BALANCE OF PAYMENTS MANUAL

INTERNATIONAL MONETARY FUND

Contents

REGIONAL ALLOCATION

APPENDICES

INDEX

Foreword

Measurement of the external positions of member countries has been a central feature of International Monetary Fund operations since inception. Such measurement is conducted in the dual context of Fund responsibility for surveillance of countries' economic policies and provision of financial assistance in support of adjustment measures to correct balance of payments disequilibria. Consequently, the Fund has a compelling interest in developing and promulgating appropriate international guidelines for the compilation of sound and timely balance of payments statistics. Such guidelines, which have evolved to meet changing circumstances, have been embodied in successive editions of the *Balance of Payments Manual* (the *Manual*) since the first edition was published in 1948. Because of the important relationship between external and domestic economic developments, timely, reliable, and comprehensive balance of payments statistics based on an appropriate and analytically oriented methodology are an indispensable tool for economic analysis and policy making. Indeed, with the growing interdependence of the world's economies, the need for such statistics—which reflects in part the underlying movement towards greater liberalization and integration of markets—has increased over time.

I am particularly pleased to introduce the fifth edition of the *Manual*, which addresses the many important changes and innovations that have occurred in international transactions since the fourth edition was published in 1977. The fifth edition of the *Manual* also addresses, for the first time, the important area of international investment position statistics. In addition, concepts in the *Manual* have been harmonized, as closely as possible, with those of the revised *System of National Accounts 1993* and with the Fund's methodologies pertaining to money and banking and government finance statistics.

The revised *Manual* has been prepared by the Fund's Statistics Department in close consultation with balance of payments experts in member countries and international and regional organizations (including the Statistical Office of the European Communities, the Organisation for Economic Cooperation and Development, the United Nations, and the World Bank). The process underlying the revision of the *Manual* demonstrates the spirit of international collaboration and cooperation, and I would like to thank all of the national and international experts involved for their invaluable assistance. In this regard, I am particularly grateful to Mr. Pierre Esteva, chairman of the Fund's Working Party on the Statistical Discrepancy in World Current Account Balances, and to Baron Jean Godeaux, chairman of the Working Party on the Measurement of International Capital Flows. Their assessments of the effects of the unprecedented changes in the conduct of international transactions contributed significantly to the revision of the structure and classification of the international accounts.

I would like to commend the *Manual* to compilers and users around the world and to urge member countries to adopt the conceptual guidelines of the fifth edition as the basis for compiling balance of payments and international investment position statistics and for reporting this information to the Fund.

Michel Camdessus
Managing Director
International Monetary Fund

Preface

The fifth edition of the *Balance of Payments Manual* (the *Manual*) continues the series of international standards that have been issued by the International Monetary Fund (IMF) for providing guidance to member countries in the compilation of balance of payments and related data on the international investment position.

Since the fourth edition of the *Manual* was published in 1977, important changes have occurred in the manner in which international transactions are conducted. These changes are, in particular, a result of the liberalization of financial markets, innovations in the creation and packaging of financial instruments, and new approaches to the restructuring of external debt. In addition, there has been unprecedented growth in the volume of international trade in services. All these developments have necessitated changes in the treatment and classification of such transactions within the structure of the balance of payments accounts. Furthermore, since publication of the fourth edition, experience with application of that edition has brought to light a number of instances in which guidelines could usefully be augmented and recommendations clarified. An additional impetus to the preparation of the fifth edition of the *Manual* was the work undertaken to revise the system of economic and financial statistics encompassed in the *System of National Accounts 1993* (*SNA*). There was the need to achieve, to the maximum extent possible, harmonization between the two systems and with IMF statistical systems pertaining to money and banking statistics and government finance statistics.

The fifth edition of the *Manual* provides international guidelines for the compilation of data for an articulated set of international accounts encompassing the measurement of external transactions (balance of payments), on the one hand, and the stock of external financial assets and liabilities (the international investment position) on the other. This edition of the *Manual* provides explicit links between the outstanding stock of external financial assets and liabilities and corresponding changes that occur, during specified periods, in these external financial instruments. The changes reflect transactions, valuation changes, and other adjustments in the relevant financial instruments. The delineation of an articulated set of international accounts represents a major shift in orientation from the fourth to the fifth edition. The fifth edition also differs from its predecessor in other important respects. First, the current account of the balance of payments is redefined to exclude capital transfers, which are included in an expanded and renamed capital and financial account. This change provides for a greater degree of harmonization and integration with the *SNA* in terms of the underlying concepts and the identification of major aggregates. Second, within the current account, clear distinctions are made among goods, services, income, and current transfers. As a reflection of the heightened analytical and policy interest in data on international trade in services (particularly in the context of the *General Agreement on Tariffs and Trade* negotiations on services) considerable disaggregation is introduced in the classification of international services transactions.

The classification of the financial account follows a hierarchical structure for functional categories, asset or liability distinctions, instrument specification, sectorization, and the distinction between long- and short-term instruments. In addition, the classifications underlying the income components of the current and financial accounts and the international investment position are closely aligned to enhance analytic potential.

Despite the extensive revision of the *Manual*, IMF recommendations for balance of payments compilation maintain a high degree of continuity. Thus, compilers who have been producing statistics that conform reasonably well to the standards established in previous editions should not experience great difficulty in adapting procedures for data collection or in reporting according to the recommendations of the fifth edition. The basic concepts and principles in the *Manual* remain generally valid and any necessary adjustments may be readily effected within a largely unchanged theoretical framework.

The fifth edition of the *Manual* was produced by the IMF Statistics Department—primarily through the work of a consultant, Mr. Jack Bame (formerly the associate director for international economics at the Bureau of Economic Analysis, U.S. Department of Commerce), and through close consultation with national compilers of balance of payments statistics and experts from interested international and regional organizations. The reports of the IMF working parties on the Statistical Discrepancy in World Current Account Balances and on the Measurement of International Capital Flows also contributed to the development of the *Manual*. In addition, an advisory group of IMF staff provided assistance in articulating IMF operational and analytic needs in the area of balance of payments statistics. The members of the group were Mr. Bruce Smith, senior advisor in the Southeast Asia and Pacific Department; Mr. Peter Clark, assistant director in the Research Department; and Mr. Michael Kuhn, division chief in the Policy Development and Review Department. The project was supervised by Mr. Mahinder S. Gill, assistant director for the Balance of Payments and External Debt Division in the IMF Statistics Department. Most of the original drafting was done by Mr. Bame. He also was responsible for subsequent redrafting undertaken to reflect comments received from national compilers and concerned international and regional organizations and to incorporate conclusions that were reached at the meeting of balance of payments experts held at IMF headquarters in March 1992. Through comments on earlier drafts or through drafting of selected chapters and appendices, staff of the Balance of Payments and External Debt Division made specific contributions: Mr. Gill (Chapter 3 and Appendix 1), Mr. Jan Bové and Mrs. Florencia Frantischek (Appendix 4), and Mr. Abul Siddique (Appendix 3). Mr. Clark of the Research Department made a particularly valuable contribution by preparing Appendix V, which addresses selected issues in balance of payments analysis. Ms. Nancy Basham, Statistics Department, edited and coordinated print production and Ms. Suzanna Persaud, administrative staff of the Balance of Payments and External Debt Division, typed the various drafts and the final version of the *Manual*.

The IMF benefitted immensely from the contributions and comments made by experts who participated in the March 1992 meeting of balance of payments experts. Their deliberations culminated in a set of conclusions that, coupled with further consultation through correspondence, formed the basis for redrafting and finalizing the fifth edition. The IMF staff wishes to acknowledge, with thanks, indebtedness to the following experts in national balance of payments offices and to representatives from regional and international organizations who participated in the meeting and contributed to the preparation of the *Manual*.

Australia	Ms. Barbara Dunlop
Brazil	Ms. Maria Oliveira Nabao
Canada	Ms. Lucie Laliberté
Chile	Mrs. Teresa Cornejo Black
China	Ms. Wang Lingfen
France	Mr. Jacques Cuny
	Dr. Marc Auboin
Germany	Dr. Rudolf Seiler
Hungary	Mrs. P. Horvath
Iran	Mrs. Mehrangiz Tavassoli
Italy	Dr. Antonello Biagioli
Japan	Mr. Shinichi Yoshikuni
	Mr. Takashi Kori
Kenya	Mr. Pius P. Kallaa
Libya	Mr. Ali Ramadan Shnebesh
Mexico	Mr. Jorge Carriles
Netherlands, The	Dr. Marius van Nieuwkerk
Saudi Arabia	Mr. Mohammed Al-Hakami
	Mr. Mohanna Al-Mohanna
Sweden	Mr. Gunnar Blomberg
United Kingdom	Mr. John E. Kidgell
	Mr. Bruce Buckingham
United States	Dr. J. Steven Landefeld
Zaire	Ms. Nkobafily Marie Marthe Lebughe
EUROSTAT	Mr. J. C. Roman
OECD	Mr. Erwin Veil
UN	Mr. Jan van Tongeren
World Bank	Datuk Ramesh Chander

John B. McLenaghan
Director, Statistics Department
International Monetary Fund

Balance of Payments

Conceptual Framework

I. Introduction

Purposes of the *Balance of Payments Manual*

1. Like editions issued in 1948, 1950, 1961, and 1977, this 1993 edition of the *Balance of Payments Manual* (the *Manual*) serves as an international standard for the conceptual framework underlying balance of payments statistics. The *Manual* also functions as a guide for member countries submitting regular balance of payments reports to the International Monetary Fund (the IMF or the Fund). In preparing this fifth edition, the IMF made every effort to ascertain the needs and to reflect the viewpoints of national compilers and various users of balance of payments statistics and international investment position data.

2. The primary purposes of the *Manual* are (i) to provide standards for concepts, definitions, classifications, and conventions and (ii) to facilitate the systematic national and international collection, organization, and comparability of balance of payments and international investment position statistics. A companion volume, the *Balance of Payments Compilation Guide* (the *Guide*), provides practical guidance to national compilers on the collection, presentation, and systematization of external statistics. The *Guide* is particularly useful for countries in which statistical systems are in the early stages of development or in transition.

Changes from the Fourth Edition

3. The scope and orientation of this *Manual* differ from those of the fourth edition in a number of respects. One important change is the expansion of the conceptual framework to encompass balance of payments flows (transactions) and stocks of external financial assets and liabilities (the international investment position). A clear distinction is made between (i) transactions and (ii) other changes in the accounts—valuation, reclassification, and other adjustments. Transactions or other changes may result in changes in stocks, but only transactions are reflected in balance of payments accounts. For example, in the fifth edition, the allocation or cancellation of special drawing rights (SDRs) and the monetization or demonetization of gold (each with counterpart entry) are not included among transactions in the balance of payments accounts but as adjustment items affecting the international investment position.

4. Additionally, linkage of the international investment position and balance of payments accounts to the rest of the world account in the System of National Accounts (SNA) is strengthened and harmonized to the maximum extent possible. Cases in point are identical treatments, in the two systems, of residence, valuation, timing, and reinvested earnings on direct investment. Also, to increase harmonization with the SNA, a distinction between current and capital transfers is introduced in the *Manual*. As a result of the change, the former balance of payments ***capital account*** is redesignated as the **capital and financial account**. These and other changes reflect the efforts of international experts and coordinating groups, including national accountants and balance of payments compilers. Their efforts also serve to integrate the balance or payments more effectively with other IMF statistical systems such as money and banking, government finance, and international banking.

5. There are also changes in the treatments of international services, income, and certain financial transactions. First, in contrast to the fourth edition, the fifth edition makes a clear distinction in the **current account** between international transactions in services and transactions in income. In the fourth edition, labor and nonfinancial property income were grouped together with services other than shipment, travel, and transportation, and investment income was covered separately. In the fifth edition, the two main components of income flows between residents and nonresidents—*compensation of employees* and *investment income*—are separately identified as components of the **current account**. This treatment harmonizes with the concept of income presented in the *System of National Accounts 1993 (SNA)* and strengthens the links between the balance of payments ***income account*** and ***financial account*** and between balance of payments flows and the stocks of assets and liabilities comprising the international investment position. Second, the component list of transactions in services is expanded to reflect the growing importance of services and the contributions of various international fora to the development of a codified list that satisfies the requirements and provides links between separate statistical systems.

6. In the fifth edition, coverage of financial flows and stocks is significantly expanded and restructured. The modification reflects, first, an orientation towards compatibility with other IMF statistical systems and the SNA and, second, widespread alterations in the nature and composition of international financial transactions since publication of the fourth edition in 1977. These changes include the emergence of financial innovations, new instruments, and transactors that are partly associated with a trend towards increased asset securitization. Such developments tend, in many instances, to blur the distinction between long- and short-term maturities and to make it more difficult to identify resident/nonresident transactions, especially when such transactions involve a number of currencies and a variety of actual and contingent financial instruments or arrangements. Together with the easing or abolition of exchange controls in many countries and the progressive deregulation of national financial markets, these developments create new challenges and problems for compilers and data users. Further complications arise as a result of external debt problems experienced by a number of countries (e.g., accounting for arrears, debt forgiveness or debt reduction schemes, and associated innovative financial arrangements). Partly in response to such developments, classification of the **financial account** is re-oriented. To cover new financial instruments, coverage of nonequity *portfolio investment* is broadened to include long- and short-term securities, and supplementary classifications covering exceptional financing transactions (with selected arrears-related entries for balance of payments accounts) and other items of analytical interest are introduced.

Uses of Balance of Payments and International Investment Position Data

7. Balance of payments and international investment position data are most important, of course, for national and international policy formulation. External aspects (such as payments imbalances and inward and outward foreign investment) play a leading role in economic and other policy decisions in the increasingly interdependent world economy. Such data are also used for analytical studies; that is, to determine the causes of payments imbalances and the necessity for implementing adjustment measures; relationships between merchandise trade and direct investment; aspects of international trade in services; international banking flows and stocks; asset securitization and principal market developments; external debt problems, income payments, and growth; and links between exchange rates and current account and financial account flows. In addition, external data are utilized extensively, along with other variables, for balance of payments projections and the relationship of these projections to changes in countries' stocks of external assets and liabilities. Finally, balance of payments and international investment position data constitute an indispensable link in the compilation of data for various components of the national accounts (e.g., production accounts, income accounts, capital and financial accounts, and the related measurement of national wealth).

8. Previous brief references to changes in coverage, classification, and orientation do not represent an all-inclusive list of differences between the fourth and fifth editions of the *Manual*. Other modifications in the treatment of specific components will be evident—and thoroughly covered—in appropriate chapters. In *direct investment*, for example, changes are effected in criteria for flows between affiliated banks (and related stock positions) and in the distinction between long- and short-term intercompany transactions. Aspects of regional presentation, covered in an appendix in the fourth edition, comprise a chapter in this *Manual* to reflect growing international interest in this area. To address the expanded conceptual framework that encompasses stocks of external assets and liabilities, the fifth edition presents a new chapter on the international investment position and a full exposition of the classification, components, and links to balance of payments accounts and balance sheet aspects of the SNA.

9. In contrast to a rather central position in the fourth edition, the discussion of selected issues in balance of payments analysis is presented in Appendix 5 of the fifth edition. Such issues and the nature and limitations of various presentations can be better understood after the concepts, structure, and classification of standard components have been covered. A thorough treatment of analytic material requires more extensive coverage than would be appropriate in this *Manual*. Therefore, only selected issues are highlighted to help identify causes of payments imbalances, to determine financing requirements, and to focus on appropriate adjustment measures.

10. Although there are significant differences between the fourth and fifth editions of the *Manual*, the latter preserves the continuity of the data collection framework and IMF reports. Every effort has been made to delineate principles and concepts clearly; to relate these appropriately to practical considerations and limitations; and to establish conventions that may be applied, when data sources allow, within a consistent framework. Because the development of statistical systems varies, standard components and classification schemes presented in the *Manual* may be excessively detailed for many IMF member countries and inadequately detailed for others. The framework provides flexibility in this respect. The former group may provide limited data on selected components—and subsequently add to these, if possible—and the latter group may be encouraged to provide supplementary data.

Structure of the *Manual*

11. Part one of the *Manual* covers the conceptual framework of international accounts. Part two deals with the structure and classification of accounts, and part three is concerned with regional allocation.

II. Conceptual Framework of the Balance of Payments and International Investment Position

Definitions

12. Part one of this *Manual* deals with the conceptual framework of balance of payments accounts and the international investment position. Part one covers the framework's relationship to national accounts; to concepts of residence, valuation, and time of recording; and to the unit of account and conversion.

13. The balance of payments is a statistical statement that systematically summarizes, for a specific time period, the economic transactions of an economy with the rest of the world. Transactions, for the most part between residents and nonresidents,[1] consist of those involving goods, services, and income; those involving financial claims on, and liabilities to, the rest of the world; and those (such as gifts) classified as transfers, which involve offsetting entries to balance—in an accounting sense—one-sided transactions. (See paragraph 28.)[2] A transaction itself is defined as an economic flow that reflects the creation, transformation, exchange, transfer, or extinction of economic value and involves changes in ownership of goods and/or financial assets, the provision of services, or the provision of labor and capital.

14. Closely related to the flow-oriented balance of payments framework is the stock-oriented international investment position. Compiled at a specified date such as year end, this investment position is a statistical statement of (i) the value and composition of the stock of an economy's financial assets, or the economy's claims on the rest of the world, and (ii) the value and composition of the stock of an economy's liabilities to the rest of the world. In some instances, it may be of analytic interest to compute the difference between the two sides of the balance sheet. The calculation would provide a measure of the net position, and the measure would be equivalent to that portion of an economy's net worth attributable to, or derived from, its relationship with the rest of the world. A change in stocks during any defined period can be attributable to transactions (flows); to valuation changes reflecting changes in exchange rates, prices, etc.; or to other adjustments (e.g., uncompensated seizures). By contrast, balance of payments accounts reflect only transactions.

Principles and Concepts

15. The remainder of this chapter deals with the conceptual framework of international accounts; that is, the set of underlying principles and conventions that ensure the systematized and coherent recording of international transactions and stocks of foreign assets and liabilities. Relevant aspects of these principles, together with practical considerations and limitations, are thoroughly discussed in subsequent chapters.

Double-entry System

16. The basic convention applied in constructing a balance of payments statement is that every recorded transaction is represented by two entries with equal values. One of these entries is designated a credit with a positive arithmetic sign; the other is designated a debit with a negative sign. In principle, the sum of all credit entries is identical to the sum of all debit entries, and the net balance of all entries in the statement is zero.

17. In practice, however, the accounts frequently do not balance. Data for balance of payments estimates often are derived independently from different sources; as a result, there may be a summary net credit or net debit (i.e., net errors and omissions in the accounts). A separate entry, equal to that amount with the sign reversed, is then made to balance the accounts. Because inaccurate or missing estimates may be offsetting, the size of the net residual cannot be taken as an indicator of the relative accuracy of the balance of payments statement. Nonetheless, a large, persistent

[1]The exceptions to the resident/nonresident basis of the balance of payments are the exchange of transferable foreign financial assets between resident sectors and, to a lesser extent, the exchange of transferable foreign financial liabilities between nonresidents. (See paragraph 318.)

[2]The definitions and classifications of international accounts presented in this *Manual* are intended to facilitate reporting of data on international transactions to the Fund. These definitions and classifications do not purport to give effect to, or interpret, various provisions (which pertain to the legal characterization of official action or inaction in relation to such transactions) of the Articles of Agreement of the International Monetary Fund.

residual that is not reversed should cause concern. Such a residual impedes analysis or interpretation of estimates and diminishes the credibility of both. A large net residual may also have implications for interpretation of the investment position statement (See the discussion in Chapter 23.)

18. Most entries in the balance of payments refer to transactions in which economic values are provided or received in exchange for other economic values. These values consist of real resources (goods, services, and income) and financial items. Therefore, the offsetting credit and debit entries called for by the recording system are often the result of equal amounts having been entered for the two items exchanged. When items are given away rather than exchanged, or when a recording is one-sided for other reasons, special types of entries—referred to as *transfers*—are made as the required offsets. (The various kinds of entries that may be made in the balance of payments are discussed in paragraphs 26 through 31.)

19. Under the conventions of the system, a compiling economy records credit entries (i) for real resources denoting exports and (ii) for financial items reflecting reductions in an economy's foreign assets or increases in an economy's foreign liabilities. Conversely, a compiling economy records debit entries (i) for real resources denoting imports and (ii) for financial items reflecting increases in assets or decreases in liabilities. In other words, for assets—real or financial—a positive figure (credit) represents a decrease in holdings, and a negative figure (debit) represents an increase. In contrast, for liabilities, a positive figure shows an increase, and a negative figure shows a decrease. Transfers are shown as credits when the entries to which the transfers provide the offsets are debits and as debits when those entries are credits.

20. The content or coverage of a balance of payments statement depends somewhat on whether transactions are treated on a gross or on a net basis. The *Manual* contains recommendations on which transactions should be recorded gross or net. The recommendations are appropriately reflected in the list of standard components and in suggested supplementary presentations.

Concepts of Economic Territory, Residence, and Center of Economic Interest

21. Identical concepts of economic territory, residence, and center of economic interest are used in this *Manual* and in the *SNA*. Economic territory may not be identical with boundaries recognized for political purposes. A country's economic territory consists of a geographic territory administered by a government; within this geographic territory, persons, goods, and capital circulate freely. For maritime countries, geographic territory includes any islands subject to the same fiscal and monetary authorities as the mainland.

22. An institutional unit has a center of economic interest and is a resident unit of a country when, from some location (dwelling, place of production, or other premises) within the economic territory of the country, the unit engages and intends to continue engaging (indefinitely or for a finite period) in economic activities and transactions on a significant scale. (One year or more may be used as a guideline but not as an inflexible rule.)

Principles for Valuation and Time of Recording

23. A uniform basis of valuation for the international accounts (both real resources and financial claims and liabilities) is necessary for compiling, on a consistent basis, any aggregate of individual transactions and an asset/liability position consistent with such transactions. In this *Manual*, the basis of transaction valuations is generally actual market prices agreed upon by transactors. (This practice is consistent with that of the *SNA*.) Conceptually, all stocks of assets and liabilities are valued at market prices prevailing at the time to which the international investment position relates. A full exposition of valuation principles; recommended practices; limitations; and the valuation of transfers, financial items, and stocks of assets and liabilities appears in Chapter 5. (The exposition includes cases in which conditions may not allow for the existence or assumption of market prices.)

24. In the *Manual* and the *SNA*, the principle of accrual accounting governs the *time* of *recording* for transactions. Therefore, transactions are recorded when economic value is created, transformed, exchanged, transferred, or extinguished. Claims and liabilities arise when there is a change in ownership. The change may be legal or physical (economic). In practice, when a change in ownership is not obvious, the change may be proxied by the time that parties to a transaction record it in their books or accounts. (The recommended timing and conventions for various balance of payments entries, together with exceptions to and departures from the change of ownership principle, are covered in Chapter 6.)

Concept and Types of Transactions

25. Broadly speaking, changes in economic relationships registered by the balance of payments stem primarily from dealings between two parties. These parties are, with one exception (see footnote 1), a resident and a nonresident, and all dealings of this kind are covered in the balance of payments. Recommendations for specific entries are embodied in the list of standard components (see Chapter 8) and are spelled out in detail from Chapter 9 onward.

26. Despite the connotation, the balance of payments is not concerned with *payments*, as that term is generally understood, but with *transactions*. A number of international transactions that are of interest in a balance of payments context may not involve the payment of money, and some are not paid for in any sense. The inclusion of these transactions, in addition to those matched by actual payments, constitutes a principal difference between a balance of payments statement and a record of foreign payments.

