formation and believe that this needs further description and definition. We believe that the correct treatment of freely available R&D needs to be set out in the SNA along with guidance on measurement.

We remain however concerned that payments for the use of intellectual property arising from the activity of Research and Development are more akin to property income as defined in the current SNA, as opposed to rental payments for capital services provided. The recent allocation of Microsoft patent rights from the USA to Ireland, and the redirection of the associated licence fees to Ireland, seem more like a change in Gross National Income through a re-direction of property income, than an increase in GDP due to an increase in rental through ownership of fixed assets. We believe this subject requires further consideration before the issue is closed.

10 Patented entities

If R&D is not treated as capital formation, but as current activity leading to the "discovery" of intellectual property, then payment for the use of intellectual property protected by patent should be treated as property income as in the current SNA 1993, and not as payments for a service.

11 Originals and copies

We believe that recognising copies of an original as capital assets in their own right is a mistake. However, in as far as access to originals is increasingly through relatively short-term licence arrangements, double-counting will be avoided. The issue of double-counting of assets, and so raising the level of GDP, has not been resolved.

12 Databases

We do not think this subject has been adequately resolved, and questions remain.

13 Other intangible fixed assets

We agree with all the recommendations made by the AEG.

14 Costs of ownership transfer

We agree with all the recommendations made by the AEG.

15 Cost of capital services

The steps recommended are a valuable and practical first stage towards a fuller recognition of capital services in the accounts. We would have liked to have gone further but accept the recommendations.

16 Government and non-market producers: cost of capital of own assets

We agree with the compromise now being recommended by the AEG. There is strong logic for extending the costs recognised in the accounts and the change will also meet the needs of users of the accounts.

17 Mineral exploration

We agree with all the recommendations made by the AEG.

18 Right to use/exploit non-produced resources between residents and non-residents

We agree with all the recommendations made by the AEG.

19 Military expenditures

The recommendations are good especially as they align with the way government often does its own accounts making the new recommendations easier to implement accurately than the current SNA.

20 Land improvements

We agree with all the recommendations made by the AEG.

21 Contracts leases and licences

We do not believe that the generic issue of contracts, leases and licences has been satisfactorily resolved - in particular we believe that contracts and licences that can attain value in their own right do so as a form of financial derivative, and not as an intangible non-produced fixed asset. The current approach will give rise to inconsistencies with the treatment of encumbered assets generally. A particular cause of concern is the implication that the asset value of nuclear power stations which will require significant decommissioning costs should be shown reflecting the associated costs. So a £250m power station with decommissioning costs of £50 million at the end of its 25 year life will be shown in the accounts (ignoring allowing for discounting) as value £200m at the beginning, and -£50million at the end. This is better represented in the accounts as £250m depreciating to zero, with an associated financial arrangement to which the station owes £50 million at the beginning, and pays it off gradually as a floating fund so that the fund has asset value of £50m at the end to pay for the decommissioning.

In terms of the very specific issues raised in the consultation document, recognising value in transferable contracts as that of a fixed asset raises issues of consistency with the treatment of encumbrances and sharing ownership what have not been adequately addressed in the revision.

Similarly, recognising as non-financial assets, contracts allowing a degree of monopoly profits in the exercise of a sanctioned activity, is inconsistent with the recognition of payment for government licences, whether restricted or not, as a tax.

22 Goodwill and other non-produced assets

We agree with the recommendations made by the AEG.

23 Obsolescence and consumption of fixed capital .

We agree with the specific recommendation under this general heading. We look forward to commenting on the forthcoming manual on capital assets being prepared by the OECD, where this issue will be further described. We believe there is scope for further clarification of obsolescence, and how the decline in value of intellectual property can be best described

24 Public-private partnerships (PPPs) (including buuild-own-operate-transfer (BOOT) schemes)

PPPs and BOOT schemes have been in use in many countries for over 15 years - that is before SNA93 was finalised - and their number and scale is often large. Thus it would have been highly desirable to give firm guidance in this revision. However, we recognise the practical difficulties of doing so especially while relevant IPSASs are still under discussion as these will partly determine the information available to compile the national accounts. The recommendation is thus in our view a second best to be used if nothing better is available in time. We consider this issue large and important enough to merit a late set of recommendations if the timetable and production process can accommodate it.