Exchanges

27. The most numerous and important transactions found in the balance of payments may be characterized as *exchanges*. A transactor (economic entity) provides an economic value to another transactor and receives in return an equal value. The economic values provided by one economy to another may be categorized broadly as real resources (goods, services, income) and financial items. The parties that engage in the exchange are residents of different economies, except in the case of an exchange of foreign financial items between resident sectors. The provision of a financial item may involve not only a change in the ownership of an existing claim or liability but also the creation of a new claim or liability or the cancellation of existing ones. Moreover, the terms of a contract pertaining to a financial item (e.g., contractual maturity) may be altered by agreement between the parties. Such a case is equivalent to fulfillment of the original contract and replacement by a contract with different terms. All exchanges of these kinds are covered in the balance of payments.

Transfers

28. Transactions involving *transfers* differ from exchanges in that one transactor provides an economic value to another transactor but does not receive a quid pro quo on which, according to the conventions and rules adopted for the system, economic value is placed. This absence of value on one side is represented by an entry referred to as a *transfer*. Such transfers (economic value provided and received without a quid pro quo) are shown in the balance of payments. ***Current transfers*** are included in the **current account** (see Chapter 15) and *capital transfers* appear in the ***capital account***. (See Chapter 17.)

Migration

29. Because an economy is defined in terms of the economic entities associated with its territory, the scope of an economy is likely to be affected by changes in entities associated with the economy.

30. Migration occurs when the residence of an individual changes from one economy to another because the person moves his or her abode. Certain movable, tangible assets owned by the migrant are, in effect, imported into the new economy. The migrant's immovable assets and certain movable, tangible assets located in the old economy become claims of the new economy on the old economy. The migrant's claims on, or liabilities to, residents of an economy other than the new economy become foreign claims or liabilities of the new economy. The migrant's claims on, or liabilities to, residents of the new economy cease to be claims on, or liabilities to, the rest of the world for any economy. The net sum of all these shifts is equal to the net worth of the migrant, and his or her net worth must also be recorded as an offset if the other shifts are recorded. These entries are made in the balance of payments where the offset is conventionally included with transfers.

Other imputed transactions

31. In some instances, transactions may be imputed and entries may be made in balance of payments accounts when no actual flows occur. Attribution of reinvested earnings to foreign direct investors is an example. The earnings of a foreign subsidiary or branch include earnings attributable to a direct investor. The earnings, whether distributed or reinvested in the enterprise, are proportionate to the direct investor's equity share in the enterprise. Reinvested earnings are recorded as part of direct investment income. An offsetting entry with opposite sign is made in the ***financial account*** under *direct investment*-reinvested earnings to reflect the direct investor's increased investment in the foreign subsidiary or branch. (Reinvested earnings are discussed in chapters 14 and 18.)

Changes Other Than Transactions

Reclassification of claims and liabilities

32. The classification of financial items presented in this *Manual* is designed to reveal the motivation of creditor or debtor. Financial items are subject to reclassification in accordance with changes in motivation. A case in point is the distinction between *direct investment* and other types of investment. For example, several independent holders of *portfolio investment* (in the form of corporate equities issued by a single enterprise located abroad) may form an associated group to have a lasting, effective voice in the management of the enterprise. Their holdings will then meet the criteria for *direct investment*, and the change in the status of the investment could be recorded as a reclassification. Such a reclassification would be reflected, at the end of the period during which it occurred, in the international investment position but not in the balance of payments. Similarly, claims on nonresidents can come under, or be released from, the control of resident monetary authorities. In such cases, there are reclassifications between *reserve assets* and assets other than reserves.

Valuation changes

33. The values of real resources and financial items are constantly subject to changes stemming from either or both of two causes. (i) The price at which transactions in a certain type of item customarily take place may undergo alteration in terms of the currency in which that price is quoted. (ii) The exchange rate for the currency in which the price is quoted may change in relation to the unit of account that is being used. Valuation changes are not included in the balance of payments but are included in the international investment position.

III. Balance of Payments and National Accounts

Introduction

34. Conceptually, balance of payments accounts and related data on the international investment position are closely linked to a broader system of national accounts that provides a comprehensive and systematic framework for the collection and presentation of the economic statistics of an economy. The international standard for this framework is the System of National Accounts (SNA), which encompasses transactions, other flows, stocks, and other changes affecting the level of assets and liabilities from one accounting period to another. Linkage of the balance of payments and the SNA is reinforced by the fact that, in almost all countries, balance of payments and international investment position data are compiled first and subsequently incorporated into national accounts.

35. The SNA is a closed system in that both ends of every transaction are recorded; that is, each transaction is shown as a use for one part of the system and as a resource for another part. Stocks of assets affected by transactions are covered as of the beginnings and ends of appropriate periods. Stocks of assets also are affected by valuation and other volume changes (such as uncompensated seizures or destruction of assets) that occur during the period and cause additional differences in stock value.

36. In the SNA, transactors and holders of stocks are the resident economic entities of a particular economy. For the SNA to be closed, there must be a segment to capture flows that involve uses or resources for nonresident entities. That segment is known as the *rest of the world account.* The segment for resident entities or sectors consists of accounts for production, income generation, primary and secondary distribution of income, redistribution of income, consumption, and accumulation. Since the system is closed, the rest of the world account is constructed from the perspective of the rest of the world rather than that of the compiling economy. Consequently, entries in the balance of payments and the international investment position are reversed in the presentation of rest of the world accounts.

37. In this chapter, the balance of payments and the international investment position are described in relation to the SNA and links between those international accounts and relevant segments of the SNA are discussed.

Relationship Between the SNA and Principles Underlying the Balance of Payments

38. As the balance of payments and the international investment position are integral parts of the SNA, there is virtually complete concordance—between the *Manual* and the *SNA*—on such issues as the delineation of resident units (producers or consumers), valuation of transactions and the stock of external assets and liabilities, time of recording transactions and stocks, conversion procedures, coverage of international transactions in real resources (goods, services and income), and transfers (current and capital). There is concordance, as well, on external financial assets and liabilities and coverage of the international investment position.

Resident units

39. The *SNA* and the *Manual* identify resident producers and consumers in identical fashion. Both invoke the concepts of *economic territory* and the *center of economic interest* to identify resident units. (These concepts are elaborated in Chapter 4.)

Valuation

40. In the *Manual* and the *SNA,* market price is the primary concept for valuation of transaction accounts and balance sheet accounts. (The market price concept is defined and elaborated in Chapter 5.)

Time of recording

41. Balance of payments and national accounts are constructed, in principle, on an accrual basis. The two systems employ essentially identical applications of the accrual basis in specific categories of transactions. (Chapter 6 provides a full discussion on application of the accrual basis underlying balance of payments accounts.)

Conversion procedures

42. Both systems employ consistent procedures for converting transactions denominated in a variety of currencies or units of account into the unit of account (usually the domestic currency) adopted for compiling the balance of payments statement or the national accounts. (See Chapter 7.) There also is concordance between the two systems on conversion procedures used in constructing balance sheet accounts.

Classification

43. It would be convenient, for some purposes, if the classification of transactions in the balance of payments and the rest of the world account of the SNA were identical in all respects. Differences are justifiable, however, because the two statements have different uses. Whereas the classification scheme of the rest of the world account maintains the basic, fundamental distinction between production flows, income flows, and accumulation flows, that subclassification is of lesser importance in the context of balance of payments analysis. Congruence of underlying principles makes the balance of payments consistent with the SNA framework and permits the balance of payments to be described in the context of the SNA. This overall congruence is more important than exact, detailed concordance between the balance of payments and SNA accounts pertaining to relationships of resident units with the rest of the world.

44. Before examining the relationship between the SNA rest of the world account and the balance of payments accounts and international investment position, readers may find it useful to consider how the broad elements of the latter two statements relate to integrated economic accounts for the economy as a whole, as well as to institutional sectors of the economy.

Integrated Economic Accounts

45. Integrated economic accounts (see pages 14–19) in the form of T-accounts provide an overview of structural elements of the SNA by depicting various facets of economic phenomena (e.g., production, income, consumption, accumulation, and wealth) in three types of accounts: current accounts, accumulation accounts, and balance sheets. Details for the total economy and various institutional sectors are presented separately in these accounts. Resources, stocks of liabilities, and net worth (and changes thereof) are shown on the right side of the accounts; uses and stocks of assets (and changes thereof) are shown on the left side in the tabular presentation. However, in the account for goods and services, the sources of supply (resources) from the economy's output and imports are shown on the left side, and the distribution of that supply (uses such as exports, intermediate consumption, and final consumption by the economy) is shown on the right side. For each category of transactions, the sum of the entries on the right side of the accounts is equal to the sum of the entries on the left side. Because the SNA is closed, external flows are portrayed or measured from the perspective of the rest of the world to achieve this equality. Thus, for example, payments of compensation to employees (uses) by various institutional sectors may exceed receipts (resources) for the household sector because some payments are made to nonresidents (resources for the rest of the world). The inclusion of payments to nonresidents on the resources side (for the rest of the world sector) ensures that both sides of the account are equal.

46. SNA current (transactions) accounts—the first set of integrated economic accounts—portray (i) output, intermediate consumption, and value added for each sector and the total economy, as well as the disposition of domestic production and imports of goods and services; (ii) distributive, from the viewpoint of producers, transactions that are directly linked to the process of production or, alternatively, the composition of value added; (iii) primary income distribution showing how gross value added is distributed to factors of labor, capital, and government and, when appropriate, reflects flows to and from the rest of the world; (iv) secondary income distribution; (v) income redistribution covering, in principle, current taxes on income, wealth, and other current transfers and allowing for the derivation of disposable income and adjusted disposable income; and (vi) use of income. Saving is a balancing item for all transactions accounts and provides a link to accumulation accounts.

47. Accumulation accounts of the SNA show changes in assets and liabilities and net worth (the difference, for any sector or for the total economy, between assets and liabilities) and follow a presentation similar to balance sheets. A first group of accounts covers transactions that would correspond to all changes in assets, liabilities, and net worth if saving and voluntary transfers of wealth were the only sources of change in net worth. A second group of accounts relates to changes—in assets, liabilities, and net worth—that are due to other factors. The first group of accumulation accounts contains the capital account and the financial account. These two accounts are distinguished to show a balancing item (i.e., net lending/net borrowing) useful for economic analysis. The second group covers changes—in assets, liabilities, and net worth—that are a result of other factors affecting the values and volume of assets and liabilities. Examples of such changes are discoveries or depletion of subsoil resources, natural catastrophes, uncompensated seizures of assets, etc., and price and exchange rate changes that affect only the values of assets and liabilities.

48. Flows reflected in the balance of payments affect, in important ways, the total economy's activities associated with production, generation and distribution of income, consumption, and accumulation activities. For instance, credit and debit entries for goods and services in balance of payments accounts are equivalent to flows of exports and imports of goods and services. These flows are reflected in the economy's account for goods and services and consequently affect the measurement of gross domestic product (GDP) and its composition in terms of final demand components (e.g., final consumption, gross capital formation, etc.). When measured from the final demand side, GDP is equivalent to the sum of entries in the uses column of the goods and services account less imports (the first entry on the resources side of the account) in the integrated accounts. Flows of exports and imports of goods and services are defined, in terms of coverage, in virtually identical fashion in the *SNA* and the *Manual*.

49. In viewing—for both institutional sectors and the total economy—the generation of income, the allocation of primary income, the secondary distribution of income, and the redistribution of income in kind, readers should note that, apart from income flows generated domestically and included in the measure of gross value added or GDP, there are income flows to or from the rest of the world. These flows (in the form of compensation of employees; property income; taxes on production and imports; current taxes on income, wealth, etc.; and other current transfers) constitute additional sources of income. These additional sources of income are included in the measurement of sectoral and national disposable income and, consequently, in sectoral and national saving—the balancing item between disposable income and final consumption. In terms of the balance of payments, compensation of employees and property income flows comprise the income category, while taxes and other current transfers are identical with the coverage of current transfers.

50. Accumulation activity of the total economy and domestic institutional sectors is portrayed, in the SNA, in the capital and financial accounts. The capital account shows (i) sources of financing accumulation (saving and net capital transfers) on the changes in liabilities side; (ii) the composition of investment (gross or net) which takes into account the consumption of fixed capital (capital formation) on the changes in assets side; and (iii) acquisitions less disposals of nonproduced, nonfinancial assets. Changes in net worth that result from saving and net capital transfers represent the sum of sources of financing accumulation. The balancing item between sources of financing and the sum of net capital formation and net purchases of nonproduced, nonfinancial assets constitutes net lending/net borrowing for each sector and the nation as a whole. Net capital transfers (capital transfers receivable less capital transfers payable) for each sector contain both intersectoral flows and transactions with the rest of the world. Within the total economy, however, intersectoral flows cancel each other so that the net flow constitutes transactions relating only to the rest of the world. In the balance of payments, net lending/net borrowing for the total economy corresponds to the sum of the current account balance and the balance on capital account transactions within the capital and financial account. The measure of net lending/net borrowing for the total economy also represents net financial investment vis-à-vis the rest of the world. In the integrated accounts, net lending/net borrowing for the total economy is equivalent to amounts shown in columns for the rest of the world. However, because the rest of the world columns are viewed from the perspective of nonresidents and balance of payments accounts are viewed from that of the compiling economy, changes in assets of the rest of the world represent changes in liabilities of the compiling economy, and vice versa.

51. According to the guidelines for residence (see Chapter 4), transactions in land can only take place between resident entities. When a nonresident entity (other than a foreign government or international organization acquiring land for use as an extraterritorial enclave) acquires land in the domestic economy, the acquisition is considered a financial investment (included in net incurrence of liabilities) in a notional resident enterprise.

52. The financial account of the SNA shows the net acquisition of financial assets and the net incurrence of liabilities. Transactions in financial assets and liabilities for each institutional sector and the total economy encompass those among domestic sectors and those related to the rest of the world. Consolidated domestic flows cancel each other so that transactions for the economy as a whole are (i) accounted for by transactions vis-à-vis the rest of the world and (ii) equal to flows shown in columns for the rest of the world. In the balance of payments, transactions (from the viewpoint of the compiling economy) in the ***financial account*** of the **capital and financial account** correspond to entries in columns for the financial account of the rest of the world, but changes in assets of the rest of the world represent changes in liabilities for the compiling economy and vice versa.

53. The linkage between key aggregates of accounts of the total economy and balance of payments flows can, by the use of symbols, be summarized algebraically within a savings/investment framework.

C = private consumption expenditure
G = government consumption expenditure

I = gross domestic investment
S = gross saving

X = exports of goods and services
M = imports of goods and services

NY = net income from abroad
GDP = gross domestic product

GNDY = gross national disposable income
CAB = current account balance in the balance of payments

NCT = net current transfers
NKT = net capital transfers

NPNNA = net purchases of nonproduced, nonfinancial assets
NFI = net foreign investment or net lending/net borrowing vis-à-vis the rest of the world

Balance of payments flows are italicized in the following equations.

$$\text{GDP} = \text{C} + \text{G} + \text{I} + X–M$$

($X–M$ = balance on goods and services in the balance of payments)

$$\text{CAB} = X - M + NY + NCT$$
$$\text{GNDY} = \text{C} + \text{G} + \text{I} + CAB$$
$$\text{GNDY} - \text{C} - \text{G} = \text{S}$$
$$\text{S} = \text{I} + CAB$$
$$\text{S} - \text{I} = CAB$$
$$\text{S} - \text{I} + \text{NKT} - \text{NPNNA} = CAB + NKT – NPNNA = \text{NFI}$$

($NKT – NPNNA$ = balance on the capital account of the balance of payments)

54. Balance sheet accounts for the total economy and domestic institutional sectors depict the level and composition of the stock of assets and liabilities at the beginnings and ends of appropriate reference periods.

55. The difference between the sum of assets and the sum of liabilities equals the net worth of the economy and the sectors. In the integrated accounts, financial assets and liabilities recorded in columns for the total economy are an aggregation of the financial assets and liabilities of individual sectors; balance sheet accounts of a nation as a whole are not fully consolidated. If accounts were fully consolidated, the financial assets and liabilities of domestic sectors would cancel each other, and the economy's financial assets and liabilities would refer to the stock of external assets and liabilities (the international investment position). From that perspective, the national wealth or net worth of an economy consists of its stock of nonfinancial assets plus the net international investment position (stock of external assets minus stock of external liabilities). The IIP also may be derived from the integrated accounts column for assets and liabilities of the rest of the world. As the IIP viewpoint is that of the compiling economy, the assets of the rest of the world represent liabilities of the compiling economy and vice versa.

56. Appendix 1 contains a discussion of the relationship of (i) various SNA accounts pertaining to the rest of the world to (ii) balance of payments accounts and the IIP. Because there is concordance between the underlying principles of the two systems, the focus of Appendix 1 is on classification issues and ways of constructing bridges to derive relevant national accounts flows and stocks from balance of payments accounts and the IIP.

INTEGRATED ECONOMIC ACCOUNTS — CURRENT ACCOUNTS

USES

Accounts	Total	Goods and services (resources)	S.2 Rest of world	S.1 Total economy	S.15 Nonprofit institutions serving households	S.14 House-holds	S.13 General govern-ment	S.12 Financial copor-ations	S.11 Nonfinacial corpor-ations
I. PRODUCTION/ EXTERNAL ACCOUNT OF GOODS AND SERVICES									
II.1.1 GENERATION OF INCOME ACCOUNT									
II.1.2. ALLOCATION OF PRIMARY INCOME ACCOUNT									
II.2 SECONDARY DISTRIBUTION OF INCOME ACCOUNT									
II.3 REDISTRIBUTION OF INCOME IN KIND ACCOUNT									
II.4 USE OF INCOME ACCOUNT									

INTEGRATED ECONOMIC ACCOUNTS — CURRENT ACCOUNTS

RESOURCES

Code	Transactions and Balancing Items	S.11 Nonfinancial corporations	S.12 Financial corporations	S.13 General government	S.14 Households	S.15 Nonprofit institutions serving households	S.1 Total economy	S.2 Rest of the world	Goods and services (uses)	Total	Accounts
P.7 P.6 P.1 P.2 D.21-D.31 B.1g/B.1*g K.1 B.1n B.11	Imports of goods and services Exports of goods and services Output Intermediate consumption Taxes less subsidies on products Value added, gross/Gross domestic product Consumption of fixed capital VALUE ADDED, NET/NET DOMESTIC PRODUCT EXTERNAL BALANCE OF GOODS AND SERVICES										I. PRODUCTION/ EXTERNAL ACCOUNT OF GOODS AND SERVICES
D.1 D.2-D.3 D.21-D.31 D.29-D.39 B.2g B.3g B.2n B.3n	Compensation of employees Taxes less subsidies on production and imports Taxes less subsidies on products Other taxes less subsidies on production Operating surplus, gross Mixed income, gross OPERATING SURPLUS, NET MIXED INCOME, NET										II.1.1 GENERATION OF INCOME ACCOUNT
D.4 B.5g B.5n	Property income Balance of primary incomes, gross/National income, gross BALANCE OF PRIMARY INCOMES NET/NATIONAL INCOME, NET										II.1.2. ALLOCATION OF PRIMARY INCOME ACCOUNT
D.5 D.61 D.62 D.7 B.6g B.6n	Current taxes on income, wealth, etc. Social contributions Social benefits other than social transfers in kind Other current transfers Disposable income, gross DISPOSABLE INCOME, NET										II.2 SECONDARY DISTRIBUTION OF INCOME ACCOUNT
D.63 B.7g B.7n	Social transfers in kind Adjusted disposable income, gross ADJUSTED DISPOSABLE INCOME, NET										II.3 REDISTRIBUTION OF INCOME IN KIND ACCOUNT
B.6g B.6n P.4 P.3 D.8 B.8g B.8n B.12	Disposable income, gross DISPOSABLE INCOME, NET Actual final consumption Final consumption expenditure Adjustment for the change in net equity of households in pension funds Saving, gross SAVING, NET CURRENT EXTERNAL BALANCE										II.4 USE OF INCOME ACCOUNT

INTEGRATED ECONOMIC ACCOUNTS — ACCUMULATION ACCOUNTS

CHANGES IN ASSETS

Accounts	Total	Goods and services (resources)	S.2 Rest of world	S.1 Total economy	S.15 Nonprofit institutions serving households	S.14 House-holds	S.13 General govern-ment	S.12 Financial copor-ations	S.11 Nonfinacial corpor-ations
III.1 CAPITAL ACCOUNT									
III.2 FINANCIAL ACCOUNT									
III.3.1. OTHER CHARGES IN VOLUME OF ASSETS ACCOUNT									
III.3.2 REVALUATION ACCOUNT									

INTEGRATED ECONOMIC ACCOUNTS — ACCUMULATION ACCOUNTS

CHANGES IN LIABILITIES AND NET WORTH

Code	Transactions and Balancing Items	S.11 Nonfinancial corporations	S.12 Financial corporations	S.13 General government	S.14 Households	S.15 Nonprofit institutions serving households	S.1 Total economy	S.2 Rest of the world	Goods and services (uses)	Total	Accounts
B.8	SAVING, NET										III.1
B.12	CURRENT EXTERNAL BALANCE										
P.51	Gross fixed capital formation										CAPITAL ACCOUNT
K.1	Consumption of fixed capital (–)										
P.52	Changes in inventories										
P.53	Acquisitions less disposals of valuables										
K.2	Acquisitions less disposals of nonproduced, nonfinancial assets										
D.9	Capital transfers, receivable										
D.9	Capital transfers, payable (-)										
B.10.1	CHANGES IN NET WORTH DUE TO SAVING AND CAPITAL TRANSFERS										
B.9	NET LENDING (+)/NET BORROWING (–)										
F	Net acquisition of financial assets										III.2
F	Net incurrence of liabilities										
F.1	Monetary gold and SDRs										FINANCIAL ACCOUNT
F.2	Currency and deposits										
F.3	Securities other than shares										
F.4	Loans										
F.5	Shares and other equity										
F.6	Insurance technical reserves										
F.7	Other accounts receivable/payable										
K.3 through K.10 and K.12	Other volume changes, total										III.3.1.
K.3	Economic appearance of nonproduced assets										OTHER CHANGES IN VOLUME OF ASSETS ACCOUNT
K.4	Economic appearance of produced assets										
K.5	Natural growth of non-cultivated biological resources										
K.6	Economic disappearance of nonproduced assets										
K.7	Catastrophic losses										
K.8	Uncompensated seizures										
K.9	Other volume changes in nonfinancial assets n.e.c.										
K.10	Other volume changes in financial assets and liabilities n.e.c.										
K.12	Changes in classifications and structure										
Of which											
AN	Nonfinancial assets										
An 1	Produced assets										
AN 2	Nonproduced assets										
AF	Financial assets/liabilities										
B.10.2	CHANGES IN NET WORTH DUE TO OTHER CHANGES IN VOLUME OF ASSETS										
K.11	Nominal holding gains/losses										III.3.2
AN	Nonfinancial assets										
AN.1	Produced assets										REVALUATION ACCOUNT
AN.2	Nonproduced assets										
AF	Financial assets/liabilities										
B.10.3	CHANGES IN NET WORTH DUE TO NOMINAL HOLDING GAINS (+)/LOSSES (–)										

INTEGRATED ECONOMIC ACCOUNTS — BALANCE SHEETS

ASSETS

Accounts	Total	Goods and services (resources)	S.2 Rest of world	S.1 Total economy	S.15 Nonprofit institutions serving households	S.14 House-holds	S.13 General govern-ment	S.12 Financial copor-ations	S.11 Nonfinacial corpor-ations
IV.1 OPENING BALANCE SHEET									
IV.2 CHANGES IN BALANCE SHEET									
IV.3 CLOSING BALANCE SHEET									

INTEGRATED ECONOMIC ACCOUNTS — BALANCE SHEETS

LIABILITIES

Code	Transactions and Balancing Items	S.11 Nonfinancial corporations	S.12 Financial corporations	S.13 General government	S.14 Households	S.15 Nonprofit institutions serving households	S.1 Total economy	S.2 Rest of the world	Goods and services (uses)	Total	Accounts
AN	Nonfinancial assets										IV.1
AN.1	Produced assets										
AN.2	Nonproduced assets										OPENING
AF	Fnancial assets/liabilities										BALANCE
											SHEET
B.90	NET WORTH										
	Total changes in assets										IV.2
AN	Nonfinancial assets										CHANGES IN
AN.1	Produced assets										BALANCE
AN.2	Nonproduced assets										SHEET
AF	Financial assets/liabilities										
B.10	CHANGES IN NET WORTH, TOTAL										
B.10.1	SAVING AND CAPITAL TRANSFERS										
B.10.2	OTHER CHANGES IN VOLUME OF ASSETS										
B.10.3	NOMINAL HOLDING GAINS (+)/ LOSSES (–)										
AN.1	Nonfinancial assets										IV.3
AN.2	Produced assets										
AF	Nonproduced assets										CLOSING
	Financial assets/liabilities										BALANCE
											SHEET
B.90	NET WORTH										

IV. Resident Units of an Economy

Concept and Definition of Residence

57. Residence is a particularly important attribute of an institutional unit in the balance of payments because the identification of transactions between residents and nonresidents underpins the system. Residence is also important in the SNA because the residency status of producers determines the limits of domestic production and affects the measurement of GDP and many important flows.

58. The concept of residence used in this *Manual* is identical to that used in the *SNA*. The concept is not based on nationality or legal criteria, although it may be similar to concepts of residence used for exchange control, tax, and other purposes in many countries. The concept of residence is based on a sectoral transactor's *center of economic interest*. Moreover, country boundaries recognized for political purposes may not always be appropriate for economic purposes. Therefore, it is necessary to recognize the *economic territory* of a country as the relevant geographical area to which the concept of residence is applied. An institutional unit is a resident unit when it has a center of economic interest in the economic territory of a country.

Economic Territory of a Country

59. The economic territory of a country consists of the geographic territory administered by a government; within this territory, persons, goods, and capital circulate freely. In a maritime country, economic territory includes islands that belong to the country and are subject to the same fiscal and monetary authorities as the mainland; goods and persons move freely to and from the mainland and the islands without any customs or immigration formalities. The economic territory of a country includes the airspace, territorial waters, and continental shelf lying in international waters over which the country enjoys exclusive rights and has, or claims to have, jurisdiction over fishing rights and rights to fuels or minerals below the sea bed. The economic territory of a country also includes territorial enclaves in the rest of the world. These are clearly demarcated land areas (such as embassies, consulates, military bases, scientific stations, information or immigration offices, aid agencies, etc.) located in other countries and used by governments that own or rent them for diplomatic, military, scientific, or other purposes with the formal political agreement of governments of countries where the land areas are physically located. While goods or persons may move freely between a country and its territorial enclaves located abroad, such goods or persons become subject to control by governments of the countries where the goods or persons are located if they move out of the enclaves. In addition, economic territory includes free zones and bonded warehouses or factories operated by offshore enterprises under customs control. (These are considered part of the economic territory of the country in which the free zones, etc. are physically located.)

60. The economic territory of an international organization (see paragraph 88 for characteristics) consists of territorial enclave(s) over which the organization has jurisdiction; these are clearly demarcated land areas or structures that the international organization owns or rents and uses for organizational purposes formally agreed upon with the country, or countries, in which the enclave(s) are physically located.

61. Therefore, although territorial enclaves used by foreign governments or international organizations may be physically located within a country's geographical boundaries, such enclaves are not included in the country's economic territory.

Center of Economic Interest

62. An institutional unit has a center of economic interest within a country when there exists, within the economic territory of the country, 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.

63. In most cases, it is reasonable to assume that an institutional unit has a center of economic interest in a country if the unit has already engaged in economic activities and transactions on a significant scale in the country for one year or more, or if the unit intends to do so. The conduct of economic activities and transactions over a period of one year normally implies a center of interest, but the choice of any specific period of time is somewhat arbitrary. The one-year period is suggested *only as a guideline* and not as an inflexible rule.

64. Ownership of land and structures located within a country's economic territory is sufficient qualification for the owner to have a center of economic interest in the country. Land and buildings can only be used for purposes of production in the country where they are located and their owners, in their capacity as owners, are subject to the laws and regulations of that country. However, an owner who is resident in another country may not have any economic interest, other than ownership of land or buildings, in the country where the land or buildings are located. In that case, the owner is treated as if he has transferred his ownership to a notional institutional unit that is actually resident in the country. The notional unit is treated as being owned and controlled by the nonresident owner—much as a quasi-corporation is owned and controlled by its owner. Rents and rentals paid by the tenants of the land or buildings are paid to the notional resident unit; in turn, this unit transfers the income to the actual nonresident owner.

Resident Institutional Units

65. The sectors of an economy are composed of two main types of institutional units: (i) households and individuals who make up a household and (ii) legal and social entities, such as corporations and quasi-corporations (e.g., branches of foreign direct investors), nonprofit institutions, and the government of that economy. These institutional units must meet certain criteria to be considered resident units of the economy.

Residence of Households and Individuals

66. A household has a center of economic interest when household members maintain, within the country, a dwelling or succession of dwellings treated and used by members of the household as their principal residence. All individuals who belong to the same household must be residents of the same country. If a member of an existing household ceases to reside in the country where his or her household is resident, the individual ceases to be a member of that household.

67. If a resident household member leaves the economic territory and returns to the household after a limited period of time, the individual continues to be a resident even if he or she makes frequent journeys outside the economic territory. The individual's center of economic interest remains in the economy in which the household is resident. Treated as residents are

travelers or visitors—individuals who leave an economic territory for limited periods of time (less than one year) for business or personal purposes (see paragraphs 71, 243, and 244);

workers or employees—individuals who work some or all of the time in economic territories that differ from those of their resident households. Such individuals are

- workers who may, because of seasonal demand for labor, work part of the year in another country and then return to their households;
- border workers who regularly (each day) or somewhat less regularly (e.g., each week) cross frontiers to work in neighboring countries;
- staff of international organizations who work in the enclaves of those organizations;
- locally recruited staff of foreign embassies, consulates, military bases, etc.;
- crews of ships, aircraft, or other mobile equipment operating partly or wholly outside an economic territory.

68. An individual may cease being a member of a resident household when he or she works continuously for one year or more in a foreign country. If the individual rejoins his or her original household only for infrequent short visits and sets up a new household or joins a household in the country where he or she works, the individual can no longer be treated as a member of the original household. Most of the individual's consumption takes place in the country where he or she lives or works, and the individual clearly has a center of economic interest there.

69. Even if an individual continues to be employed and paid by an enterprise that is resident in his or her home country, that person should normally be treated as a resident in the host country if he or she works continuously in the host country for one year or more. In these circumstances, the person should be treated as an employee of a quasi-corporation owned by the enterprise and resident in the country where the work takes place. Technical assistance personnel on long-term assignments should be treated as residents of the countries where they work and as employees of their host governments, of international organizations functioning on behalf of governments, or of international organizations actually financing the technical assistance work. Transfers of funds should be imputed from the governments or international organizations that actually employ the technical assistance personnel to the host governments to cover the cost of salaries, allowances, transportation expenses, administrative costs, etc. related to the technical assistance personnel.

70. The situation differs for military personnel and civil servants (including diplomats) employed abroad in government enclaves. Those enclaves—military bases, embassies and the like—form part of the economic territory of the employing government, and the personnel often live as well as work in the enclaves. Therefore, government employees working in such enclaves continue to have centers of economic interest in their home countries while, and however long, they work in the enclaves. They continue to be residents in their home countries even if they live in dwellings outside the enclaves.

71. However long they study abroad, students should be treated as residents of their countries of origin, as long as they remain members of households in their home countries. In these circumstances, their centers of economic interest remain in their countries of origin rather than in the countries where they study. Medical patients staying abroad are also treated as residents of their countries of origin, even if their stays are one year or more, as long as they remain members of households in their countries of origin.

72. Some individuals have several international residences where they may remain for short periods (e.g., three months in each of four countries) during a specific year. For these individuals, the centers of economic interest often are international rather than designated economies. While consideration should be given to such factors as tax status, citizenship (can be dual), etc., this *Manual* and the *SNA* do not recommend a specific treatment. The choice is left to the discretion of the economies concerned. The treatment should be coordinated, if possible, to foster international comparability.

Residence of Enterprises

73. An enterprise is said to have a center of economic interest and to be a resident unit of a country (economic territory) when the enterprise is engaged in a significant amount of production of goods and/or services there or when the enterprise owns land or buildings located there. The enterprise must maintain at least one production establishment in the country and must plan to operate the establishment indefinitely or over a long period of time. Together with other considerations covered in paragraph 78, a guideline of one year or more, to be applied flexibly, is suggested.

Definition and activity

74. The term *enterprise,* as used in this *Manual* , is inclusive of the terms *corporation* and *quasi-corporation* as defined in the *SNA*. A corporation is a legal entity created for the purpose of producing goods or services for the market. A corporation may be a source of profit or other financial gain to its owner(s). A corporation is collectively owned by shareholders who have the authority to appoint directors responsible for the general management of the corporation. Owned by a resident or a nonresident institutional unit, a quasi-corporation is an unincorporated enterprise that is operated as if it were a separate corporation with a complete set of accounts. The de facto relationship of a quasi-corporation to its owner is the same as that of a corporation to its shareholders. (For purposes of sectoring, in the *SNA*, quasi-corporations are treated as corporations—that is, as institutional units separate from the units to which the quasi-corporations legally belong.)

Types of enterprises

75. Enterprises may be either privately owned and/or controlled, publicly owned and/or controlled, or controlled by residents and/or nonresidents. Enterprises may be financial or nonfinancial institutions.

76. In accord with the preceding definition, private enterprises include (i) incorporated enterprises (e.g., corporations, joint stock companies, limited liability partnerships, cooperatives, or other business associations recognized as independent legal entities by virtue of registration under company and similar acts, laws, or regulations); (ii) unincorporated enterprises; and (iii) nonprofit institutions.

77. Public enterprises are (i) unincorporated government enterprises and (ii) public corporations incorporated by virtue of company acts or other public acts, special legislation, or administrative regulations. Public corporations hold and manage the financial assets and liabilities, as well as the tangible and nonfinancial intangible assets, that are involved in corporation business. Both government enterprises and public corporations sell to the public most of the goods or services they produce. The principal public monetary institution, which issues currency and (sometimes) coin and is commonly the chief holder of the country's international reserves, is usually the central bank—the publicly owned and/or controlled monetary authority.

Attribution of production

78. Production undertaken outside the economic territory of a resident enterprise by the personnel, plant, and equipment of that resident enterprise is treated as part of host country production and the enterprise is treated as a resident unit (branch or subsidiary) of that country if the enterprise meets the conditions noted in paragraph 73. In addition, the enterprise must, among other considerations, maintain a complete and separate set of accounts of local activities (i.e., income statement, balance sheet, transactions with the parent enterprise), pay income taxes to the host country, have a substantial physical presence, receive funds for enterprise work for the enterprise account, etc. If these conditions are not met, the activity should be classified as an export of services by a resident enterprise. Production can generate such an export only if the production is classified as domestic production (undertaken by a resident even though the physical process takes place outside the economic territory). These considerations also apply to the particular case of construction activity carried out abroad by a resident producer. Special mention should be made of construction involving major specific projects (bridges, dams, power stations, etc.) that often take several years to complete and are carried out and managed by nonresident enterprises through unincorporated site offices. In most instances, site offices will meet the criteria that require site office production to be treated (as would that of a branch or affiliate) as the production of a resident unit and as part of the production of the host economy rather than as an export of services to that economy.

79. Offshore enterprises engaged in manufacturing processes (including assembly of components manufactured elsewhere) are residents of the economies in which the offshore enterprises are located. This statement applies regardless of location in special zones of exemption from customs or other regulations or concessions. The statement also applies to nonmanufacturing operations (i.e., trading and financial enterprises), including so-called special purpose enterprises. (See paragraphs 365 and 381.)

Units operating mobile equipment

80. Principles used to determine the residence of an enterprise are likewise applicable to an enterprise that operates mobile equipment outside the economic territory where the enterprise is resident. (The mobile equipment could consist of ships, aircraft, drilling rigs and platforms, railway rolling stock, etc.) Such operations may take place in (i) international waters or airspace or (ii) another economy. In the first case (an enterprise with operations taking place in international waters or airspace), the activities should be attributed to the economy in which the operator maintains residence. In the second case (an enterprise with production taking place in another economy), the enterprise may be considered to have a center of economic interest in the other economy. Thus, if the enterprise is accounted for separately by the operator and is recognized as a separate enterprise by tax and licensing authorities of the other economy, production should be attributed to the economy in which the production occurs. Otherwise, production is attributed to the original operator's country of residence. If operations (such as a railway network) are carried out by an enterprise on a regular and continuing basis in two or more countries, the enterprise is deemed to have a center of economic interest in each country and thus to have separate resident units in each. The enterprises must also be accounted for separately by the operator and recognized as separate enterprises by tax and licensing authorities in each country of operation. In cases involving the leasing of mobile equipment to one enterprise by another for a long or indefinite period, the lessee enterprise is deemed to be the operator, and activities are attributed to the country where the lessee is resident.

81. For ships flying flags of convenience, it is often difficult to determine the residence of the operating enterprise. There may be complex arrangements involving ownership, mode of operation, and chartering of such ships. In addition, the country of registry differs, in most instances, from the operator's (or owner's) country of residence. Nonetheless, in principle, the shipping activity is attributed to the country of residence of the operating enterprise. If an enterprise establishes, for tax or other considerations, a branch (direct investment) in another country to manage the operation, the operation is attributed to the resident (branch) operating in that country.

82. In certain exceptional cases, it may be difficult to determine the residence of an enterprise that operates mobile equipment. For example, the enterprise may consist of a corporation that is registered in two or more countries as a result of being established through special legislation enacted cooperatively by two or more governments. Such enterprises may be treated in two ways. All of the corporation's transactions may be allocated to the countries of registry in proportion to the amounts of financial capital that the countries have contributed or in proportion to their shares in the equity of the corporation. Alternatively, the corporation may be treated as a resident of the country where corporation headquarters are located. Corporation premises in other countries would be treated as foreign branches (direct investment enterprises) and classified as residents of the countries where the premises are located. The first method is preferable, but both ways of treating such corporations are consistent with the general principles of the *Manual* and the *SNA*. The choice between methods may be made, with reference to consistent treatment by partner countries, on the basis of statistical convenience.

Agents

83. Transactions of agents should be attributed to the economies of principals on whose behalf the transactions are undertaken and not to the economies of agents representing or acting on behalf of principals. However, services rendered by agents to enterprises represented should be attributed to the economies in which the agents are residents.

Residence of Nonprofit Institutions

84. A nonprofit institution (NPI) is resident in the country or economic territory where the NPI has a center of economic interest. In most instances, this center of economic interest lies in the country where the NPI was legally created and is officially recognized and recorded as a legal or social entity. In practice, residence of the vast majority of NPIs may be determined without ambiguity. However, when an NPI is engaged in charity or relief work on an international scale, it is necessary to specify the residence of any branches the NPI may maintain for dispensing relief in individual countries. If an NPI maintains a branch or unit for one year or more in a particular country, that branch or unit should be considered a resident NPI that is financed largely or entirely by transfers from abroad.

General Government

85. General government agencies that are residents of an economy include all departments, establishments, and bodies located in the economic territory of an economy's central, state, and local governments and all embassies, consulates, military establishments, and other entities, which are located elsewhere, of an economy's general government.

86. The general government of an economy covers all unclassified agencies of the public authorities. Such agencies include government departments, offices, and other bodies (whether these are covered in ordinary or extraordinary budgets or in extrabudgetary funds) that engage in administration, defense, and regulation of the public order; promotion of economic growth, welfare, and technological development; and provision of educational, health, cultural, recreational, and other social and community services free of charge or at sales prices that do not cover most or all of the costs of production. Also included are other nonprofit organizations serving individuals or business enterprises that are wholly, or mainly, financed and controlled by the public authorities and nonprofit organizations primarily serving government bodies. This category covers, as well, social security arrangements that are imposed, controlled, or financed by the government for large sections of the community. These arrangements include voluntary social security arrangements for certain sections of the community and pension funds that are considered part of public social security schemes. Such agencies may be unincorporated government enterprises that primarily produce goods and services for the government or primarily sell goods and services to the public. In addition, there are public, nonmonetary saving and lending bodies that are financially integrated with a government or that lack the authority to acquire financial assets or incur liabilities in the capital market.

87. Embassies, consulates, military establishments, and other entities of a foreign general government are considered extraterritorial by the economies in which the embassies, etc. are physically located. When resident producers of an economy construct embassies, structures, or other works in an extraterritorial enclave, the construction is part of the production and exports of the economy in which the enclave is located. Wages and salaries paid to locally recruited staff of foreign diplomatic, military, and other establishments are payments to residents of the economies in which these establishments are located.

88. International organizations that do not qualify as enterprises (see paragraph 74) form part of foreign general government for balance of payments purposes. Most political, administrative, economic, social, or financial institutions in which the members are governments (or other international organizations with memberships consisting of governments) do not qualify as enterprises. International organizations are created for the purpose of engaging in one, or both, of the following activities: (i) the provision of nonmarket services of a collective nature for the benefit of members and/or (ii) financial intermediation, or the channeling of funds between lenders and borrowers in different economies. International organizations are established by political agreement among organization members. Such agreements have the status of international treaties. International organizations are accorded appropriate privileges and immunities and are not subject to the laws and regulations of the economies in which the organizations are located. Thus, such bodies are not considered residents of any national economy, including the economies in which the organizations are located or conduct affairs. The international organizations are treated as extraterritorial entities by those economies. (However, pension funds operated by these bodies are treated as residents of the economies in which the organizations are located.) Nevertheless, the employees of these bodies are residents of national economies—specifically, of the economies in which they are expected to maintain their abodes for one year or more. In most cases, that economy will be the one in which the particular international unit is located or the one in which the employee is engaged in technical assistance or other activities on behalf of the international organization. Wages and salaries paid by international organizations to their employees are payments to residents of the economies in which the employees are stationed for one year or more. (For the treatment of technical assistance personnel, see paragraph 69.)

89. In contrast, enterprises owned jointly by two or more governments are not treated as international bodies but are, like other enterprises, considered to be residents of the economic territories where the enterprises operate.

Regional Central Banks

90. A regional central bank is an international financial institution that acts as a common central bank for a group of member countries. Such a bank has headquarters in one country and maintains national offices in each member country. Each national office acts as the central bank for that country and must be treated as an institutional unit that is separate from the headquarters institution. Each national office is a resident unit of the country where the office is located. The financial assets and liabilities of a regional central bank should be allocated among the national offices. The allocation should be made in proportion to the claims that such offices have over the bank's collective assets.

V. Valuation of Transactions and of Stocks of Assets and Liabilities

Concept of Market Price

91. A uniform system of valuation for the international accounts—for valuation of (i) transactions in real resources and financial assets and liabilities and (ii) stocks of assets and liabilities—is required for the compilation of aggregates of such statistics on a consistent basis and for international comparability purposes. The recommendation in this *Manual* is that market price be used as the basis of valuation for both transactions and stocks. Thus, transactions are generally valued at the actual prices agreed upon by transactors; stocks of assets and liabilities are valued at market prices in effect at the time to which the balance sheet relates. (See paragraphs 93, etc. for discussion of instances in which the concept may be impractical or difficult to apply.) These principles are in accord with those presented in the *SNA*.

Transactions and Market Price

92. In the frameworks of the balance of payments and the national accounts, market prices for transactions are defined as amounts of money that willing buyers pay to acquire something from willing sellers; the exchanges are made between independent parties and on the basis of commercial considerations only. Thus, according to this strict definition, a market price refers only to the price for one specific exchange under the stated conditions. A second exchange of an identical unit, even under circumstances that are almost exactly the same, could result in a different market price. A market price defined in this way is to be clearly distinguished from a price quoted in the market, a world market price, a going price, a fair market price, or any price that is intended to express the generality of prices for a class of supposedly identical exchanges rather than a price actually applying to a specific exchange. Furthermore, a market price should not necessarily be construed as equivalent to a free market price; that is, a market transaction should not be interpreted as occurring exclusively in a purely competitive market situation. In fact, a market transaction could take place in a monopolistic, monopsonistic, or any other market structure. Indeed, the market may be so narrow that it consists of the sole transaction of its kind between independent parties.

Valuing Transactions in the Absence of Market Price

93. Although conditions necessary for establishing market prices are probably present for most transactions with which the balance of payments is concerned, there may be situations in which one or more of the essential elements is lacking. Some common circumstances under which a market price, in the literal sense, cannot be readily determined are

a direct exchange of goods for other goods rather than for money (barter);

a transaction that occurs despite the fact that one party does not enter into the transaction willingly (tax payments);

a transaction in which a buyer and seller are the same entity from a legal standpoint but constitute separate entities under balance of payments conventions (a branch and the parent enterprise);

a transaction between separate legal entities that are not independent (affiliated enterprises);

a transaction in which a legal change of ownership between the two parties involved does not actually occur (goods transferred under a financial lease arrangement);

a transaction that often involves private, nonprofit entities or general government bodies as one or both of the parties, that contains at least some element of a gift or grant, and that is undertaken for other than purely commercial considerations.

94. The examples enumerated in paragraph 93 are by no means all-inclusive or mutually exclusive. In any particular case, a market price may not exist because more than one of the conditions necessary to establish it are absent.

Market Price Equivalents

95. For purposes of balance of payments recording, therefore, it is sometimes necessary to resort to the expedient of developing proxies, or substitute measures, for market prices when no actual market prices have been set.

96. A customary approach is to construct such prices by analogy with known market prices established under conditions that are considered essentially the same. For example, if a buyer and a seller engage in a barter transaction—the exchange of goods or services for other goods, services, or assets (of equal value)—the goods or services bartered should be valued at the prices that would have been received if the goods or services had been sold (e.g., a standard market quotation). This approach must be limited to those transactions to which the approach is really applicable. Transactions that are superficially alike may, in fact, be subject to implicit or concealed factors that strongly affect the values that should be placed on them.

Affiliated Enterprises

97. Transactions between affiliated enterprises integrated under the same management cannot necessarily be considered market transactions because of the lack of independence among the parties to the exchange. Whether or not the transactions portrayed in the books of the enterprises actually reflect market values can only be judged for each individual enterprise. To the extent that a group of affiliated enterprises desires to allocate its gross earnings in a realistic fashion among its separate units, bookkeeping practices would have to reflect market-related pricing for all purchases and sales by the units. In that situation, the view might reasonably be taken that pricing adopted for bookkeeping purposes, often referred to as *transfer pricing,* is no different from, or is equivalent to, market valuation. On the other hand, transfer pricing not based closely on market considerations could be expected to be common among affiliated enterprises conducting business across national boundaries because disparities between taxes and regulations imposed by different governments are a factor in management decisions on the optimum allocation of profits among units. In those circumstances, it cannot be presumed that the mode of valuation used will accurately reflect economic relationships (e.g., the ratio of income to capital). When the distortions are large, replacement of book values with market value equivalents is desirable in principle.

98. The attempt to substitute market values for book values, however, raises questions about procedure and the propriety of pricing measures substituted. Indeed, a value approximating the market price frequently will be difficult to estimate. The values to be placed on transactions among affiliated units are not necessarily equal to the market prices for any similar transactions of those units with outside parties because, by definition, market prices are established in response to demand and supply conditions prevailing in each specific market. Commodities that are otherwise physically indistinguishable might be viewed differently from a market standpoint and therefore have different market prices. For example, goods transferred to an affiliate might represent components but, if sold to outside parties, could constitute spare parts.