25a Ancillary units

We agree with all the recommendations made by the AEG.

25b Holding companies, special purpose entities, trusts

We agree with all the recommendations made by the AEG.

25c Treatment of multi-territory enterprises

We agree with all the recommendations made by the AEG.

25d Non-resident unincorporated units

We agree with all the recommendations made by the AEG.

25e Non-resident SPEs controlled by government

We fully support the recommendations. There is a potentially large and growing issue here as poorer countries exploit ways of accessing the world's financial markets to fund their development. The recommendations provide a pragmatic solution which ensures that essential information is captured without breaking the key residence principles of the national accounting system.

26 Cultivated assets.

We agree with all the recommendations made by the AEG.

27 Classification and terminology of assets

We do not agree with the proposed classification, in as far as it includes contracts, leases and licences as non-produced non-financial assets. We believe that all contracts of a generic nature should be classified under financial assets, as a form of financial derivative.

We have concerns that radio spectra are classified as a natural resource. This is part of a wider debate which has not yet taken place on how we should regard sovereign rights on land, air space, electromagnetic spectra, sea-beds etc. These rights may be independent of private or public ownership of the associated mineral rights etc.

28 Amortization of non-produced assets

We do not believe this subject has been satisfactorily resolved, but as it is a relatively minor issue, we see no point in prolonging the debate.

29 Assets boundary for non-produced intangible assets

We agree with the recommendation made by the AEG.

30 Definition of economic assets

We believe the current existing definitions are largely satisfactory, and do not expect radical changes to existing definitions.

31 Water as an asset

We agree with all the recommendations made by the AEG.

32 Informal sector

We agree with all the recommendations made by the AEG.

33 Illegal activities

We agree with all the recommendations made by the AEG.

34 Government transactions with public corporations: earnings from equity investment and capital injections

We support the recommended option which will reduce the uncertainties inherent in the present SNA. However, we reject recommendation (d). For consistency, principles applied to one sector should apply to all. The framework loses usefulness if specific rules are made for one sector that are not applied to all.

35 Tax revenues, uncollectible taxes and tax credits

We agree with the increasing consensus that payments for licences should be treated as upfront payments of taxes, where there is no underlying fixed asset.

Definition and coverage of a tax

We agree that the definition and coverage of a tax should be set out clearly, with some examples. The examples should illustrate the underlying concepts; but should not suggest that they are exhaustive or prescriptive. It is important not to try to produce a comprehensive list of treatments.

Accrual recording

We agree that taxes should be recorded on an accrual basis. And, that the expression 'due for payment' should be replaced by 'accruals'. We regret that the AEG could not agree on a single method for dealing with uncollectible taxes, but do not feel strongly enough to press for the issue to be reopened.

Tax credits

We strongly agree with the decision that payable tax credits should be recorded on a gross basis. And, that the presentation should permit the derivation of tax credits on a net basis also.

36 Public/private/government sectors delineation

We fully support the recommendations made by the AEG, which deliver valuable extra clarity on delineation...

37 Granting and activation of loan guarantees

We can accept the three sets of recommendations made by the AEG. On standardised guarantees one of our earlier concerns about being able to see the information separately is now resolved in the proposed financial assets classification. On one-off guarantees the proposal deals with most aspects of the issue but leaves one unresolved. The proposal is that the guarantees should mainly be accounted for **outside** the system unless they are called. However, there are transactions **inside** the system which are affected by the existence of the guarantee - for example borrowers benefit from paying a lower rate of interest. If no fee has been paid this represents a subsidy which is not covered by the proposal.

We also note that the recommendation to identify guarantees in the form of derivatives has implications for the SNA instrument classification which are not currently addressed under item 44 below.

38a Change of economic ownership (as term)

We agree with all the recommendations made by the AEG.

38b Assets, liabilities and personal effects of individuals changing residence (Immigrants' transfers)

We agree with all the recommendations made by the AEG.

38c Application of accrual principles to debt in arrears

We agree with the AEG's recommendations and note in particular the recommendation that unpaid FISIM be "accumulated to principal outstanding in the same way as (SNA) interest accruing but unpaid." We note, however, that SNA 93 (para 11.101) provides two options for the designation of accrued interest: (1) inclusion of accrued interest in the outstanding amounts of loans and deposits or (2) inclusion of accrued interest in the other subcategory of Other accounts receivable/payable.