99. In determining how far a transfer price deviates from or approximates a market price, the relevant comparison is not necessarily between (i) the book value for the transfer of something from one affiliate to another and (ii) the market price for the sale of the same thing by an affiliate to an outsider. A transfer between affiliates may be evaluated by measuring from the relative position of the transfer in the chain of production to the point of actual sale to an independent party. The comparison could be made in terms of costs embodied up to that stage of production. Therefore, a transfer price that does not seem commensurate with production costs incurred up to that stage is probably not an adequate proxy for a market price. If the transfer price covers the costs of production, the transfer price could be accepted as a suitable proxy for a market price, even though the transfer price is different from the price charged for a similar exchange between the affiliate and an independent party. Production cost information available in the books of an affiliate may, of course, be affected by the use of transfer pricing for the input of goods and services acquired from other affiliates.

100. The exchange of commodities between affiliated enterprises may often be one that does not occur between independent parties (for example, specialized components that are usable only when incorporated in a finished product). Similarly, the exchange of services, such as management services and technical know-how, may have no near equivalents in the types of transactions in services that usually take place between independent parties. Thus, for transactions between affiliated parties, the determination of values comparable to market values may be very difficult, and compilers may have no choice other than to accept valuations based on explicit costs incurred in production or any other values assigned by the enterprise. Such values will probably not be entirely arbitrary as the tax, customs, exchange control, and other public authorities usually exercise some influence over the accounting practices of these enterprises in order to establish conformance with government regulations by affiliated and independent enterprises.

101. Because balance of payments accounting is based on the axiom of double entries, any substitution should, in principle, be applied consistently in the statement. If, for example, the book value of goods shipped from a direct investment enterprise to the parent is to be replaced by a market value equivalent, the double entry rule requires that the direct investment income and/or financial flows also be adjusted by the same amount.

102. In view of practical difficulties involved in substituting an imputed or notional market value for an actual transfer value, substitution should be the exception rather than the rule. If certain transfer prices are so divorced from those of similar transactions that the transfer prices significantly distort measurement, the prices should either be replaced by market price equivalents or be separately identified for analytical purposes.

103. Selection of the best market value equivalents to replace book values is an exercise calling for cautious and informed judgment. In most cases, sample surveys, contacts with enterprises and government agencies engaging in international transactions on a large scale, exchanges of information between compilers in partner countries, or similar statistical research will be necessary to provide the basis for such judgment.

Noncommercial Transactions

104. One important category of transaction that is, by definition, noncommercial and thus has no market price is the provision of an economic value for which the offset constitutes a transfer. In such a transaction, one party receives a real or financial asset from another party and, in return, provides nothing of economic value. In addition to outright gifts, other transactions may take place at implied prices that include some element of grant or concession so that those prices also are not market prices. Examples of such transactions could include negotiated exchanges of goods between governments and government loans bearing lower interest rates than those consistent with grace and repayment periods or other terms for purely commercial loans. Transactions by general government bodies and private, nonprofit entities not engaged in purely commercial undertakings are often subject to noncommercial considerations. Transfers may also be provided or received, however, by other sectors of the economy.

105. When real resources are transferred, without a quid pro quo, to nonresidents by the government or private, nonprofit institutions of an economy, the same values must be reflected in the balance of payments of both recipient and donor. In conformity with the procedure used for the national accounts, such resources should be valued at the market prices that would have been received if the resources had been sold. Imputations made in this way may not always approximate the desired basis of valuation. The donor's view of the imputed value of the transaction will often be quite different from that of the recipient. The suggested rule of thumb is to use the value assigned by the donor as a basis for recording.

Financial Items

106. Transactions in financial items should be recorded in the balance of payments at the prices at which the items are acquired or disposed of. If financial items are traded in an organized market and if the buyer and seller deal with each other through an agent, the prices established in the market—which will probably be the prices recorded in the statistics in any case—will meet the definition of a market price for purposes of the balance of payments. If financial items are not traded in the market, however, application of the market price concept may not be so apparent. In fact, cash items (currency and transferable deposits that can be redeemed on demand at the nominal values) have only one value that could be assigned for any purpose, so this value could be regarded as the actual market price. Market prices to be imputed to nonmarketable financial items, which are primarily loans in one form or another, are the nominal values. However, if a secondary market in such items is created and the items become marketable, often—as in the case of loans to some heavily debt-burdened countries—at substantial discounts from nominal values, those market prices should be recorded for transactions in such loans. (For details on related valuation adjustments, debt/equity swaps, etc., see paragraphs 456 and 471.) Valuation of financial items in the balance of payments should exclude any service charges, fees, commissions, or income; these amounts should be recorded in the appropriate component of the **current account**.

Valuation of Stocks of Assets and Liabilities

107. In principle, all asset and liability stocks comprising a country's international investment position should be measured at market prices. This concept assumes that such stocks are continuously (regularly) revalued—for example, by reference to actual market prices for financial assets such as shares and bonds or, in the case of direct investment, by reference to enterprise balance sheets.

108. The market price measurement cannot always be implemented because of the absence of regular revaluations. For example, balance sheet value is often the only valuation available or reported for direct investment. That value might be assigned on the basis of original cost, a more recent revaluation, or current value. (The use of current value would be in accordance with the market price principle.) When direct investment enterprises are listed on stock exchanges, the listed prices should be used as the market values of shares in those enterprises.

VI. Time of Recording

Principle of Timing

109. In the double-entry system of the balance of payments, two entries must be recorded simultaneously for each transaction. Simultaneous recording ensures that both entries show the transaction occurring at the same time, that is, on the same date. Determination of the time, or date, when a transaction occurs is governed by rules.

110. A typical transaction consists of a series of actions. For example, a party may engage in a set of actions and transactions by entering into a formal agreement to provide goods or services, by acquiring a claim for payments, and by receiving settlement on that claim.

111. All of the actions that make up a transaction are significant from an economic standpoint, and some can be assigned specific dates (date of contract or commitment, for example). In addition, an action—such as entering into a contract—may establish parameters for subsequent transactions—such as settlement by payment or other considerations. However, in balance of payments accounts (and in the SNA), transactions are recorded when economic value is created, transformed, exchanged, transferred, or extinguished. The time of recording for a transaction is governed by the principle of accrual accounting. Claims and liabilities arise when there is a change in ownership. The change may be a legal one or a physical or economic one involving control or possession.

112. If an exchange of resources involves a change of ownership, double-entry recording of both sides of the exchange is required. Two stages of the exchange may be involved: (i) provision of one resource accompanied by the acquisition of a financial claim on the recipient of the resource, and (ii) provision of the other resource accompanied by extinguishment of the claim.

113. Because a double-entry system is used to record balance of payments transactions, it is especially important to establish a principle for determining the time when the two sides of a transaction should be entered in the accounts. The principle helps to ensure simultaneous recording of the entries. When a change in ownership is not obvious, the change is considered to occur at (or is proxied by) the time the parties to the transaction record it in their books or accounts. In practice, however, the two entries for a transaction often are derived independently from different sources and accounting records, and conventions for time of recording for the participants in that transaction may differ. Consequently, simultaneous recording of the two sides may not be achieved.

Application to Goods

114. (Also see Chapter 10.) Trade statistics, by convention or necessity, often are recorded on the basis of customs documents reflecting the physical movement of goods across the national or customs frontier of an economy. Actual movement of the goods may not occur at the same time as the change, between a resident and a nonresident, in ownership of the goods. Likewise, an exchange record system that reflects payments may not coincide in timing with the change in ownership of the goods. The change in ownership, as noted in paragraph 123, is considered to occur at (or is proxied by) the time the parties to the transaction record it in their books or accounts. Thus, goods for export are generally considered to change ownership when the exporter ceases to carry the goods on his books as a real asset and makes a corresponding change in his financial items. Goods for import are considered to change ownership when the importer enters the goods on his books as a real asset and makes a corresponding change in his financial items. This convention is designed to promote consistency between ***goods*** and the **financial account** in the balance of payments of the compiling country, as well as consistency between the compilation of ***goods*** by exporting and importing countries.

115. Under this convention, it is seldom difficult to perceive the time at which ownership of an asset changes. Numerous transactions consist of an exchange, such as goods for financial assets, between two enterprises. Accounting entries will be made in each company's books for this exchange; the entries will show the same dates for acquisition of the goods and relinquishment of the financial asset, on the one hand, and for acquisition of the financial asset and relinquishment of the goods, on the other. Ideally, the entries should be dated the same by both parties. This treatment provides a fixed point of time to which a balance of payments transaction may be related.

116. However, even when this convention is followed, the two parties to a transaction may not enter it in their books at the same time. As a result, differences in timing and possible inconsistencies arise between the compilations of partner countries.

117. In practice, trade statistics based on customs documents reflecting physical movement of goods across national or customs frontiers may be used in the absence of other statistics to approximate, by showing evidence of physical possession, the timing of changes in ownership.

118. When the provision of a real resource and a related extension of credit are involved, each transaction should be recorded in the balance of payments at the time it occurs. That is, when an importer turns over cash (a prepayment) to an exporter before he acquires ownership of the goods, records must also show the importer's acquisition of a claim, which remains outstanding for the duration of the interim period, on the exporter. Similarly, when an importer makes a postpayment some time after he acquires goods, records must show the importer's interim liability to the exporter. These claims and liabilities are extinguished in due course; that is, in the first instance, by the delivery of the goods and, in the second, by the cash payment made for the goods. The creation and the extinguishing of an obligation, as well as the change in ownership of goods and payment for the goods, are shown in the balance of payments in the periods in which each occurs.

Exceptions to the Change of Ownership Principle

119. Some goods transactions are recorded in the balance of payments even though no change of legal ownership occurs. Among such transactions are those that involve goods under financial lease arrangements (see paragraph 206) and goods shipped between the parent of a direct investment enterprise and branches or affiliates (see paragraph 205). For both parties to achieve simultaneous recording in such transactions, it is recommended that the entries be dated, whenever possible, as of the day that most closely approximates the change in physical possession of the goods. For financial leases, commencement of the leases would best approximate the change in control and possession. For affiliated transactions, dates of entry in the books of the entities involved would be appropriate.

120. Another exception to the change of ownership principle relates to goods that are sent abroad for processing but do not change ownership. For purposes of recording in the rest of the world account of the SNA, goods sent abroad for processing that involves a substantial physical change are distinguished from other processing. In the SNA, goods sent abroad for processing and reclassified, upon return, in a different three-digit group of the Central Product Classification (CPC) are included, on a gross basis, under goods. The value of other processing is recorded under services. Although that concept is recognized in this *Manual*, because of practical difficulties in implementation, it is recommended that all processing of goods that cross the frontier be recorded, on a gross basis, under ***goods***. The processing may be performed abroad (and involve the export of a good and its subsequent re-import) or performed in the compiling economy (and involve an import and subsequent export). Further elaboration of the treatment of goods for processing (and of the value of repairs on goods) appears in paragraphs 197 through 200.

Applications to Other Transactions

121. Transactions in services are generally recorded when the services are rendered (delivered or received); these dates often coincide with dates on which the services are produced. In some instances, there may be prepayments or postpayments for such services (freight, insurance, port services, etc.). Entries in the appropriate accounts should then be made (as explained in paragraph 118). Under *investment income*, interest is recorded on an accrual basis, which is a continuous method of recording that matches the cost of capital with the provision of capital. If the interest is not actually paid, an entry is required, together with an offsetting credit entry in the ***financial account*** for the claim associated with nonpayment (i.e., an increase in liabilities). The two entries are particularly important for zero coupon and other deep discounted bonds. The difference between the issue price and the value at maturity is treated, on an accrual basis, as interest over the life of the bond. (See paragraph 396 for details.) Dividends are recorded as of the dates payable. Reinvested earnings on direct investment are recorded in the periods when earned.

122. One party may impose various taxes, fines, and other components of transfers on another party. These amounts are recorded upon the occurrence of underlying transactions or other flows that give rise to the liabilities. In some instances, taxes on income may be recorded in a subsequent period. (See paragraph 307.) Other transfers are recorded when the resources (goods, services, financial items) to which the transfers provide offsets change ownership.

123. Transactions in financial items are considered to have taken place when both creditor and debtor have entered the claim and liability, respectively, in their books. A date (the value date) may actually be specified to ensure matching entries in the books of both parties. If no precise date can be fixed, the date on which the creditor receives payment or some other financial claim is decisive. Loan drawings are entered in the accounts when actual disbursements are made; loan repayments are entered when due for payment. For loan repayments not made, entries are recorded as if repayments of the contractual obligations were made. In addition, entries are recorded for (i) replacements by new liabilities that are short-term (for immediate payment) or (ii) replacements by new loans, if the original loans are subject to rescheduling or other special financing arrangements associated with balance of payments difficulties in an economy. (See paragraphs 454 through 458 for comments relating to exceptional financing.)

Other Timing Adjustments

124. In choosing among available statistical sources, compilers may wish to consider the advantage of using data for which the correct timing is already recorded. For example, records of actual drawings on loans are preferable to sources that quote authorization dates or program dates that may not be realized in fact. Even sources chosen by compilers as generally the most suitable may not have been specifically designed to yield balance of payments information.

125. Timing adjustments to trade statistics may be necessary because trade statistics do not reflect physical movements correctly in all cases. (However, systematic defects of that sort would not create noticeable errors unless the value of trade changed sharply from period to period.) Timing adjustments could be necessary, for example, if compilers of trade accounts cease recording monthly statistics before all customs declarations have been tabulated and defer the recording of the remainder to the following month. When practices of this sort lead to distortions, the amounts should be estimated and timing adjustments applied.

126. A change in the ownership of goods can vary widely from the time at which the goods are recorded in trade statistics if a lengthy voyage is part of the process of importing or exporting. If the unit value of trade changes substantially from the beginning to the end of the reporting period, the possible difference of one or two months between the shipment or receipt of goods and the change of ownership can be a source of error in the statement for a particular country and a source of asymmetries between partner countries. No empirical basis has been established for presuming that ownership normally changes either at the beginning or the end of a voyage. Inquiries, perhaps on a sample basis, are required to ascertain specific practices, and timing adjustments should, in principle, be applied to correct the trade statistics for those classes of goods that are found to change ownership at times other than those at which the goods were recorded in the trade statistics.

127. Goods on consignment (goods intended for sale but not actually sold when the goods cross the frontier) should, in principle, be included in ***goods*** only at the time ownership changes. Such goods are often recorded, on the assumption that a change of ownership has occurred or will shortly occur, at the time the goods cross the frontier. If that treatment is followed and there is no change of ownership, the goods will subsequently have to be recorded again as a deduction from exports and imports.

VII. Unit of Account and Conversion

128. The compilation of balance of payments and international investment position statements is complicated by the fact that the values of transactions in real resources and financial items and the values of components of stocks of external financial assets and liabilities may be expressed initially in a variety of currencies or in other standards of value, such as SDRs or European currency units (ECUs). The conversion of these values into a reference unit of account (usually the national currency of the compiler) is a requisite for the construction of consistent and analytically meaningful statements. In addition, a standard or universal unit of account is necessary to allow for aggregation on a global or regional basis and to facilitate international comparisons.

Unit of Account

129. There are two viewpoints, not mutually exclusive, as to the necessary attributes of a unit of account—that of the national compiler and that of international organizations, such as the International Monetary Fund. From the perspective of the national compiler, the national currency unit is the obvious choice for the balance of payments and international investment position statements. Statements so denominated are compatible with the national accounts and most of the economy's other economic and monetary statistics expressed in that unit. Also, some statistics (such as customs returns for goods, banking data, and direct investment estimates) will already have been converted from foreign currencies to the national currency and/or be expressed in the national unit when such statistics are reported to the compiler. However, if the currency is subject to significant depreciation relative to other currencies involved in the international transactions of the economy, a statement denominated in national currency would be of diminished analytical value. For example, if transactions are expressed in national currency, apparent growth in current transactions could be the result of an unstable national currency that has depreciated in comparison with currencies actually used for the transactions. Such a circumstance might complicate the analysis of balance of payments developments.

130. From the perspective of international organizations such as the IMF, a standard unit of account is required for global presentation and analysis. It is preferable that the unit of account be a stable one; that is, values of international transactions expressed in that unit should not be significantly affected by changes (relative to the unit of account) in values of currencies in which those transactions occur. Transactions expressed in a unit that is stable in this sense nonetheless may reflect price changes resulting from other causes; that is, a series expressed in a so-called stable unit of account is not the equivalent of a volume or constant price series. Another consideration is the convenience of using a unit (such as the U.S. dollar or SDR) that is reasonably familiar to most users of balance of payments statistics. The theoretical ideal of a widely recognized and perfectly stable standard unit of account simply does not exist.

131. For reporting to the IMF, countries are requested to compile statements in the unit of account adopted for national use. A country that employs a multiple exchange rate system and prepares a statement in national currency should do so by utilizing one of several methods suggested in this chapter. (See paragraphs 134 and 135.) The IMF may, for its purposes, convert countries' statements into the universal unit considered most suitable in existing circumstances. That unit may be periodically changed according to developments in the relationships among transactions currencies and according to the time span covered by balance of payments statistics for which a unit of account is selected.

Conversion Principles and Practices

132. In concordance with the principles defined in this *Manual* and in the *SNA* for time of recording and valuation, the most appropriate exchange rates to be used for conversion of balance of payments entries from transaction currencies into units of account are the market rates prevailing on the transaction dates. If those market rates are not available, the average rates for the shortest period applicable should be used. The midpoint between buying and selling rates should be used so that any service charge—the spread between the midpoint and those rates—is excluded. When forward contracts are utilized to hedge or protect transactors against changes in exchange rates, such transactions are conceptually distinct from those involved with the acquisition or sale of goods, services, or financial items from or to nonresidents. Exceution of the contract is virtually simultaneous with the change of ownership or delivery of the underlying asset. If there is a difference between the prevailing exchange rate and the actual rate of conversion established by the forward contract (or other financial derivative), that difference is reflected in a separate transaction related to the contract (derivative).

133. For conversion of data on stocks of external financial assets and liabilities, the market exchange rates prevailing on the date to which the balance sheet relates (i.e., the midpoint between the buying and selling spot rates) is recommended.

Multiple Official Exchange Rates and Conversion

134. Under a multiple exchange rate regime, two or more exchange rates are applicable to different categories of transactions; the rates favor some categories and discourage others. Such rates incorporate elements similar to taxes or subsidies. Because the multiple rates influence the values and the undertaking of transactions expressed in national currency, net proceeds implicitly accruing to authorities as a result of these transactions are calculated as implicit taxes or subsidies. The amount of the implicit tax or subsidy for each transaction can be calculated as the difference between the value of the transaction in national currency at the actual exchange rate applicable and the value of the transaction at a *unitary rate* that is calculated as a weighted average of all official rates used for external transactions.

135. A unitary rate might be used for conversion by an economy that has a multiple exchange rate system (and wishes to express its balance of payments statements in the national currency) to avoid expressing transactions at values including elements of transfers between residents and authorities. Although the unitary rate may approximate a single official rate that would exist in the absence of multiple rates, this single calculated rate may not approximate any equilibrium or market rate. As a result, the calculated implicit taxes, subsidies, or transfers may not fully reflect the impact of a multiple or rate system. Thus, from a purely conceptual point of view, the usefulness of the unitary rate for conversion is somewhat limited. Another alternative is the use of a principal rate (the actual exchange rate applying to the largest part of external transactions) for conversion.

136. For conversion of stocks of external financial assets and liabilities in a multiple rate system, the actual exchange rate applicable to specific assets or liabilities at the beginning or end of the accounting period is used.

Black or Parallel Market Rates

137. Parallel (unofficial) or black market rates cannot be ignored in the context of a multiple rate regime and can be treated in different ways. For instance, if there is one official rate and a parallel market rate, the two should be handled separately; transactions should be converted at the exchange rate for each. If there are multiple official rates and a parallel rate, the official rates and the parallel rate should be treated as distinct markets in any calculation of a unitary rate. The multiple official rates, which involve implicit official taxes, subsidies, or transfers, should be used to calculate a weighted average rate that can serve as the basis for estimating the tax or subsidy component of the various rates. (See paragraph 134.) Transactions effected at the parallel rate usually should be separately converted at that rate. However, in some instances, parallel markets may be considered effectively integrated with the official exchange rate regime. Such is the case when most or all transactions in the parallel market are sanctioned by the authorities and/or when the authorities actively intervene in the market to affect the parallel rate. In this instance, the calculation of the unitary rate should include both the official and parallel market rates. If only limited transactions in the parallel market are sanctioned by the authorities, the parallel rate should not be included in the calculation of a unitary rate.

138. The midpoint between buying and selling rates in the parallel market should be calculated (separately from official rates) for conversion so that any service charge is excluded. The same practice is recommended for official rates. (See paragraph 132.) Revenues obtained from trading currencies between official and parallel markets are treated as holding (capital) gains.

Balance of Payments

Structure and Classification

VIII. Classification and Standard Components of the Balance of Payments

Structure and Classification

139. Part two of this *Manual* deals with the structure and classification of balance of payments accounts and the international investment position. Part two encompasses the standard components of both sets of accounts and contains discussions and elaboration of the **current account**, the **capital and financial account**, selected supplementary information, and the international investment position.

140. Balance of payments statistics must be arranged within a coherent structure to facilitate their utilization and adaptation for multiple purposes—policy formulation, analytical studies, projections, bilateral comparisons of particular components or total transactions, regional and global aggregations, etc. (See paragraph 7.)

141. The structure and classification of balance of payments standard components reflect conceptual and practical considerations, take into account views expressed by national balance of payments experts, and are in general concordance with the *SNA* and with harmonization of the expanded classification of international transactions in services with the Central Product Classification (CPC). (See Appendix 3.)

142. The classification system also reflects efforts to link the structure of the **financial account** to that of the income accounts and that of the international investment position. The scheme is designed as a flexible framework to be used by many countries in the long-term development of external statistics. Some countries may not be able to provide data for many items; other countries may be able to provide additional data.

Standard Components

143. The determination of standard components (see the table at end of this chapter) is based on a number of considerations. The following list comprises those that have been given the greatest weight:

The item should exhibit distinctive behavior. The economic factor or factors that influence the item should be different from those that influence other items, or the item should respond differently to the same factor or combination. This response to economic influences is what the balance of payments purports to make evident.

The item should be important for a number of countries. Importance may be defined as a function of behavior (unusual variability, for example) or as absolute size.

It should be possible to collect statistics for the item without undue difficulty. However, the desirability of collection should be evaluated according to the two previous criteria.

The item should, on a separate basis, be necessary for other purposes—such as incorporation into, or reconciliation with, the national accounts.

The list of standard components should not be unduly long. A large number of countries, including many that are statistically less advanced, are asked to report uniformly on the components.

To the extent practicable, standard components should be in concordance with, and apply to, other IMF statistical systems, the SNA, and—for ***services*** in particular—the CPC.

144. The list of standard components carries no implication that recommendations made in this *Manual* are intended to inhibit countries from compiling and publishing additional data of national importance. IMF requests for information will not be limited to standard components when further details are required to understand the circumstances of particular countries or to analyze new developments. Supplementary information can also be most useful for verifying and reconciling the statistics of partner countries and, for example, analyzing exceptional financing transactions. (See the **Selected Supplementary Information** table at the end of this chapter.) IMF staff will, from time to time, consult with countries to decide on the reporting of additional details.

145. Few countries are likely to have significant information to report for every standard component.

Furthermore, several components may be available only in combination, or a minor component may be grouped with one that is more significant. The standard components should nevertheless be reported to the IMF as completely and accurately as possible. National compilers are in better positions than IMF staff to make estimates and adjustments for components that do not exactly correspond to the basic series of the compiling economy.

Net Errors and Omissions

146. Application of the principles presented in this *Manual* should result in a consistent body of positive and negative entries with a net (conceptual) total of zero. In practice, however, when all actual entries are totaled, the resulting balance will almost inevitably show a net credit or a net debit. That balance is the result of errors and omissions in the compilation of statements. Some errors and omissions may be related to recommendations for practical applications approximating principles.

147. In balance of payments statements, the standard practice is to show a separate item for net errors and omissions. Labeled by some compilers as a balancing item or statistical discrepancy, that item is intended as an offset to the overstatement or understatement of the recorded components. Thus, if the balance of those components is a credit, the item for net errors and omissions will be shown as a debit of equal value, and vice versa.

148. Sometimes the errors and omissions that occur in the course of compilation offset one another. Therefore, the size of the residual item does not necessarily provide any indication of the overall accuracy of the statement. Nonetheless, interpretation of the statement is hampered by a large net residual.

Major Classifications

149. The standard components, which are listed at the end of this chapter, are comprised of two main groups of accounts:

> The **current account** pertains to ***goods and services***, ***income***, and ***current transfers***.
>
> The **capital and financial account** pertains to (i) *capital transfers* and *acquisition or disposal of nonproduced, nonfinancial assets* and (ii) financial assets and liabilities.

This arrangement is based on historical precedent common in most countries and on a major change introduced in this *Manual*. The former capital account is renamed and becomes the **capital and financial account**. Reflecting harmonization with the SNA, this change introduces that system's distinction between *capital transfers* and ***current transfers*** into the balance of payments and concordance of the accounts with the capital and financial accounts of the SNA.

150. Most items entered in the **current account** of the standard components should show gross debits and credits. Most entries in the **capital and financial account** should be made on a net basis; that is, each component should be shown only as a credit or a debit. (Recommended treatments for specific items and exceptions are discussed in appropriate chapters.) Inflows of real resources, increases in financial assets, and decreases in liabilities should be shown as debits; outflows of real resources, decreases in financial assets, and increases in liabilities should be shown as credits. Transfers, both in sections 1.C and 2.A, should be numerically equal with opposite sign to the entries for which the transfers provide offsets.

Detailed Classifications

151. The following classifications of standard components have been developed in accordance with the criteria set out in paragraph 143. The structure and characteristics of the **current account** and the **capital and financial account** and significant changes from the fourth to the fifth edition of the *Manual* are discussed in chapters 9 and 16, respectively. The standard components of the **current account** are described fully in chapters 10 through 15, and those of the **capital and financial account** are covered in chapters 17 through 21.

Current Account (1.)

152. Covered in the **current account** are all transactions (other than those in financial items) that involve economic values and occur between resident and nonresident entities. Also covered are offsets to current economic values provided or acquired without a quid pro quo. Specifically, the major classifications are ***goods and services, income***, and ***current transfers***.

Goods and services (1.A.)

Goods (1.A.a.)

153. *General merchandise* covers most movable goods that residents export to, or import from, nonresidents and that, with a few specified exceptions, undergo changes in ownership (actual or imputed).

154. *Goods for processing* covers exports (or, in the compiling economy, imports) of goods crossing the frontier for processing abroad and subsequent re-import (or, in the compiling economy, export) of the goods, which are valued on a gross basis before and after processing. The treatment of this item in the ***goods*** account is an exception to the change of ownership principle.

155. *Repairs on goods* covers repair activity on goods provided to or received from nonresidents on ships, aircraft, etc. Although the physical movement of these goods is similar to that described in paragraph 154, the repairs are valued at the prices (fees paid or received) of the repairs and not at the gross values of the goods before and after repairs are made.

156. *Goods procured in ports by carriers* covers all goods (such as fuels, provisions, stores, and supplies) that resident/nonresident carriers (air, shipping, etc.) procure abroad or in the compiling economy. The classification does not cover auxiliary services (towing, maintenance, etc.), which are covered under *transportation.*

157. *Nonmonetary gold* covers exports and imports of all gold not held as *reserve assets* (monetary gold) by the authorities. *Nonmonetary gold* is treated the same as any other commodity and, when feasible, is subdivided into gold held as a store of value and other (industrial) gold.

Services (1.A.b.)

158. *Transportation* covers most of the services that are performed by residents for nonresidents (and vice versa) and that were included in shipment and other transportation in the fourth edition of the *Manual.* However, freight insurance is now included with *insurance services* rather than with *transportation. Transportation* includes freight and passenger transportation by all modes of transportation and other distributive and auxiliary services, including rentals of transportation equipment with crew. Certain exceptions are noted in chapters 10, 11, and 13.

159. *Travel* covers goods and services—including those related to health and education—acquired from an economy by nonresident travelers (including excursionists) for business and personal purposes during their visits (of less than one year) in that economy. *Travel* excludes international passenger services, which are included in *transportation.* Students and medical patients are treated as travelers, regardless of the length of stay. Certain others—military and embassy personnel and nonresident workers—are not regarded as travelers. However, expenditures by nonresident workers are included in *travel,* while those of military and embassy personnel are included in *government services n.i.e.* These cases are noted in chapters 12–13.

160. *Communications services* covers communications transactions between residents and nonresidents. Such services comprise postal, courier, and telecommunications services (transmission of sound, images, and other information by various modes and associated maintenance provided by/for residents for/by nonresidents).

161. *Construction services* covers construction and installation project work that is, on a temporary basis, performed abroad/in the compiling economy or in extraterritorial enclaves by resident/nonresident enterprises and associated personnel. Such work does not include that undertaken by a foreign affiliate of a resident enterprise or by an unincorporated site office that, if it meets certain criteria, is equivalent to a foreign affiliate. Such residency aspects are covered in chapters 4 and 13.

162. *Insurance services* covers the provision of insurance to nonresidents by resident insurance enterprises and vice versa. This item comprises services provided for freight insurance (on goods exported and imported), services provided for other types of direct insurance (including life and non-life), and services provided for reinsurance. (For the method of calculating the value of insurance services, see paragraphs 256 and 257.)

163. *Financial services* (other than those related to insurance enterprises and pension funds) covers financial intermediation services and auxiliary services conducted between residents and nonresidents. Included are commissions and fees for letters of credit, lines of credit, financial leasing services, foreign exchange transactions, consumer and business credit services, brokerage services, underwriting services, arrangements for various forms of hedging instruments, etc. Auxiliary services include financial market operational and regulatory services, security custody services, etc.

164. *Computer and information services* covers resident/nonresident transactions related to hardware consultancy, software implementation, information services (data processing, data base, news agency), and maintenance and repair of computers and related equipment.

165. *Royalties and license fees* covers receipts (exports) and payments (imports) of residents and nonresidents for (i) the authorized use of intangible nonproduced, nonfinancial assets and proprietary rights—such as trademarks, copyrights, patents, processes, techniques, designs, manufacturing rights, franchises, etc. and (ii) the use, through licensing agreements, of produced originals or prototypes—such as manuscripts, films, etc.

166. *Other business services* provided by residents to nonresidents and vice versa covers merchanting and other trade-related services; operational leasing services; and miscellaneous business, professional, and technical services. (See the **Selected Supplementary Information** table at the end of this chapter and paragraphs 261 through 264 for details.)

167. *Personal, cultural, and recreational services* covers (i) audiovisual and related services and (ii) other cultural services provided by residents to nonresidents and vice versa. Included under (i) are services associated with the production of motion pictures on films or video tape, radio and television programs, and musical recordings. (Examples of these services are rentals and fees received by actors, producers, etc. for productions and for distribution rights sold to the media.) Included under (ii) are other personal, cultural, and recreational services—such as those associated with libraries, museums—and other cultural and sporting activities.

168. *Government services n.i.e.* covers all services (such as expenditures of embassies and consulates) associated with government sectors or international and regional organizations and not classified under other items.

Income (1.B.)

169. *Compensation of employees* covers wages, salaries, and other benefits, in cash or in kind, and includes those of border, seasonal, and other nonresident workers (e.g., local staff of embassies).

170. *Investment income* covers receipts and payments of income associated, respectively, with residents' holdings of external financial assets and with residents' liabilities to nonresidents. *Investment income* consists of direct investment income, portfolio investment income, and other investment income. The direct investment component is divided into income on equity (dividends, branch profits, and reinvested earnings) and income on debt (interest); portfolio investment income is divided into income on equity (dividends) and income on debt (interest); other investment income covers interest earned on other capital (loans, etc.) and, in principle, imputed income to households from net equity in life insurance reserves and in pension funds.

Current transfers (1.C.)

171. ***Current transfers*** are distinguished from *capital transfers*, which are included in the **capital and financial account** in concordance with the *SNA* treatment of transfers. Transfers are the offsets to changes, which take place between residents and nonresidents, in ownership of real resources or financial items and, whether the changes are voluntary or compulsory, do not involve a quid pro quo in economic value. ***Current transfers*** consist of all transfers that **do not involve** (i) transfers of ownership of fixed assets; (ii) transfers of funds linked to, or conditional upon, acquisition or disposal of fixed assets; (iii) forgiveness, without any counterparts being received in return, of liabilities by creditors. All of these are *capital transfers*. ***Current transfers*** include those of general government (e.g., current international cooperation between different governments, payments of current taxes on income and wealth, etc.), and other transfers (e.g., workers' remittances, premiums—less service charges, and claims on non-life insurance). A full discussion of the distinction between ***current transfers*** and *capital transfers* appears in Chapter 15; see also paragraphs 175 and 344.

Capital and Financial Account (2.)

172. The **capital and financial account** has two major components—the ***capital account*** and the ***financial account***—that are in concordance with those same accounts in the SNA. Assets represent claims on nonresidents, and liabilities represent indebtedness to nonresidents. The two parties to a transaction in assets or liabilities are usually a resident and a nonresident but, in some instances, both parties may both be residents or nonresidents. (See paragraph 318.)

173. All valuation changes and all other changes that do not reflect transactions (see paragraph 310) in foreign assets and liabilities are excluded from the **capital and financial account** but reflected in the international investment position. Supplementary statements identify certain items that are of analytical interest and affect various accounts. Examples of such items are liabilities constituting foreign authorities' reserves and exceptional financing transactions, which are discussed in Chapter 22.

174. Classification of the ***financial account*** and the income components of the **current account** are interrelated and must be consistent to facilitate analysis, to form an effective link between the balance of payments and the international investment position, and to be compatible with the SNA and other IMF statistical systems.

Capital account (2.A.)

175. The major components of the ***capital account*** are *capital transfers* and *acquisition/disposal of nonproduced, nonfinancial assets. Capital transfers* consist of those involving transfers of ownership of fixed assets; transfers of funds linked to, or conditional upon, acquisition or disposal of fixed assets; or cancellation, without any counterparts being received in return, of liabilities by creditors. *Capital transfers* include two components: (i) general government, which is subdivided into debt forgiveness and other, and (ii) other, which is subdivided into migrants' transfers, debt forgiveness, and other transfers. (See Chapter 15 for a discussion of the distinction between *capital transfers* and ***current transfers***.) *Acquisition/disposal of nonproduced, nonfinancial assets* largely covers intangibles—such as patented entities, leases or other transferable contracts, goodwill, etc. This item does not cover land in a specific economic territory but may include the purchase or sale of land by a foreign embassy. (See paragraph 312.)

Financial account (2.B.)

176. The classification of standard components in the ***financial account*** is based on these criteria:

All components are classified according to type of investment or by functional subdivision (*direct investment, portfolio investment, other investment, reserve assets*).

For the category of *direct investment*, there are directional distinctions (abroad or in the reporting economy) and, for the equity capital and other capital components within this category, asset or liability distinctions.

For the categories of *portfolio investment* and *other investment*, there are the customary asset or liability distinctions.

Particularly significant for *portfolio investment* and *other investment* is the distinction by type of instrument (equity or debt securities, trade credits, loans, currency and deposits, other assets or liabilities). In this *Manual*, traditional and new money market and other financial instruments and derivatives are included in *portfolio investment.*

For *portfolio investment* and *other investment*, there are distinctions by sector of the domestic creditor for assets and by sector of the domestic debtor for liabilities. These distinctions serve to facilitate links with the income accounts, the international investment position, the SNA, and other statistical systems.

The traditional distinction, which is based on original contractual maturity of more than one year or one year or less, between long- and short-term assets and liabilities applies only to *other investment.* In recent years, the significance of this distinction has clearly diminished for many domestic and international transactions. Consequently, the long- and short-term distinction is accorded less importance in the *SNA* and in this *Manual* than in previous editions. However, because the maturity factor remains important for specific purposes—analysis of external debt, for example—it is retained in this *Manual* for *other investment.*

177 *Direct investment*—reflecting the lasting interest of a resident entity in one economy (direct investor) in an entity resident in another economy (direct investment enterprise)—covers all transactions between direct investors and direct investment enterprises. That is, *direct investment* covers the initial transaction between the two and all subsequent transactions between them and among affiliated enterprises, both incorporated and unincorporated. Direct investment transactions occuring abroad and in the reporting economy are subclassified into equity capital, reinvested earnings, and other capital (intercompany transactions). For equity capital and other capital, claims on and liabilities to affiliated enterprises and to direct investors are distinguished. Transactions between affiliated banks and between other affiliated financial intermediaries are limited to equity and permanent debt capital. (See paragraph 372.)

178. *Portfolio investment* covers transactions in equity securities and debt securities; the latter are subsec-tored into bonds and notes, money market instruments, and financial derivatives (such as options) when the deriva-tives generate financial claims and liabilities. Various new financial instruments are covered under appropriate instrument classifications. Transactions covered under *direct investment* and *reserve assets* are excluded.

179. *Other investment* covers short- and long-term trade credits; loans (including use of Fund credit, loans from the Fund, and loans associated with financial leases); currency and deposits (transferable and other—such as savings and term deposits, savings and loan shares, shares in credit unions, etc.); and other accounts receivable and payable. Transactions covered under *direct investment* are excluded.

180. *Reserve assets* covers transactions in assets that are considered by the monetary authorities of an economy to be available for use in funding payments imbalances and, in some instances, meeting other financial needs. Such availability is not closely linked in principle to formal criteria such as ownership or currency of denomination. The items covered are monetary gold, SDRs, reserve position in the Fund, foreign exchange assets (currency, deposits, and securities), and other claims.

181. Coverage and identification of reserve asset components are linked to an analytic concept, are in part judgmental, and are not always amenable to application of objective, formal criteria or clear rankings as to conditionality and other considerations. In contrast to the treatment in the fourth edition of the *Manual*, valuation changes in *reserve assets* are excluded, along with counterparts to such changes, in the fifth edition. Also excluded are the allocation or cancellation of SDRs, the monetization or demonetization of gold, and counterpart entries. These changes, which do not constitute transactions, are reflected in the international investment position.

Balance of Payments: Standard Components

	Credit	Debit
1. Current Account		
A. Goods and services		
a. Goods		
1. General merchandise		
2. Goods for processing		
3. Repairs on goods		
4. Goods procured in ports by carriers		
5. Nonmonetary gold		
5.1 Held as a store of value		
5.2 Other		
b. Services		
1. Transportation		
1.1 Sea transport		
1.1.1 Passenger		
1.1.2 Freight		
1.1.3 Other		
1.2 Air transport		
1.2.1 Passenger		
1.2.2 Freight		
1.2.3 Other		
1.3 Other transport		
1.3.1 Passenger		
1.3.2 Freight		
1.3.3 Other		
2. Travel		
2.1 Business		
2.2 Personal*		
3. Communications services		
4. Construction services		
*5. Insurance services***		
6. Financial services		
7. Computer and information services		
8. Royalties and license fees		
9. Other business services		
9.1 Merchanting and other trade-related services		
9.2 Operational leasing services		
9.3 Miscellaneous business, professional, and technical services*		
10. Personal, cultural, and recreational services		
10.1 Audiovisual and related services		
10.2 Other personal, cultural, and recreational services		
11. Government services n.i.e.		

* See **Selected Supplementary Information** table on page 50 for components.
** Memorandum items: 5.1 Gross premiums
5.2 Gross claims

Balance of Payments: Standard Components

	Credit	Debit
B. ***Income***		
1. Compensation of employees		
2. Investment income		
2.1 Direct investment		
2.1.1 Income on equity		
2.1.1.1 Dividends and distributed branch profits***		
2.1.1.2 Reinvested earnings and undistributed branch profits***		
2.1.2 Income on debt (interest)		
2.2 Portfolio investment		
2.2.1 Income on equity (dividends)		
2.2.2 Income on debt (interest)		
2.2.2.1 Bonds and notes		
2.2.2.2 Money market instruments and financial derivatives		
2.3 Other investment		
C. ***Current transfers***		
1. General government		
2. Other sectors		
2.1 Workers' remittances		
2.2 Other transfers		
2. Capital and Financial Account		
A. Capital account		
1. Capital transfers		
1.1 General government		
1.1.1 Debt forgiveness		
1.1.2 Other		
1.2 Other sectors		
1.2.1 Migrants' transfers		
1.2.2 Debt forgiveness		
1.2.3 Other		
2. Acquisition/disposal of nonproduced, nonfinancial assets		
B. Financial account		
1. Direct investment		
1.1 Abroad		
1.1.1 Equity capital		
1.1.1.1 Claims on affiliated enterprises		
1.1.1.2 Liabilities to affiliated enterprises		
1.1.2 Reinvested earnings		
1.1.3 Other capital		

***If distributed branch profits are not identified, all branch profits are considered to be distributed.

Balance of Payments: Standard Components

	Credit	Debit
1.1.3.1 Claims on affiliated enterprises		
1.1.3.2 Liabilities to affiliated enterprises		
1.2 In reporting economy		
1.2.1 Equity capital		
1.2.1.1 Claims on direct investors		
1.2.1.2 Liabilities to direct investors		
1.2.2 Reinvested earnings		
1.2.3 Other capital		
1.2.3.1 Claims on direct investors		
1.2.3.2 Liabilities to direct investors		
2. Portfolio investment		
2.1 Assets		
2.1.1 Equity securities		
2.1.1.1 Monetary authorities		
2.1.1.2 General government		
2.1.1.3 Banks		
2.1.1.4 Other sectors		
2.1.2 Debt securities		
2.1.2.1 Bonds and notes		
2.1.2.1.1 Monetary authorities		
2.1.2.1.2 General government		
2.1.2.1.3 Banks		
2.1.2.1.4 Other sectors		
2.1.2.2 Money market instruments		
2.1.2.2.1 Monetary authorities		
2.1.2.2.2 General government		
2.1.2.2.3 Banks		
2.1.2.2.4 Other sectors		
2.1.2.3 Financial derivatives		
2.1.2.3.1 Monetary authorities		
2.1.2.3.2 General government		
2.1.2.3.3 Banks		
2.1.2.3.4 Other sectors		
2.2 Liabilities		
2.2.1 Equity securities		
2.2.1.1 Banks		
2.2.1.2 Other sectors		
2.2.2 Debt securities		
2.2.2.1 Bonds and notes		
2.2.2.1.1 Monetary authorities		
2.2.2.1.2 General government		
2.2.2.1.3 Banks		
2.2.2.1.4 Other sectors		

	Credit	Debit
2.2.2.2 Money market instruments		
2.2.2.2.1 Monetary authorities		
2.2.2.2.2 General government		
2.2.2.2.3 Banks		
2.2.2.2.4 Other sectors		
2.2.2.3 Financial derivatives		
2.2.2.3.1 Banks		
2.2.2.3.2 Other sectors		
3. Other investment		
3.1 Assets		
3.1.1 Trade credits		
3.1.1.1 General government		
3.1.1.1.1 Long-term		
3.1.1.1.2 Short-term		
3.1.1.2 Other sectors		
3.1.1.2.1 Long-term		
3.1.1.2.2 Short-term		
3.1.2 Loans		
3.1.2.1 Monetary authorities		
3.1.2.1.1 Long-term		
3.1.2.1.2 Short-term		
3.1.2.2 General government		
3.1.2.2.1 Long-term		
3.1.2.2.2 Short-term		
3.1.2.3 Banks		
3.1.2.3.1 Long-term		
3.1.2.3.2 Short -term		
3.1.2.4 Other sectors		
3.1.2.4.1 Long-term		
3.1.2.4.2 Short-term		
3.1.3 Currency and deposits		
3.1.3.1 Monetary authorities		
3.1.3.2 General government		
3.1.3.3 Banks		
3.1.3.4 Other sectors		
3.1.4 Other assets		
3.1.4.1 Monetary authorities		
3.1.4.1.1 Long-term		
3.1.4.1.2 Short-term		
3.1.4.2 General government		
3.1.4.2.1 Long-term		
3.1.4.2.2 Short-term		

	Credit	Debit
3.1.4.3 Banks		
3.1.4.3.1 Long-term		
3.1.4.3.2 Short-term		
3.1.4.4 Other sectors		
3.1.4.4.1 Long-term		
3.1.4.4.2 Short-term		
3.2 Liabilities		
3.2.1 Trade credits		
3.2.1.1 General government		
3.2.1.1.1 Long-term		
3.2.1.1.2 Short-term		
3.2.1.2 Other sectors		
3.2.1.2.1 Long-term		
3.2.1.2.2 Short-term		
3.2.2 Loans		
3.2.2.1 Monetary authorities		
3.2.2.1.1 Use of Fund credit and loans from the Fund		
3.2.2.1.2 Other long-term		
3.2.2.1.3 Short-term		
3.2.2.2 General government		
3.2.2.2.1 Long-term		
3.2.2.2.2 Short-term		
3.2.2.3 Banks		
3.2.2.3.1 Long-term		
3.2.2.3.2 Short-term		
3.2.2.4 Other sectors		
3.2.2.4.1 Long-term		
3.2.2.4.2 Short-term		
3.2.3 Currency and deposits		
3.2.3.1 Monetary authorities		
3.2.3.2 Banks		
3.2.4 Other liabilities		
3.2.4.1 Monetary authorities		
3.2.4.1.1 Long-term		
3.2.4.1.2 Short-term		
3.2.4.2 General government		
3.2.4.2.1 Long-term		
3.2.4.2.2 Short-term		
3.2.4.3 Banks		
3.2.4.3.1 Long-term		
3.2.4.3.2 Short-term		
3.2.4.4 Other sectors		
3.2.4.4.1 Long-term		
3.2.4.4.2 Short-term		

	Credit	Debit
4. Reserve assets		
4.1 Monetary gold		
4.2 Special drawing rights		
4.3 Reserve position in the Fund		
4.4 Foreign exchange		
4.4.1 Currency and deposits		
4.4.1.1 With monetary authorities		
4.4.1.2 With banks		
4.4.2 Securities		
4.4.2.1 Equities		
4.4.2.2 Bonds and notes		
4.4.2.3 Money market instruments and financial derivatives		
4.5 Other claims		

Selected Supplementary Information

1. *Liabilities constituting foreign authorities' reserves*
    - 1.1 Bonds and other securities
        - 1.1.1 Monetary authorities
        - 1.1.2 General government
        - 1.1.3 Banks
        - 1.1.4 Other sectors
    - 1.2 Deposits
        - 1.2.1 Monetary authorities
        - 1.2.2 Banks
    - 1.3 Other liabilities
        - 1.3.1 Monetary authorities
        - 1.3.2 General government
        - 1.3.3 Banks
        - 1.3.4 Other sectors
2. *Exceptional financing transactions*
    - 2.1 Transfers
        - 2.1.1 Debt forgiveness
        - 2.1.2 Other intergovernmental grants
        - 2.1.3 Grants received from Fund subsidy accounts
    - 2.2 Direct investment
        - 2.2.1 Investment associated with debt reduction
        - 2.2.2 Other
    - 2.3 Portfolio investment: borrowing by authorities or by other sectors on behalf of authorities—liabilities*
    - 2.4 Other investment—liabilities*
        - 2.4.1 Drawings on new loans by authorities or by other sectors on behalf of authorities
        - 2.4.2 Rescheduling of existing debt
        - 2.4.3 Accumulation of arrears
            - 2.4.3.1 Principal on short-term debt
            - 2.4.3.2 Principal on long-term debt
            - 2.4.3.3 Original interest
            - 2.4.3.4 Penalty interest
        - 2.4.4 Repayments of arrears
            - 2.4.4.1 Principal
            - 2.4.4.2 Interest
        - 2.4.5 Rescheduling of arrears
            - 2.4.5.1 Principal
            - 2.4.5.2 Interest
        - 2.4.6 Cancellation of arrears
            - 2.4.6.1 Principal
            - 2.4.6.2 Interest

*Specify sector involved and standard component in which the item is included.