By contrast, the MFSM (Para. 227) states: Accrued interest on deposits, loans, and securities other than shares should be incorporated into the outstanding amount of the financial asset or liability, rather than being treated as part of other accounts receivable/payable. For unimpaired loans, the practical impact of the SNA's alternative treatments is unlikely to be large, but for non performing loans the second treatment would presumably imply a more substantial accumulation of accruals within other receivables and the loss of this component from the FISIM calculation. A clarification is therefore needed on whether SNA Rev1 will retain the SNA93 options on the designation of accruals or whether it adopts the later and stricter MFSM treatment.

39a Meaning of national economy

We agree with all the recommendations made by the AEG.

39b Predominant centre of economic interest (as term)

We agree with all the recommendations made by the AEG.

39c Residence of entities with little or no physical presence

We agree with all the recommendations made by the AEG.

39d Non-permanent workers

We agree with all the recommendations made by the AEG.

40 Goods for Processing

We agree with all the recommendations made by the AEG. The implications for national recording should be described.

41 Merchanting

We agree with all the recommendations made by the AEG.

42 Retained earnings of mutual funds, insurance companies, and pension funds

We support the recommendations made by the AEG. As noted, however, it is important to resolve the issue about the inclusion of holding gains and losses mentioned in the conclusions.

43a Treatment of index-linked debt instruments

We consider the dual treatments for instruments indexed to broadly based and narrowly based underlyings to be unsatisfactory and would favour a single treatment using the method proposed for use where the index series is potentially volatile. Specifically, given the constraint that interest recognition is to be based on the so called "debtor approach", we consider that interest should be based on the expected yield at the time of issue.

43b Debt indexed to a foreign currency

We agree with all the recommendations made by the AEG.

43c Interest at concessional rates

We agree with all the recommendations made by the AEG.

43d Fees payable on securities lending and gold loans

We accept the AEG's recommendations as a pragmatic solution to a complex question but note that, in the case of Gold lending, there is normally a transfer of physical metal "allocated gold" so that the nature of such transactions are more complex than implied here. While there may be a case for assigning associated payments as property income as indicated, the treatment of these specialised transactions warrants separate attention on the longer term work programme along with repurchase agreements and securities lending.

44 Financial assets classifications

The UK generally supports the proposals for the financial instrument classification as recommended by the AEG. We nevertheless have the following specific comments:

In the associated discussion of gold at the 4th AEG meeting, we agree with the AEG's recommendations on the five questions posed under this heading but consider that the account of this topic in the meeting report indicates the need for particular care when relevant SNA text is being drafted. Specifically, the short report of the meeting says: "Again it is raised whether non-monetary gold should be classified as a financial asset rather than under valuables in the asset classification. Non-monetary gold being a financial asset would allow for the gold transactions to be netted, in line with financial transactions." We consider this account to be misleading. The proposals in the agenda paper and the recommendations of the AEG do not affect either the classification of non monetary gold or its accounting treatment. The issue is rather to clarify that holdings of unallocated gold are financial assets (deposits) within the system rather than monetary or non monetary gold. This clarification will ensure that the bulk of bullion market dealing - which occurs using unallocated metal accounts - is recorded in the financial account while still leaving holdings of non monetary gold in the system to be recorded as valuables and reported gross in the relevant flow accounts. Holdings of allocated gold constitute title to physical metal and may be classified as monetary or non monetary gold depending on the classification of the institution holding title. Unallocated gold by contrast is an unsecured claim against a third party to deliver physical gold. In form it is directly comparable to an unsecured claim against a third party to deliver currency - a deposit in the language of the SNA.

We support the separate identification of monetary gold and SDRs.

We support the retention of the distinction between Loans and Deposits and favour the identification of a new subcategory - inter bank positions - to remove the current ambiguity in the classification of such positions.

We support the separate identification of credit default products within financial derivatives (as proposed under topic 37) but note that this leads to a mix of instrument and risk based sub classifications under this heading. One possible resolution could be to make the main sub classifications: Market risk products; Credit risk products; and Employee stock options; and then to further divide Market risk products into forward type instruments and options.