3. Other transactions
- 3.1 Portfolio investment income
  - 3.1.1 Monetary authorities
  - 3.1.2 General government
  - 3.1.3 Banks
  - 3.1.4 Other sectors
- 3.2 Other (than direct investment) income
  - 3.2.1 Monetary authorities
  - 3.2.2 General government
  - 3.2.3 Banks
  - 3.2.4 Other sectors
- 3.3 Other investment (liabilities)
  - 3.3.1 Drawings on long-term trade credits
  - 3.3.2 Repayments of long-term trade credits
  - 3.3.3 Drawings on long-term loans
  - 3.3.4 Repayments of long-term loans

4. Services sub-items
- 4.1 Travel (personal)
  - 4.1.1 Health-related
  - 4.1.2 Education-related
  - 4.1.3 Other
- 4.2 Miscellaneous business, professional, and technical services
  - 4.2.1 Legal, accounting, management consulting, and public relations
  - 4.2.2 Advertising, market research, and public opinion polling
  - 4.2.3 Research and development
  - 4.2.4 Architectural, engineering, and other technical services
  - 4.2.5 Agricultural, mining, and on-site processing
  - 4.2.6 Other

IX. Structure and Characteristics of the Current Account

182. The standard components and coverage of the **current account** and the **capital and financial account** are discussed in Chapter 8; coverage of the **current account** is referred to in paragraphs 152 through 171. As presented in this *Manual*, the **current account** is in concordance with SNA coverage of external accounts for goods and services, primary incomes, and current transfers. (See Chapter 3.) Because the net balance on the **current account** constitutes an integral part of the measure of an economy's saving, the net balance can be viewed as one meaningful indicator of an economy's saving and spending behavior. To the extent that national saving exceeds or falls short of net domestic investment (net capital formation), the net balance on current transactions (current external balance in the SNA), on net capital transfers, and on acquisition or disposal of nonproduced, nonfinancial assets represents the amount of an economy's net foreign investment or net lending or borrowing vis-à-vis the rest of the world.

Characteristics and Classification

183. As presented in this *Manual*, the structure of the **current account** contains most of the components traditionally included. The structure of the account has, however, significantly altered—with regard to major classifications and specific components—from that presented in the fourth edition. The structure remains in accord with the considerations stated in Chapter 8, paragraph 143.

184. ***Goods*** usually comprises the largest category of transactions that, for the most part, involve changes of ownership between residents and nonresidents. The scope of this classification has been expanded from that in the fourth edition to include—in addition to general merchandise, which covers most movable goods—(i) the movement of goods for processing (when no change of ownership occurs); (ii) the value of repairs on goods (not the value of the movement of goods undergoing repair); and (iii) goods procured in ports by nonresident carriers. In addition, *nonmonetary gold* is specified under ***goods*** as a sub-item to be identified, if feasible, as gold to be held as a store of value or as other (industrial) gold. Further detailed subdivisions of goods (commodity end-use categories, for example) often are desirable for analytical purposes and are provided in the balance of payments publications of many countries.

185. ***Services*** is the second major category of the **current account.** Both the production of, and international trade in, services differ from production and trade related to goods. International trade in goods is conducted separately from production. For example, goods may be produced in one economy and subsequently delivered to residents, who may or may not be known when production occurs, of another economy. In contrast, the production of a service is linked to an arrangement made—between a particular producer in one economy and a particular consumer or group of consumers in another—prior to the time that production occurs. Thus, international trade in services is closely linked with international production of services, as the production process itself involves a resident and a nonresident. Nonetheless, the boundary between ***goods*** and ***services*** is sometimes blurred; items classified as ***goods*** may include some element of ***services*** and vice versa.

186. As presented in this *Manual*, ***services*** covers traditional items (such as travel and transportation) that were included in the fourth edition presentation and items (such as communications, financial and computer services, royalties and license fees, and many types of other business services) that are becoming increasingly important in international transactions. In contrast to the treatment in the fourth edition, in this *Manual*, transactions in ***services*** are clearly separated from income transactions. This treatment is in accordance with the *SNA*; allows, to the extent practicable, for linkage with the CPC; and better serves to facilitate international negotiations concerning issues pertaining to ***services***.

187. *Transportation* (the first item listed among ***services***) comprises freight services, together with supporting and auxiliary services, by all modes of transportation for the movement of goods and the international carriage of passengers. (*Transportation* does not cover the carriage, within an economy, of nonresident passengers by resident carriers.) There is a close interrelationship between freight services and goods and, in some instances, such services may not be subject to clear distinctions from ***goods***. There may be analytical interest in both separate and inclusive treatment of the two for purposes of various domestic and international comparisons. Passenger transportation is closely linked with *travel*, in which some related services are included. *Transportation* subsumes, with the exception of freight insurance, the shipment and other transportation items as presented in the fourth edition of the *Manual*. Freight insurance is now included with *insurance services*. (See Chapter 13, paragraphs 255 through 257.) The new grouping should facilitate international comparisons and is in accord with other statistical systems.

188. *Travel* differs from other components of ***services*** in that it is a demand-oriented activity. The traveler (consumer) moves to the location of the economy that provides the goods and services desired. *Travel* is subdivided into two major components: business and personal.

189. Treated as part of a residual item in the fourth edition of the *Manual*, other services are accorded increased prominence in the fifth edition. Both the structure and classification of the specific other services are related to the importance attached to these items by international bodies [e.g. in the *General Agreement on Tariffs and Trade (GATT)*] as a basis for negotiations and by analysts involved with domestic and international aspects of trade, production, and related issues. Although the significance of these services varies widely in the international accounts of countries, the structure provides a ready reference for items likely to assume increasing importance in international transactions.

190. ***Income*** comprises *compensation of employees* and *investment income* (covering direct investment income and other dividends and interest). This treatment of ***income*** as a separate component of the **current account** accords with that in the *SNA*; tightens the links between income and financial account flows and between the balance of payments and the international investment position; and increases the analytical usefulness of the international accounts.

191. ***Current transfers*** are grouped separately from ***goods***, ***services***, and ***income*** because the former are generally conceived as showing distinctive characteristics. The distinction between real resources and transfers, however, may sometimes be rather arbitrary. For example, receipts by an economy from certain individuals working abroad are classified either as ***current transfers*** or as *compensation of employees*; the classification depends on how long the individuals have stayed in the countries where they are working. The *Manual* and the *SNA* define a ***current transfer*** in the same way, and the disaggregation of transfers into ***current transfers*** and *capital transfers*—a departure from previous editions—aligns with *SNA* treatment and with various analytical presentations. This change removes inconsistencies in the use and meaning of the term *current* as it concerns transactions and balancing items in the *Manual* and the *SNA*. (The distinction between ***current transfers*** and *capital transfers* is discussed in Chapter 15.)

Gross Recording, Valuation, and Time of Recording

192. In the **current account,** gross outflows from and gross inflows to the economy should, in principle, be recorded as credits and debits, respectively. Individual components are defined in such a way that entries would be made on a gross basis. This emphasis on gross recording in the **current account** stems from the fact that credit and debit entries for many specific types of current transactions are seldom related in a causal way. For example, even though provision and acquisition of travel services are included in the single component for *travel*, provision of travel services has, from an economic standpoint, little connection with the acquisition by the same economy of such services. Moreover, gross figures are utilized in contexts other than the analysis of balance of payments developments. In general, gross transactions recorded in the **current account** are often indicators of the relative importance of particular items within an economy and of the relative importance of various economies in international transactions. Gross transactions recorded in the **current account** are therefore used to compare economies and to provide weights for aggregation. Also, gross figures provide a better basis for analysis of changes in net balances. Two specific applications important for the IMF represent the use of gross figures: (i) Valuation of the SDR is based on a basket of currencies selected in consideration of the issuing countries' shares in world exports of goods and services and weighted in broad proportion to those shares. (ii) The relative size of an IMF member's gross transactions in the **current account** is one factor used to determine the relative quota of a Fund member.

193. Exceptions to the general rule of gross recording are sometimes made because of the practical difficulty of collecting certain information on a gross basis (e.g., some transportation services) or because of netting procedures used to derive certain estimates. These considerations are discussed in appropriate chapters. Nonetheless, gross recording remains the principle for recording transactions in the **current account** and, in general, is more useful than net recording for balance of payments and other analyses.

194. Principles and practices dealing with valuation and time of recording for current account transactions are discussed in chapters 5 and 6, respectively, and in chapters 10 through 15.

X. Goods

Coverage and Principles

195. As subsequently defined in this *Manual*, ***goods*** covers *general merchandise*, *goods for processing*, *repairs on goods*, *goods procured in ports by carriers*, and *nonmonetary gold*. In accordance with general balance of payments principles, change of ownership is the principle determining the coverage and time of recording of international transactions in ***goods***. Certain exceptions are applied to the principle; these are discussed in subsequent sections. Exports and imports of goods are recorded at market values at points of uniform valuation, that is, the customs frontiers of exporting economies.

Definitions

196. *General merchandise* refers, with some exceptions specified later in this chapter, to movable goods for which changes in ownership—actual or imputed—occur between residents and nonresidents.

197. *Goods for processing* covers goods that are exported or imported for processing and that involve two transactions: (i) the export of a good (e.g., crude oil, vehicle parts, fabric) and (ii) the re-import of the good (refining of crude oil into petroleum, transformation of fabric into clothing) on the basis of a contract and for a fee. Symmetrically, processing performed (for nonresidents) in the partner economy consists of an import followed by an export. The inclusion, on a gross basis, of these transactions under ***goods*** is an exception to the change of ownership principle.

198. Processing can consist of any activity performed under contract: oil refining, metal processing, vehicle assembly, clothing manufacture, etc. In this *Manual*, there is concordance with the *SNA* concept of distinguishing between processing in which goods undergo substantial physical change and other processing. The former is included under goods and the latter, under services, in the *SNA*. However, because it is difficult to make such a distinction and because most international processing involves substantial physical change, it is recommended, for practical reasons, that *all processing be included under* ***goods***. The basis of the conceptual distinction is that goods originally exported or imported essentially lose identity by being transformed or incorporated into other goods. The goods subsequently re-imported or re-exported essentially become new goods produced abroad or in the compiling economy and classified in a different group (three-digit level) of the CPC than the goods originally exported abroad or originally imported into the partner economy. The value of the goods before and after processing should be recorded when the goods are exported and then imported, or vice versa. (Corresponding entries in the ***financial account*** are required when goods remain in the processing economy after the end of a recording period.)

199. Excluded from the category of *goods for processing* are goods subject to on-site processing involving an import not followed by an export (or vice versa). These goods are included under *general merchandise*. Two particular cases warrant mention. The first concerns the treatment of goods that are sent abroad for processing and subsequently sold to a resident of the processing economy. Such goods are included under exports of *general merchandise*. The payment for processing is entered as a debit under ***services,*** and an adjustment is made to the merchandise export figure to include the value of processing. The second case concerns the treatment of goods that are sent abroad for processing in one economy and then sold to another economy. A service payment from the original economy to the processing economy is entered under merchanting and other trade-related services, and an export (including the value of processing) from the original economy to the (third) purchasing economy is recorded under *general merchandise*. Included under processing (on practical grounds, as noted in paragraph 198) are goods to which some value (e.g., packaging, labeling, etc.) is added. (This added value would be recorded in the SNA as a transaction in services.)

200. The category of *repairs on goods* covers repair activity that involves work performed by residents on movable goods owned by nonresidents (or vice versa). Examples of such goods are ships, aircraft, and other transportation equipment. In contrast to the value recorded for *goods for processing*, the value recorded for *repairs on goods* reflects the value of the repairs (the fee paid or received) rather than the gross value of the goods before and after repairs. The *SNA* distinction between repairs performed on investment goods and those performed on other goods is recognized as a valid one. (The latter are included under services in the SNA.) Nonetheless, it is recommended that *the value of all repairs be included under* ***goods***. This recommendation is made because of the practical difficulty involved in making distinctions between the two types of goods and the fact that the bulk of international repairs are performed on investment goods. Excluded are construction repairs (recorded under *construction services*), computer repairs (recorded under *computer and information services*), and maintenance performed in ports and airports on transportation equipment (recorded under other transportation services).

201. *Goods procured in ports* covers goods (e.g., fuels, provisions, stores, and supplies) procured by resident or nonresident carriers abroad or in the compiling economy. Related services (e.g., towing, storage, maintenance, etc.) are excluded; these are recorded under other transportation services.

202. *Nonmonetary gold* covers exports and imports of all gold not held as reserve assets (monetary gold) by the authorities. *Nonmonetary gold* is treated as any other commodity and, when feasible, is subdivided into gold held as a store of value and other (industrial) gold.

Change of Ownership

203. With specified exceptions, application of the change of ownership (between a resident and nonresident) concept to goods ensures, in principle, that the ***goods*** component is consistent in coverage and timing with other items, particularly financial items, in the balance of payments. However, international standards for trade statistics (see the *Guide*), as well as customs returns in most countries, are based instead on physical movements of goods across national or customs frontiers. Although the goods that change ownership internationally are for the most part the same goods that move across frontiers, the changes and movements often do not occur at exactly the same time.

Convention for recording

204. Goods for export are generally considered to change ownership at the time the exporter ceases to carry the goods on his books as a real asset (i.e., when he records a sale and makes a corresponding entry in his financial items). Goods for import are considered to change ownership when the importer enters them on his books as a real asset (i.e., when he records a purchase and makes a corresponding entry in his financial items). This convention is designed to promote consistency between the ***goods*** component and the ***financial account*** in the balance of payments of the compiling country, as well as consistency between the compilation of ***goods*** by the exporting and importing countries. In practice, however, exporters and importers may not enter the transactions in their books as of the same date, so significant differences in timing may result even when this convention is followed.

Other exceptions to change of ownership rule

205. The definition of residence presented in this *Manual* has implications for the coverage of ***goods*** because of the change of ownership rule. Although enterprises are always considered residents of the economies in which the enterprises operate, enterprises in different economies may be under the same management. Affiliated enterprises may therefore engage in transactions that are not subject to the legal changes of ownership that would occur if the enterprises were independently managed. In fact, transactions between a parent company and a direct investment branch (an unincorporated enterprise) could never involve legal changes of ownership in the literal sense because both parties are part of the same legal entity. Moreover, while a parent company and a direct investment subsidiary (an incorporated enterprise) constitute separate legal entities, a different balance of payments treatment for transactions that take the form of legal changes of ownership and those that do not would seem neither feasible nor desirable. Therefore, it is recommended that transactions involving goods and taking place between direct investment enterprises and parent companies or other related enterprises should be recorded as if changes of ownership have occurred. (Exceptions are transactions in goods specified in paragraph 209.)

206. There are also important instances in which the possession of goods passes, without the defined change of ownership, between residents and nonresidents who are not affiliated. The effect of a legal change of ownership between independent parties can be achieved by other means. A significant example is financial leasing or lease arrangements (made for a capital good for most or all of its expected economic life) under which the lessor expects to recover most or all of the cost of the goods and the carrying charges. It is recommended that the economic nature of these transactions be given precedence over the legal form. Therefore, a financial lease arrangement is to be taken as presumptive evidence that a change of ownership is intended. A change of ownership is imputed because in practice, the lessee assumes the rights, risks, rewards, and responsibilities of ownership and, from an economic point of view, can be regarded as the de facto owner. A financial lease is a means by which the lessee finances the purchase (as opposed to taking out a loan for the purchase) of the good. The full equivalent of the market value of the goods (not the cumulative total of expected lease payments) should be recorded under ***goods***, and an offsetting entry should be made in the ***financial account*** to record the credit extended to the lessee.

207. In contrast, a change, between a resident and a nonresident, in ownership of goods may occur when goods do not physically cross the frontier of the economy of the resident who acquires or relinquishes ownership. When goods are acquired from one economy, relinquished again to that or some other economy, and do not cross the frontier of the economy in which the temporary owner is a resident, the activity is considered a merchanting transaction rather than an import and re-export of the goods. It is recommended that the country of the temporary owner exclude such goods from the ***goods*** component unless the recording periods in which the goods are acquired and relinquished are not the same. If the recording periods differ, increases or decreases in stocks abroad from one reporting period to another should be shown as imports of goods or reductions in imports. (For a fuller explanation of the treatment of these transactions, see paragraphs 213 and 262.)

Inclusion, in exports or imports, of goods not crossing frontiers

208. Goods not crossing frontiers should be included in exports or imports if changes of ownership occur. Exceptions are changes of ownership that are temporary (see preceding paragraph) or not related to significant economic activity. Such changes are to be disregarded. Examples of goods that do not cross frontiers but should nonetheless be included in exports or imports are

ships, aircraft, railway rolling stock, gas and oil drilling rigs and production platforms, and other movable equipment not tied to a fixed location

nonmonetary gold

goods consumed in resident-owned, offshore installations (e.g., gas and oil drilling rigs and production platforms, ships, or aircraft that are operating in international waters or airspace and are purchased from nonresidents)

goods salvaged and fish and other marine products caught by ships of the compiling economy and sold directly abroad

goods purchased in one foreign country by the government of the compiling economy for its own use in a foreign country

goods lost or destroyed after ownership has been acquired by the importer but before the goods have crossed a frontier.

Exclusion, from exports or imports, of goods crossing frontiers but not changing ownership

209. Goods that cross frontiers without changing ownership should not be covered under ***goods***, except as noted in paragraphs 197 and 198 and in the previous section on other exceptions to the change of ownership rule. The principal types of goods that may cross frontiers without changes of ownership are

direct transit trade (i.e., goods in transit through an economy)

returned exports and imports (see paragraph 210)

goods shipped under operational, that is, nonfinancial leasing arrangements (see paragraph 263)

transportation equipment, fishing vessels, gas and oil drilling rigs, and other mobile equipment that leaves or enters an economy without changes of ownership

shipments by a specific economy to that economy's military and diplomatic establishments located outside the territory of the economy

goods that cross frontiers and are lost or destroyed before being delivered by exporters

temporary exports and imports of goods that are not for sale (e.g., display equipment for trade fairs and exhibitions; art exhibits; animals for breeding, show, or racing; stage and circus equipment)

samples of no commercial value.

The recommendation that transactions between direct investment affiliates be recorded as if changes of ownership have occurred (see paragraph 205) does not extend to these goods.

210. When the execution of a contract for the sale of goods is not completed after the goods have been shipped out of the exporting economy and the goods are later returned to the original owner, such goods have not changed ownership. In concept, revised entries should be made to exports for the period when the goods were initially (and incorrectly) recorded. However, in many instances, it will not be possible to anticipate, at the time goods originally cross a frontier, whether or not such goods will be returned in the future. Therefore, purely for statistical convenience, it is suggested that deductions, which are later found necessary, from exports and imports should be made in the periods when the goods are returned.

Goods Classified Under Other Categories

211. Almost all movable goods for which changes of ownership occur between residents and nonresidents are classified under ***goods***. However, a few specified goods are classified elsewhere.

Goods classified under services

212. Some goods are classified under ***services*** because the relevant data include these goods indistinguishably or because the goods respond to economic factors differently than most goods do. The primary types of goods classified under ***services*** and the items under which the goods are recorded are

goods acquired by travelers (*travel*) for their own use, by diplomatic and military missions or agencies or by official personnel (*government services n.i.e.*), and by nonresident workers (*travel*)

newspapers and periodicals (not in bulk) sent on the basis of direct subscription (*computer and information services*)

goods that do not cross frontiers and are acquired and relinquished within the same recording period (*other business services*).

213. If goods are acquired in one recording period and relinquished in a later period, however, the goods should be recorded in the balance of payments of the temporary owner's economy as imports in the period in which the goods are acquired and deducted from imports in the period in which the goods are relinquished. In this case, changes from one recording period to another in stocks of goods located abroad and valued at acquisition cost constitute part of ***goods*** for the economy of the owner. In either situation, any difference between the value of the goods when acquired and relinquished is entered as merchanting under *other business services.*

Goods treated as financial items

214. Certain physical items are regarded as financial items and should not be included under ***goods***. Examples are

evidences of financial claims, even though such claims have material form and are movable (Examples of such goods are paper money and coin in current circulation and securities that have been issued.)

monetary gold treated as a financial asset (Monetary gold transactions between authorities of different economies should be included in the ***financial account***.)

nonfinancial assets—including land, structures, equipment, and inventories—that belong to an enterprise and are considered financial assets for the owner of that enterprise when the owner is not a resident of the economy in which the enterprise operates (A change of ownership resulting from the acquisition of these assets by an existing enterprise is thus treated as a financial transaction and is not included in ***goods***, except to the extent that such a change of ownership is actually accompanied by a physical movement of goods.)

Special Types of Goods

215. Classification of certain physical items as ***goods*** is sometimes questioned, most often because the goods may be accorded exceptional treatment under customs regulations or in trade returns. Examples of such goods, all of which should be recorded under ***goods*** if the items qualify according to the definition and rules in this *Manual*, are

commodity gold (i.e., *nonmonetary gold*), silver bullion, diamonds, and other precious metals and stones

paper money and coin not in current circulation and unissued securities, all of which should be valued as commodities rather than at face value

electricity, gas, and water

livestock driven across frontiers

parcel post

government exports and imports of goods, including goods financed by grants and loans (other than those exported and imported to and from government agencies and personnel)

goods transferred to or from the ownership of a buffer stock organization

migrants' effects

smuggled goods, whether or not detected by customs

other unrecorded shipments of goods such as gifts and goods of less than stated minimum value.

Time of Recording

216. In principle, exports and imports of goods should be recorded when ownership of the goods passes from a resident to a nonresident, or vice versa. In practice, a change of ownership is recognized (or is proxied) when the two parties to the transaction record it in their books or accounts. (See paragraphs 114 through 118 and paragraph 204.)

217. Neither physical movement, on which trade returns are largely based, nor payment, which is reflected in exchange records, will necessarily coincide in timing with changes in the ownership of goods. The *Guide* contains details on adjustments that would theoretically be necessary for statistics derived from those two sources. Except for large, discrete transactions (such as deliveries of ships or aircraft), the appropriate adjustments are often quite difficult to make. Information, especially in a form that can be related to the time of physical movement or the time of payment for the same goods, is seldom available on the actual time that a change of ownership occurs. If the overall value of trade, the regional pattern of trade, or the terms of payment for trade change substantially from the beginning to the end of the recording period, however, failure to adjust for timing is likely to be an important source of error in the balance of payments statement and an important cause of asymmetry between the ***goods*** components for different countries.

218. Goods on consignment (i.e., goods intended for sale but not actually sold at the time of crossing a frontier) should, in principle, be included in merchandise only at the time ownership changes. In practice, such goods are sometimes recorded at the time the goods cross a frontier. The assumption in such instances is that a change of ownership has occurred or will shortly occur. If this treatment is followed and there is no change of ownership, the goods must subsequently be recorded again, in the same manner as returned exports and imports (see paragraph 210), as a deduction from exports and imports.

Valuation

219. The value at which goods should be recorded in the balance of payments is the market value of the goods at the point of uniform valuation—the customs frontier of the economy from which the goods are exported. That is, the goods are valued free on board (f.o.b.) at that frontier. At least two aspects of this general statement require elaboration.

Market valuation

220. The concept of market value and the specific application of the concept to internationally traded goods are discussed in Chapter 5. The United Nations (UN) deals at length with the valuation of exports and imports according to the UN standard for such statistics. The *General Agreement on Tariffs and Trade* also provides an extensive treatment of the standard to be applied for the customs valuation of imports. (See the Guide.)

Point of valuation

221. Delivery of goods by the exporter to the importer invariably signifies a change of ownership and may occur at any time and place from the point at which the goods are produced to the point of final use. A clear distinction between (i) items regarded as goods and (ii) any additional distributive services that might be included in the final value of those goods is made in this *Manual.* This distinction is made whether the distributive services are performed before or after the change of ownership occurs. Thus, goods will be uniformly valued in the limited sense that a borderline between goods and distributive services can be established in accordance with one standard rule.

222. The standard, or rule, is that ***goods*** shall cover, in principle, the value of goods and related distributive services at the time the goods reach the customs frontier of the economy from which the goods are to be exported. The value of the goods includes the value of any loading of the goods on board the carrier at that frontier. That is, exports and imports of goods are valued f.o.b. at the customs frontier of the exporting economy. In the application of this rule, customs bonded warehouses, customs bonded manufacturing plants, and free areas are included within the customs frontier of the controlling and supervising economy. The customs frontier need not coincide physically with the national boundary and could be located in the interior of the economy.

223. Uniformity of this kind means that differing practices for delivery of goods by exporters to importers, as well as changes in those practices from one period to another, have no effect on the determination of services included in the value of goods. No rule can be formulated, however, to produce what could be considered, in a basic economic sense, a uniform point of valuation for goods. Indeed, this kind of uniform valuation could more appropriately be viewed as uniform classification. The objective is to include in ***goods*** only a standard partial list of related distributive services; the principle that both the goods and the services should be valued at market prices is not in question in this context.

224. While adoption of any of several uniform points of valuation may be analytically useful, problems of a statistical nature arise. A principal difficulty is that shipping practices are not standard, and the documents on which the compiler must usually rely as the basis for estimates of goods and transportation services will often cover shipping services performed on both sides of the customs frontier (or of any other uniform point) without a detailed subdivision of the total shipping costs. For example, shipment by truck from door to door may be provided, or goods in containers may be moved between central warehouses that are distant from the customs frontiers in the exporting and importing economies. A primary consideration for specifying the customs frontier of the exporting economy, rather than some other location, as the point of valuation is that the frontier is the point at which customs officials place valuations on exports and, for a significant group of countries, on imports as well. It is thus the point most likely to be reflected in trade statistics.

225. As a practical matter, the service of loading goods on board the carrier at the customs frontier is frequently performed by or for the account of the carrier. In such a case, trade statistics are likely to exclude the cost of such services, but data on freight charges will almost certainly include them. It is not suggested in this *Manual* that an attempt be made to reallocate such charges from *transportation* to ***goods***. Instead, it is recognized that the recommended f.o.b. basis for recording goods may, in practice, be a free alongside ship (f.a.s.) basis rather than a strict f.o.b. basis.

226. Goods delivered to an importer at some point within the exporting economy might not be shipped to the customs frontier of that economy during the same recording period. When this is the situation, an entry should be made in one period for the value of the goods at the point of delivery and, in a subsequent period, an entry should be made for the cost of shipment from that point to the customs frontier. Both of these entries are included in ***goods***.

227. Application of the uniform valuation rule may result in the inclusion, under ***goods***, of some service flows between nonresidents or between residents of the same economy. An exporter may deliver goods before the goods reach the customs frontier of his economy, and the importer may then employ a supplier of distributive services, who is not a resident of the exporting economy, to ship the goods to the customs frontier. An offset to such a flow of services between nonresidents is required in the balance of payments of the exporting country. To preserve a uniform valuation in the ***goods*** component, the offsetting entry should be made in *transportation.* Similarly, if the supplier of the services is the importer himself or a resident of the importer's economy, the services will not have been provided to or from residents of different economies and an offset in *transportation* is also required in the balance of payments of the importing country.

228. Treatment of services performed by agents in connection with transactions in goods also requires consideration. Some of these services apply only generally to transactions and cannot realistically be attributed to the value of goods at any particular point or date. As a practical way of dealing with the problem, it is recommended that, upon actual payment of an agent's fee by the exporter, the fee should be included in the f.o.b. value of the goods, regardless of whether the agent is a resident of the exporter's country or another country. When an agent's fee is paid by an importer, the fee should only be included in the f.o.b. value of the goods if the agent is a resident of the exporting country. Agents' fees paid by importers to residents of their own countries and to residents of countries other than the exporting country are excluded from the f.o.b. value of the goods. In all cases, when a fee is paid by a resident of one country to an agent in another, an entry should be made in *other business services*-merchanting and other trade-related services

(except when a fee is paid by an importer to an agent in the exporting country.)

229. In some instances, fees are paid by exporters to consulates of importing economies. Such fees should not be included when goods are valued at the frontier of the exporting economy. A consular fee is thus treated as a cost incurred beyond the customs frontier of the exporting economy; that is, a consular fee is incurred in the importing economy.

XI. Transportation

Definition and Coverage

230. *Transportation* covers all transportation (sea, air, and other—including land, internal waterway, space, and pipeline) services that are performed by residents of one economy for those of another and that involve the carriage of passengers, the movement of goods (freight), rentals (charters) of carriers with crew, and related supporting and auxiliary services. Some related activities are *excluded*: freight insurance, which is included in insurance services, Chapter 13; *goods procured in ports by nonresident carriers* and repairs of transportation equipment, which are included in ***goods***, Chapter 10; repairs of railway facilities, harbors, and airfield facilities, which are included in *construction services*, Chapter 13; and rentals (charters) of carriers without crew, which are included in *other business services*, Chapter 13.

231. Most transportation services, for both passengers and freight, often are provided by enterprises through the operation of carriers and similar equipment. Questions arise as to the residence of such enterprises or operators because the carrier may operate outside the economic territory, either in international waters or airspace or in one or more other economies in which the enterprise is resident. The residence of enterprises is discussed in Chapter 4, and paragraphs 80 through 82 are particularly relevant in this context.

Passenger Services

232. This component covers all services provided, between the compiling economy and abroad or between two foreign economies, in the international transportation of nonresidents by resident carriers (credit) and that of residents by nonresident carriers (debit). Also included are passenger services performed within an economy by nonresident carriers. Excluded are passenger services provided to nonresidents by resident carriers within the resident economies; these are included in *travel*, Chapter 12. In addition to the services covered by passenger fares—including fares that are a part of package tours but excluding cruise fares, which are included in *travel*—passenger services include such items as charges for excess baggage, vehicles, or other personal accompanying effects and expenditures for food, drink, or other items for which passengers make expenditures while on board carriers.

Freight Services and Conventions for Recording

233. Freight services include the loading on board or the unloading of goods from carriers if contracts between owners of goods and carriers require that the latter provide that service. When such a service is performed at the customs frontier of the country from which goods are exported, the loading charge is classified as freight if the service is provided by, or for the account of, the carrier; otherwise, the service is classified as part of ***goods***. This treatment is used because, in practice, the statistics that can be collected on freight will usually cover indistinguishably all services that are performed by, or for the account of, the carriers, whereas the statistics on goods are unlikely to include the loading charge if loading is provided by, or for the account of, the carrier.

234. The measurement of freight services is affected by the convention noted in Chapter 10—that goods are valued f.o.b. at the customs frontier of the exporting economy—and by the assumption that freight charges are borne by the importing economy. Measurement of freight services is also affected by other factors related to this convention and assumption. Included in the f.o.b. value of goods are transportation services associated with goods and performed prior to the arrival of goods at the customs frontier of the economy from which the goods are exported. Included in *transportation* are services associated with goods and performed beyond the customs frontier of the exporting economy. These services cover transportation of goods to the customs frontier of the importing economy and, within that economy, to the point of delivery. These transportation services are treated as services performed (by residents of the importing economy or by residents of other economies) for residents of the importing economy.

235. Thus, debit (payments) entries should be made in the accounts of a compiling economy for all transportation services performed (inside or outside the importing economy) in relation to imports of the compiling economy when (i) these services are performed by nonresidents and (ii) when these services are performed after the imports are loaded on board a carrier at the customs frontier of the exporting economy. Conversely, credit (receipts) entries should be made in a compiling economy's accounts for all transportation services performed by residents of the compiling economy in relation to exports of that economy when such services are performed after the exports have been loaded on board a carrier at the customs frontier. Also entered as credits are services provided by residents in relation to transport of goods between other countries. Required entries represent identifiable services performed by residents or nonresidents without regard to the ownership of goods by residents or nonresidents at the precise times when such services are performed. (This matter is difficult—if not impossible—to ascertain.) Offsetting debit and credit entries for services performed by residents of a compiling economy in relation to imports of the compiling economy (and by nonresidents in relation to exports) are not made under the convention described in paragraph 234 because the recording is consistent with a uniform f.o.b. valuation basis for merchandise. However, for other purposes (such as trade negotiations or cross-checking individual country data and the global consistency of transportation accounts), gross freight compilations that are linked to an ex-works valuation of goods and include resident-resident transactions may be useful.

236. Use of the convention admittedly does not obviate all the statistical problems that may arise in compiling data for ***goods*** and *transportation*. When these two items are derived from collection forms that show imports valued at the frontier of the importing economy (c.i.f. valuation), a separate estimate must be made for the value of the transportation services performed beyond the customs frontier of the economy from which the goods are exported. This treatment, however, essentially reallocates the element for transportation services in the c.i.f. value of imports between ***goods*** and *transportation*, so any error in estimation does not affect the two items combined. Furthermore, if the compiling economy performs any of the transportation services in connection with imports, the amount of such services must be estimated separately from a total that includes similar services performed by the compiling economy in connection with exports or other goods in transit trade. This dissagregation may be considerably more difficult to obtain than data on total receipts. In this case, any error in estimation produces, without affecting the net amount of the item, an equal overstatement or understatement of the credit and debit sides of *transportation*.

237. Gross flows between residents and nonresidents are recorded for transportation services (other than those previously covered) pertaining to goods. These services include transit trade through a compiling economy, coastal transportation or other transportation of goods between points within an economy, movements of goods to or from entities located outside territories where the entities are residents (for example, government agencies with personnel stationed abroad), and goods lost or destroyed after crossing a customs frontier but before delivery is made by the exporter.

238. In addition, offsets are made under *transportation* to certain flows that may occur between residents and between nonresidents and that may be included in ***goods*** when such goods are valued uniformly at the customs frontier of the economy from which the goods are exported. Specifically, credits are included by the importing economy for services performed within the customs frontier of the exporting economy, and debits are included by the exporting economy for services that nonresidents perform within the customs frontier of that economy.

Rentals of Transportation Equipment with Crew

239. This category covers rentals or operational leases made by residents to nonresidents and vice-versa of vessels, aircraft, freight cars, or other commercial vehicles with crews for limited periods (such as a single voyage) for the carriage of freight and/or passengers. Also included are towing and services related to the transportation of oil platforms, floating cranes, and dredges. These rentals are included, as appropriate, in passenger services or freight services. Excluded are financial leases (equivalent to changes of ownership with related payments recorded, as appropriate, under income and amortization) or time charters (for longer periods) for which paragraph 80 is particularly relevant.

Supporting and Auxiliary Services

240. This category covers a range of services provided in ports, airports, and other terminal facilities. Among such services are cargo handling (loading and unloading of containers.); storage and warehousing; packing and repacking; other towing, pilotage, and navigational aid for carriers; maintenance and cleaning of transportation equipment; and salvage operations. Also included are commissions and agents' fees associated with passenger and freight transportation. These services are recorded as other transportation services.

XII. Travel

Nature of Travel Services

241. *Travel* [3] differs from other components of international services in that it is a demand-oriented activity. The consumer (traveler)[4] moves to the location of the provider (residents of the economy visited) for the goods and services desired by the traveler. Thus, unlike other services, *travel* is not a specific type of service but an assortment of services consumed by travelers. *Travel* is not identified as a service in the CPC.

Definition

242. *Travel* covers primarily the goods and services acquired from an economy by travelers (defined in paragraph 243) during visits of less than one year in that economy. The goods and services are purchased by, or on behalf of, the traveler or provided, without a quid pro quo, for the traveler to use or give away. Excluded is the international carriage of travelers, which is covered in passenger services under *transportation*. (See paragraph 232.)

243 A traveler is an individual staying, for less than one year, in an economy of which he is not a resident for any purpose other than (i) being stationed on a military base or being an employee (including diplomats and other embassy personnel) of an agency of his or her government, (ii) being an accompanying dependent of an individual mentioned under (i), or (iii) undertaking a productive activity directly for an entity that is a resident of that economy. (See paragraphs 67 through 70.) Expenditures made by individuals covered in (i) and (ii) are recorded under *government services n.i.e.* (See Chapter 13.) Expenditures made by individuals (including seasonal and border workers) covered in (iii) are included under *travel*. Travelers include tourists, who spend at least one night in the country visited, and same-day travelers or excursionists, who stay less than twenty-four hours and do not remain overnight. The latter group may be shown as a separate category, or as a memorandum item, by economies in which same-day travelers account for significant transactions.

244. The one-year rule does not apply to students and medical patients, who remain residents of their economies of origin even if the length of stay in another economy is one year or more. All expenditures, including those for educational and health-related purposes (such as tuition, room and board paid for or provided by educational institutions, hospital charges, treatments, physicians' fees, etc.), made by students and medical patients are recorded under *travel* and separately identified, if possible, under **Selected Supplementary Information.** (See the table following Chapter 8.) Fees for services rendered abroad (including provision of correspondence courses) by teachers or doctors are recorded under *personal, cultural, and recreational services.*

Types of Travel

245. Although the list of standard components contained in this *Manual* includes only two items for *travel* (business and personal), there are distinctions within both categories. (See subsequent sections, which may be of significance for various analytical purposes, on business travel and personal travel.)

Business travel

246. The business travel category covers travelers going abroad for all types of business activities: carrier crews stopping off or lying over; government employees on official travel; employees of international organizations on official business; and employees doing work for enterprises that are not resident in the economies in which the work occurs.

247. Business travelers are those who visit an economy for sales campaigns, market exploration, commercial negotiations, missions, meetings, production or installation work, or other business purposes on behalf of an enterprise resident in another economy. *Travel*

[3] As used in this Manual, the term travel is synonymous with the term tourism used in the SNA and by the World Tourism Organization (WTO).

[4] The term *traveler* is broadly synonymous with the term *visitor* used by the WTO.

refers to personal acquisitions of goods and services (including those for which the business travelers are reimbursed by employers) but not the sales or purchases that the business travelers may conclude on behalf of the enterprises they represent. Personal expenditures on goods and services by seasonal, border, and other nonresident workers in the economies in which they are employed also are recorded under *travel*. (See paragraphs 246 and 271.) These expenditures are not included under tourism by the WTO.

248. Government employees and employees of international organizations on official travel (paragraph 246) are distinguished from employees stationed or living, respectively, in the country. (Purchases for the latter are included in *government services n.i.e.*)

Personal travel

249. This category covers travelers going abroad for purposes other than business (e.g., for leisure activities such as holidays, participation in sports and other recreational and cultural activities, visits with relatives and friends, pilgrimage and religious observances, studies, and health-related purposes). Also included in this category are government employees on leave in economies other than those in which they are residents (or those in which they are stationed) and transit travelers visiting countries en route to other destinations.

Goods and Services Covered

250. All goods and services acquired by travelers (as defined previously) from the economies in which they are traveling and for their own use are recorded under *travel*. These goods and services may be paid for by the traveler, paid for on his or her behalf, or provided to him or her without a quid pro quo (e.g., free room and board received by official visitors or by friends and relatives). In practice, information on goods and services provided without a quid pro quo will not usually be available. If information is available, a contra entry is included under *transfers*.

251. The most common goods and services entered in travel are lodging, food and beverages, entertainment, and transportation within the economy visited—all of which are consumed in the providing economy—and gifts, souvenirs, and articles (irrespective of value) purchased for travelers' own uses and taken out of the economies visited.

XIII. Other Services

Coverage

252. Other services comprise those international service transactions not covered under *transportation* and *travel*. The significance and data constraints limiting the recording of classifications of international services vary widely among countries. The classifications reflect the increasing global importance of items such as *communications services* and *financial services*; better linkage between classifications of balance of payments services and the Central Product Classification;[5] the analytic value of classifications to compilers and users; a high degree of compatibility with similar classifications of other international organizations; and the statistical requirements for multilateral negotiations on international services. The classifications also establish a framework to encompass transactions anticipated to be of growing importance in the future.

Definitions

253. *Communications services* covers two primary categories of transactions between residents and nonresidents in international communications. These are (i) telecommunications, which encompass the transmission of sound, images, or other information by telephone, telex, telegram, cable, broadcasting, satellite, electronic mail, facsimile services, etc. and include business network services, teleconferencing, and support services; and (ii) postal and courier services, which encompass the pickup, transport, and delivery of letters, newspapers, periodicals, brochures, other printed matter, parcels, and packages by national postal administrations and other operators. Also included are post office counter and mailbox rental services.

254. *Construction services* covers work performed on construction projects and installations by employees of an enterprise in locations outside the economic territory of the enterprise. (The work is generally performed for a short time period; the one-year rule is to be applied flexibly.) Goods imported by the enterprise for use in the projects are included in the value of these services rather than being recorded under ***goods***; expenditures for local supplies, etc. are included under *other business services*. Projects carried out by foreign subsidiaries or branches of enterprises (direct investors) and certain site offices are excluded because such projects are part of the production of the host economy. For aspects of residency concerning major projects (such as bridges, dams, etc.) carried out over several years and for factors that determine the attribution of production and are particularly relevant for construction site offices, see paragraph 78.

255. *Insurance services* covers the provision of various types of insurance to nonresidents by resident insurance enterprises, and vice versa. Such services cover freight insurance (i.e., insurance on goods that are in the process of being exported or imported); other types of direct insurance (i.e., life—including pension and annuity services, other casualty or accident, health, general liability, fire, marine, aviation, etc. insurance); and reinsurance. The specific classification of various types of insurance is determined by individual countries according to particular requirements. Also recorded as *insurance services* are agent commissions related to insurance transactions.

256. Treatment of freight insurance is consistent with the f.o.b. valuation of merchandise exports and imports. Insurance cost up to the customs frontier of the exporting economy is included in the f.o.b. value of the goods exported. If that insurance is paid for by the importer (e.g., through an enterprise resident in the importer's economy), the exporter is deemed to purchase the insurance and simultaneously recover the cost from the f.o.b. value recorded in the accounts. Insurance services provided for goods after the goods have crossed the customs frontier of the exporting economy are recorded as imports of insurance services by the importer when the insurance is provided by an enterprise nonresident in the importing economy. If the insurance is provided by an enterprise resident in the importing economy, no entry is made in balance of payments accounts.

257. International insurance services are estimated or valued by service charges included in total premiums

[5] The relationship of the classifications of balance of payments ***services*** to the CPC is detailed in Appendix 3.

earned rather than by total premiums. In principle, the measurement of transactions in international insurance services is consistent with that described in the *SNA* for insurance services for resident sectors. However, in practice, both the *Manual* and the *SNA* allow resident-nonresident flows associated with investment income on technical reserves to be ignored because of estimation problems, particularly for imports.[6] Thus, for goods, the insurance service charges for resident issuers providing insurance services to nonresidents (credit) are the difference between premiums earned and claims payable on goods lost or destroyed in transit. The service charges for nonresident issuers providing services to residents (debit) can be estimated by taking the ratio of estimated service charges to total premiums for exports of insurance services and applying the ratio to total premiums paid to nonresident issuers. The ratio should be based on a medium- to long-term period. For other types of direct insurance (and pension and annuity services), the service charges for nonresident insurers providing services to residents can be estimated by applying the ratio of estimated service charges to total premiums for resident insurers or to contributions received by resident pension funds. Again, the ratio should be based on a medium- to long-term period. For non-life insurance, total premiums minus the estimated service charge and claims payable should be recorded under ***current transfers***. For life insurance, premiums minus the service charges and claims payable should be recorded in the ***financial account*** under other investment. (For some purposes—e.g., for use in trade negotiations—total premiums and claims are relevant and are shown as memorandum items under *insurance services.*) For reinsurance, exports of services (credits) are, in principle, estimated as the balance of all flows occurring between resident reinsurers and nonresident insurers. Imports (debits) are, in principle, estimated as the balance of all flows occurring between resident insurers and nonresident reinsurers.

258. *Financial services* covers financial intermediary and auxiliary services (except those of insurance enterprises and pension funds) conducted between residents and nonresidents. Included are intermediary service fees, such as those associated with letters of credit, bankers' acceptances, lines of credit, financial leasing, and foreign exchange transactions. (For the latter, the spread between the midpoint rate and the buying or selling rate is the service charge.) Also included are commissions and other fees related to transactions in securities—brokerage, placements of issues, underwritings, redemptions, and arrangements of swaps, options, and other hedging instruments; commissions of commodity futures traders; and services related to asset management, financial market operational and regulatory services, security custody services, etc. Service charges on purchases of International Monetary Fund resources are included among an economy's financial service payments, as are charges (similar to commitment fees) associated with undrawn balances under stand-by or extended arrangements with the IMF.[7]

259. *Computer and information services* covers computer data and news-related service transactions between residents and nonresidents. Included are data bases, such as development, storage, and on-line time series; data processing—including tabulation, provision of processing services on a time-share or specific (hourly) basis, and management of facilities of others on a continuing basis; hardware consultancy; software implementation—including design, development, and programming of customized systems; maintenance and repair of computers and peripheral equipment; news agency services—including provision of news, photographs, and feature articles to the media; and direct, non-bulk subscriptions to newspapers and periodicals.

260. *Royalties and license fees* covers the exchange of payments and receipts between residents and nonresidents for the authorized use of intangible, nonproduced, nonfinancial assets and proprietary rights (such as patents, copyrights, trademarks, industrial processes, franchises, etc.) and with the use, through licensing agreements, of produced originals or prototypes (such as manuscripts and films). Inclusion of this item under ***services***, rather than under ***income***, is in accordance with the *SNA* treatment of such items as payments for production of services for intermediate consumption or receipts from sales of output used as intermediate inputs.

261. *Other business services* covers various categories, other than those previously defined, of service transactions between residents and nonresidents. The grouping of these services is not indicative of the

[6] Insurance technical reserves cover actuarial reserves against outstanding risks and reserves for with-profits insurance, prepayments of premiums, and reserves against unsettled claims.

[7] In the SNA, in addition to the explicit commissions and fees noted previously, there is an item for financial intermediation services indirectly measured. These reflect financial service charges that, while not explicit, may be imputed or derived from the differences between appropriate reference interest rates and rates actually applied to loans, debt securities, or deposits. Such imputations are equivalent to reclassifying a portion of interest as *financial services*. As a reflection of the views of national balance of payments compilers, this procedure is not recommended in this *Manual*. As a result, these implicit services are reported indistinguishably under *investment income* (interest).

relative importance of the services, either to each other or to previously mentioned services. For instance, merchanting and other trade-related services are very important for a number of countries, and other particular categories may be equally important for other countries. The grouping generally reflects harmonization efforts on the part of the IMF and other international organizations involved with the expansion and improvement of data on international service transactions.

262. Merchanting and other trade-related services covers commissions on goods and service transactions between (i) resident merchants, commodity brokers, dealers, and commission agents and (ii) nonresidents. (See paragraph 228.) This category includes transactions in ships, aircraft, and auction sales as well. *Merchanting* is defined as the purchase of a good by a resident (of the compiling economy) from a nonresident and the subsequent resale of the good to another nonresident; during the process, the good does not enter or leave the compiling economy. (Changes in stocks held abroad by merchants are excluded.) The difference between the value of goods when acquired and the value when sold is recorded as the value of merchanting services provided. If the commodities are not resold by the merchant in the same accounting period, an import of goods is recorded in the first period, and a negative import entry is recorded in the later period. (See paragraph 213.) Although merchanting is recorded on a net basis, separate data recorded on a gross basis may be useful for analytical purposes.

263. Operational leasing (rental) without operators covers resident-nonresident leasing (other than financial leasing) and charters of ships, aircraft, and transportation equipment such as railway cars, containers, rigs, etc. without crew.

264. Miscellaneous business, professional, and technical services covers the following services:

Legal, accounting, management consulting, and public relations services cover the provision (by or for residents for or by nonresidents) of legal advice, representation, and documentation; accounting, auditing, bookkeeping, and tax consultant services; and management consulting related to the provision of advice, guidance, or operational assistance to business.

Advertising and market research services transacted between residents and nonresidents cover the design, creation, and marketing of advertisements by advertising agencies; media placement, including the purchase and sale of advertising space; exhibition services provided by trade fairs; the promotion of products abroad; market research; and public opinion polling abroad on various issues.

Research and development services cover those services that are transacted between residents and nonresidents and associated with basic research, applied research, and experimental development of new products and processes. In principle, such activities in the sciences, social sciences, and humanities are covered; included is the development of operating systems that represent technological advances.

Architectural, engineering and other technical services cover resident-nonresident transactions related to architectural design of urban and other development projects; planning and project design and supervision of dams, bridges, airports, turnkey projects, etc.; surveying, cartography, product testing and certification, and technical inspection services.

Agricultural, mining, and on-site processing services provided by or to residents to or by nonresidents cover services associated with agricultural crops (e.g., protection against insects and disease, increasing of harvest yields, etc.); forestry services; mining-related services (e.g., analysis of ores, etc.); and on-site processing of, or work on, goods that have been imported but not re-exported (e.g., nuclear waste processing) or vice versa. (See paragraph 199.)

Other services transacted between residents and nonresidents cover items such as placement of personnel, security and investigative services; translation and interpretation; photographic services; building cleaning, etc. Also included are payments for local supplies, utility payments, etc. by nonresident enterprises engaged in construction services.

These services are listed as sub-items in the **Selected Supplementary Information** table at the end of Chapter 8.

265. *Personal, cultural, and recreational services* involving transactions between residents and nonresidents are subdivided into two categories: (i) audiovisual and related services and (ii) other cultural and recreational services. The first category comprises services and associated fees related to the production of motion pictures (on film or video tape), radio and television programs (live or on tape), and musical recordings. Included are receipts or payments for rentals; fees received by resident actors, directors, producers, etc. (or by nonresidents in the compiling economy) for productions abroad; and fees for distribution rights sold to the media for a limited number of showings in specified areas. Fees to actors, producers, etc. involved with theatrical and musical productions, sporting events, circuses, etc. and fees for distribution rights (for television, radio, etc.) for these activities are included. The second category comprises other personal, cultural, and recreational services such as those associated with museums, libraries, archives, and other cultural, sporting, and recreational activities. Also included are fees for services, including provision of correspondence courses, rendered abroad by teachers or doctors.

266. *Government services n.i.e.* is a residual category covering government service transactions (including those of international organizations) not contained in previous classifications. Included are all transactions by embassies, consulates, military units, and defense agencies with residents of economies in which the embassies, etc. are located and all transactions with other economies. (Excluded are transactions with residents of the home countries represented by the embassies, consulates, etc. and transactions in the commissaries, post exchanges, etc. of the embassies, consulates, etc.) Transactions in this category comprise those for goods and services (such as office supplies, furnishings, utilities, official vehicles and the operation and maintenance thereof, and official entertainment) and personal expenditures incurred by diplomats and consular staff and their dependents in the economies in which they are located. Also recorded in this category are transactions, subject to the same considerations as those in the preceding item, by other official entities (such as aid missions and government tourist, information, and promotion offices) located in economies abroad. Included, as well, are transactions associated with general administrative expenditures, etc. and not classified elsewhere. In addition, transactions associated with aid services that are provided by non-military agencies, do not give rise to any payments, and have offsets in transfers are recorded in this category. Last, transactions associated with the provision of joint military arrangements and peacekeeping forces, such as those of the United Nations, are recorded in *government services n.i.e.*

XIV. Income

Coverage

267. ***Income*** covers two types of transactions between residents and nonresidents: (i) those involving *compensation of employees*, which is paid to nonresident workers (e.g., border, seasonal, and other short-term workers), and (ii) those involving *investment income* receipts and payments on external financial assets and liabilities. Included in the latter are receipts and payments on *direct investment*, *portfolio investment*, *other investment*, and receipts on reserve assets. Income derived from the use of tangible assets is excluded from ***income*** and classified, as appropriate, under leasing or rentals, under *other business services*, or under *transportation*. Financial leasing arrangements are considered evidence that a change of ownership is intended (see paragraph 206), and part of the lease payments is construed as income on a financial asset.

268. Holding (capital) gains and losses are not classified as income on investments but as part of the value of the investments. All realized holding gains and losses arising from transactions are included in the ***financial account***; unrealized valuation changes are not included. However, some debt securities (such as bonds, notes, and bills) are originally issued at values that differ from the stated fixed sums that holders have the unconditional right to receive when the obligations mature. These premiums or discounts should be regarded as negative interest or interest, respectively, rather than as holding losses or gains. The values of securities entered in the ***financial account*** are the amounts for which the securities were actually issued. The fixed sums paid at maturity comprise both repayments of original principal amounts and (negative or positive) interest; the interest should be shown as *investment income*.

Definition and Classification

269. *Compensation of employees* comprises wages, salaries, and other benefits (in cash or in kind) earned by individuals—in economies other than those in which they are residents—for work performed for and paid for by residents of those economies. Included are contributions paid by employers, on behalf of employees, to social security schemes or to private insurance or pension funds (whether funded or unfunded) to secure benefits for employees. Employees, in this context, include seasonal or other short-term workers (less than one year) and border workers who have centers of economic interest in their own economies. Because embassies and consulates are considered extraterritorial to the economies in which they are located, the compensation received by local (host country) staff of these institutional entities is classified as that paid to resident entities by nonresident entities.

270. Compensation paid to employees by international organizations, which are treated as extraterritorial entities, represents payments to residents from nonresident entities if the employees are residents of the economies of location. Also, if the employees are from other economies but are employed for one year or more, they are treated as residents of the economies of location, and their compensation is classified in the same manner. Thus, in the case of employees from other economies who are employed for less than one year, no payments to residents are involved. (For treatment of technical assistance personnel working abroad on assignments of one year or more, see paragraph 69.)

271. Personal expenditures made by nonresident seasonal and border workers in the economies in which they are employed and personal expenditures made by those working on installation projects are recorded under *travel*. Taxes paid, contributions made to pension funds, etc. in those economies are recorded as current transfer payments. Gross recording of compensation and expenditures is recommended in this *Manual*, although recording may, on practical grounds, be limited to estimates of net income in some instances.

272. In practice, it is often difficult to make the distinction between persons whose earnings are classified as *compensation of employees,* even though they are not residents of the economies in which they work, and migrants who have become residents of economies by virtue of being expected to live there for a year or more. (See paragraphs 352 through 355.) The activities of an individual—whether he or she is regarded as a resident or a migrant—do not affect the aggregate transactions of the compiling economy with the rest of the world. Therefore, difficulties on this score will not, in principle, be a source of net errors and omissions in the balance of payments. Even so, efforts should be made to observe the distinction between nonresident workers and migrants. Otherwise, the comparability of balance of payments statements for the two compiling economies will suffer from dissimilar statistical treatment of the same individuals.

273. Nonresidents of an economy may engage in transactions associated with the use of land for noncommercial purposes. Such transactions are usually included indistinguishably under components other than ***income*** (for example., *travel* or *government services n.i.e.*).

274. *Investment income* (property income in the *SNA*) covers income derived from a resident entity's ownership of foreign financial assets. The most common types of *investment income* are income on equity (dividends) and income on debt (interest). Dividends, including stock dividends, are the distributed earnings allocated to shares and other forms of participation in the equity of incorporated private enterprises, cooperatives, and public corporations. Dividends represent income that is payable without a binding agreement between the creditor and the debtor. Among other types of income on equity are (i) earnings of branches and other unincorporated direct investment enterprises and (ii) direct investors' shares of earnings of incorporated direct investment enterprises. (The latter type of earnings, which are not formally distributed, are earnings other than dividends.) Shares of reinvested earnings attributed to direct investors are proportionate to the participation of the direct investors in the equity of the enterprise. Also, in principle, income is imputed to households from net equity in life insurance reserves and pension funds and included indistinguishably under other investment. Interest, including discounts in lieu of interest, comprises income on loans and debt securities (i.e., bank deposits, bills, bonds, notes, and trade advances). Net interest flows arising from interest rate swaps also are included. (See paragraph 406.) Interest is payable in accordance with a binding agreement between the creditor and the debtor.

275. The components of *investment income* are classified as direct investment, portfolio investment, and other investment income.

Direct investment income

276. The two categories under this heading—income on equity and income on debt—cover income accruing to a direct investor resident in one economy from the ownership of direct investment capital in an enterprise in another economy. (See paragraphs 330 and 368 for the definition of direct investment capital.) Income on direct investment is presented on a net basis for direct investment made abroad and in the reporting economy (i.e., receipts of income on equity and income on debt less payments on income on equity and income on debt for each).

277. Income on equity is subdivided into (i) distributed income (dividends and distributed branch profits) and (ii) reinvested earnings and undistributed branch profits. Distributed income may consist of dividends on common or preferred shares owned by direct investors in associated enterprises abroad, or vice versa.

278. Reinvested earnings comprise direct investors' shares—in proportion to equity held—of (i) earnings that foreign subsidiaries and associated enterprises do not distribute as dividends and (ii) earnings that branches and other unincorporated enterprises do not remit to direct investors. (If that part of earnings is not identified, all branch earnings are considered, by convention, to be distributed.) Thus, reinvested earnings may be calculated as the entrepreneurial income (net operating surplus) of the direct investment enterprise, plus any income or current transfers receivable, minus any income or current transfers payable. The latter include any current taxes payable on income, wealth, etc.

279. Income on debt consists of interest payable—on intercompany debt—to or from direct investors from or to associated enterprises abroad. Income on nonparticipating preference shares is treated as interest income, rather than dividend income, and is recorded in income on debt.

Portfolio investment income

280. Portfolio investment income comprises income transactions between residents and nonresidents and is derived from holdings of shares, bonds, notes, and money market instruments and associated with financial derivatives. This category is subdivided into income on equity (dividends) and income on debt (interest). See Chapter 19 for details on new financial instruments and treatment of financial derivatives, such as options. The financial instrument classification scheme for portfolio investment income is consistent with that in the ***financial account*** and with that in the international investment position. Subsectoring into domestic institutional sectors (monetary authorities, general government, banks, and other) is shown under **Selected Supplementary Information**. (See the table at the end of Chapter 8.) A variety of other supplementary disaggregations by foreign sector, etc. may be desirable for specific analytical purposes.

Other investment income

281. Other investment income covers interest receipts and payments on all other resident claims (assets) on and liabilities to nonresidents, respectively. This category also includes, in principle, imputed income to households from net equity in life insurance reserves and in pension funds. Other investment income is classified by the domestic sectors previously noted. Interest on assets comprises interest on long- and short-term loans, on deposits, on other commercial and financial claims, and on an economy's creditor position in the Fund, SDR holdings, and loans to the Fund. Interest on liabilities covers interest on loans, on deposits, and on other claims and interest related to the use of Fund credit and loans from the Fund. Also included is interest paid to the IMF on the Fund's SDR holdings in the General Resources Account. Borderline distinctions may arise between interest income and certain commissions and fees, such as commitment charges on undrawn funds. These are included in *financial services.* (See Chapter 13.)

Time of Recording of Investment Income

282. Dividends are recorded as of the date payable. Interest income is recorded on an accrual basis. If the interest is not actually paid, an income entry is recorded under the appropriate instrument and a counterpart entry is made in the ***financial account*** to reflect an increase in the claim associated with nonpayment. (See paragraph 121.)

283. For zero coupon and other deep discounted bonds, the substantial difference between the discounted issue price and the value at maturity is treated as interest. That difference is recorded as accruing over the life of the bond as a series of interest payments rather than being recorded when the interest is due for payment. If these securities are traded—prior to maturity—in the secondary market, prevailing rates that reflect the difference between the new owner's cost and the value at maturity should be used for the subsequent recording of interest on these securities. Implementation of this treatment may be difficult. (See paragraph 396.) Reinvested earnings of direct investment enterprises are recorded in the balance of payments in the periods in which the income is earned. Distributed (remitted) earnings of branches and other unincorporated enterprises are recorded as of the times the earnings are transferred.

284. This difference in times of recording for earnings that are formally distributed and for other earnings is attributable to the fact that reinvested earnings represent the net income accruing during a specific period. In contrast, dividends and remitted earnings of branches are discretionary distributions that can be made at any time—even in a period when a net loss is sustained. Therefore, these dividends and remitted earnings are not attributable to the earnings of a particular period. To determine the period in which those reinvested earnings are earned or other investment income becomes payable, it may be helpful to refer to balance sheets, annual reports, and similar documents of the direct investor or the enterprise.

Measurement and Recording of Direct Investment Earnings

285. Direct investment earnings are measured on the basis of current operating performance. Operational earnings represent income from normal operations of the enterprise and do not include any realized or unrealized holding (capital) gains or losses arising from valuation changes, such as inventory write-offs; gains or losses on plant and equipment from the closure of part or all of a business; write-offs of intangibles, including goodwill, because of unusual events or developments during the period; write-offs of research and development expenditures; losses on the write-offs of bad debts or on expropriation without compensation; abnormal provisions for losses on long-term contracts; and exchange-rate-related gains and losses. Unrealized gains or losses resulting from the revaluation of fixed assets, investments, and liabilities and any realized gains or losses resulting from the disposal of assets or liabilities should be excluded from direct investment earnings; that is, gains should not be added in and losses should not be deducted. In addition, valuation changes resulting from unforeseen obsolescence, catastrophes, and depletion of natural resources are treated as holding losses at the times that the decreases in values actually occur. Because data for many countries are available only on an all-inclusive basis, when holding gains and losses and other extraordinary income are included in reported earnings, those countries that report earnings on either an operating basis or all-inclusive basis should collect and publish supplementary information on holding gains and losses and other extraordinary items. This practice would enhance international comparability for both flows and stock positions.

286. Earnings of a direct investment enterprise are measured net of income or corporation taxes payable without penalty during the recording period by the enterprise to the economy in which that enterprise operates. This practice is followed because such taxes are considered payable by the enterprise and not by its owners. Furthermore, earnings should be calculated net of any provision for depreciation of fixed capital. Depreciation is measured by the value, at current replacement cost, of the reproducible fixed assets used up (as a result of normal wear and tear, foreseen obsolescence, and accidental damage not made good by repair) during an accounting period. In the calculation of depreciation, the expected economic life of an individual asset should be taken into account. Although depreciation should, in principle, be calculated at current replacement cost, often the only data available may be based on historical cost.

287. Dividends payable to direct investors, remitted branch earnings, and interest payable by direct investment enterprises are recorded gross of any withholding taxes. These taxes are deemed paid by the recipient and are transferred to the country of the direct investment enterprise and recorded under transfers.

288. Reinvested (undistributed) earnings of branches and other unincorporated direct investment enterprises and direct investors' shares of earnings, which are not formally distributed, of incorporated direct investment enterprises are deemed to provide additional capital to the enterprises and to increase the value of an economy's stock of foreign assets and liabilities. When such earnings are recorded in the balance of payments, therefore, entries should be made both for direct investment income and for direct investment capital. For example, reinvested earnings attributable to a resident direct investor of a direct investment subsidiary or of a branch should be entered as a credit in the **current account** under direct investment income (income on equity) and as a debit in the ***financial account*** under *direct investment-* abroad (reinvested earnings). Portfolio investors' shares in earnings, which are not formally distributed, of incorporated direct investment enterprises should not be entered in the balance of payments.

289. Direct investors' shares in net losses, other than holding (capital) losses of enterprises, should be recorded as negative income in the direct investment income component of the balance of payments. Thus, the economy recording losses on residents' direct investments made abroad should enter the losses as negative credits, while the economy in which the direct investment is made should record the losses as negative debits. This method of recording losses is used so that the credit side of the component will reflect the compiling economy's net earnings on direct investments made abroad, while the debit side will refer to nonresident direct investors' net earnings on direct investments in the compiling economy.

Stock Dividends, Bonus Shares, and Liquidating Dividends

290. The distribution of earnings, in the form of stock dividends, to nonresident shareholders is construed as a capitalization of current earnings and an alternative to distributing cash dividends. Such earnings distributions are recorded in the balance of payments in the same manner as reinvested earnings (i.e., as investment income in the **current account** and as offsetting equity investment in the ***financial account***). General bonus shares, on the other hand, represent the substitution of one type of equity (paid-up capital or capital stock) for another (reinvested earnings) and thus should not be recorded in the balance of payments. (In some countries, accumulated reserves from reinvested earnings are credited to a reserve account that is converted to bonus shares when the account reaches a certain level.) Liquidating dividends are excluded from *investment income* because such dividends represent returns of capital contributions rather than remittance (distribution) of earnings. Therefore, liquidating dividends should be recorded in the ***financial account*** as withdrawals of capital.

XV. Current Transfers

Definition and Coverage

291. When an entry in the balance of payments records that a resident entity in one economy has provided a nonresident entity with a real resource or a financial item (e.g., goods, the provision of a service, or a financial or nonfinancial asset), the double-entry system requires that an offsetting entry be made. If the offsetting entry does not consist of the provision of a real resource or a financial item, the offset is designated as a transfer. The coverage of transfers in the balance of payments is determined by decisions regarding two issues.

292. The first issue is whether or not the provision of an economic value should be recorded even when no quid pro quo is received. If such a provision is not recorded, no offsetting entry showing a transfer is required. The recommendation in this *Manual*, however, is that the balance of payments statement should show all economic values, including those without a quid pro quo, provided by residents of one economy to residents of another economy. The statement should also show changes in real resources and financial items whenever such changes result from changes of residence (migration) on the part of individuals and whenever the changes affect a specific economy and the rest of the world. The statement should exclude similar changes that come about through changes in the territory of an economy.

293. The second issue concerns the separation of benefits provided or received into (i) those regarded as economic values (i.e., those that constitute real resources or financial items) and (ii) those on which no economic value is placed (i.e., those that do not provide a quid pro quo and thus constitute transfers). The intended distinction between intangible real resources (services and income) and transfers that offer no quid pro quo cannot be precisely defined. (See paragraph 191.) In contrast to real resources, transfers, which may be voluntary or obligatory, often reflect benefits that cannot be quantified (e.g., improved political or economic relationships between parties; nonspecific amounts of services, such as administrative, protective, and defense services made available by governments to taxpayers; or intangibles, such as those involved in carrier registration, provided on a compulsory basis).

294. In a departure from all previous editions of the *Manual*, the fifth edition identifies transfers as ***current*** and *capital*. As a result of this change in treatment, only ***current transfers*** are included in the **current account**; *capital transfers* are included in the ***capital account*** component of the **capital and financial account**. The new treatment reflects international efforts to harmonize the *Manual* with the *SNA* and eliminates a major discordance between the two systems.

Distinction Between Current and Capital Transfers

295. To distinguish ***current transfers*** from *capital transfers*, the reader may find it helpful to focus on the special characteristics of *capital transfers*. First, a transfer in kind is a capital transfer when it consists of (i) the transfer of ownership of a fixed asset or (ii) the forgiveness of a liability by a creditor when no counterpart is received in return. Second, a transfer of cash is a *capital transfer* when it is linked to, or conditional on, the acquisition or disposal of a fixed asset (for example, an investment grant) by one or both parties to the transaction. A *capital transfer* should result in a commensurate change in the stocks of assets of one or both parties to the transaction. *Capital transfers* also may be distinguished by being large and infrequent, but *capital transfers* cannot be defined in terms of size or frequency.

296. ***Current transfers*** consist of all transfers that are not transfers of capital. ***Current transfers*** directly affect the level of disposable income and should influence the consumption of goods or services. That is, ***current transfers*** reduce the income and consumption possibilities of the donor and increase the income and consumption possibilities of the recipient.

297. A cash transfer could be regarded as a *capital transfer* by one party to a transaction and as a ***current transfer*** by the other party. So that a donor and a recipient do not treat the same transaction differently, it is recommended that a transfer be classified as a *capital transfer* by both parties—even if the transfer is linked to the acquisition or disposal of a fixed asset by only one of the parties. On the other hand, if available evidence creates serious doubt that a cash transfer should be classified as a *capital transfer*, the transfer should be classified as a ***current transfer***. (The *Manual* and the *SNA* contain consistent criteria for distinguishing between the two types of transfers.)

Classification

298. ***Current transfers*** are classified, according to the sector of the compiling economy, into two main categories: *general government* and *other sectors*. General government transfers comprise current international cooperation, which covers current transfers—in cash or in kind—between governments of different economies or between governments and international organizations. Included are

cash transfers effected between governments for the purpose of financing current expenditures by the recipient government

gifts of food, clothing, other consumer goods, medical supplies, etc. associated with relief efforts in the wake of famine, earthquakes, other natural disasters, war, or other actions (Administrative costs directly associated with aid are included.)

gifts of certain military equipment, that is, weapons and the equipment to support and deliver weapons, which—by convention—are not treated as fixed assets in the *Manual* or in the *SNA* (Other durable equipment—such as most structures—and transport, hospital, and communications equipment are treated as fixed assets and are included under *capital transfers*. See paragraph 349.)

annual or other regular contributions paid by member governments to international organizations and regular transfers made as a matter of policy by the international organizations to governments

payments by governments or international organizations to governments for salaries of technical assistance staff and for related costs and expenses.

299. Other transfers of general government cover offsets to transactions between governments of compiling economies and nonresidents other than governments and international organizations. Included on the credit side are current taxes on income, wealth, etc. and other transfers, such as social security scheme contributions. Social benefits, refunds of taxes, indemnity payments, and pension payments from unfunded plans are included on the debit side. Other taxes and subsidies on production, including those implicit under a multiple official exchange rate system, are covered when appropriate. (See paragraph 134.)

300. Any fines, penalties, or interest charges on the late payment of taxes are included in the value of taxes. Other fines are treated separately as ***current transfers***. By convention, payments (fees) for carrier registrations or for licenses to fish, hunt, etc. are treated as taxes and included in transfers; other fees, such as those for passports and airport fees, to governments are treated as payments for government services rather than as transfers.

301. ***Current transfers*** between other sectors of an economy and nonresidents comprise those occurring between individuals, between nongovernmental institutions or organizations (or between the two groups), or between nonresident governmental institutions and individuals or nongovernmental institutions. The same basic items (described in paragraphs 298 through 300) for the government sector are generally applicable to other sectors, although there are some differences within components. In addition, there is the category of workers' remittances.

302. Workers' remittances covers ***current transfers*** by migrants who are employed in new economies and considered residents there. (A migrant is a person who comes to an economy and stays, or is expected to stay, for a year or more.) Workers' remittances often involve related persons. Persons who work for and stay in new economies for less than a year are considered nonresidents; their transactions are appropriate mainly to the component for compensation of employees. (See paragraphs 269 through 272.)

303. Other ***current transfers***, in cash or in kind, between resident and nonresident entities include those (such as food, clothing, other consumer goods, medical supplies, etc.) for distribution to relieve hardships caused by famine, other natural disasters, war, etc. and regular contributions (including membership dues) to charitable, religious, scientific, and cultural organizations. Also covered are gifts, dowries, and inheritances; alimony and other support remittances; tickets sold by, and prizes won from, lotteries; and payments from unfunded pension plans by nongovernmental organizations.

304. Included among other transfers are entries made, on the debit side, for private parties for taxes on income, wealth, etc. and social security contributions paid to governments. (These transfers are the counterpart entries to be made, on the credit side, for general government. See paragraph 299.) Conversely, entries made, on the credit side, for social benefits and refunds of taxes to private transactors are the counterparts to such entries on the debit side for government. Premiums (minus service charges) and claims for non-life insurance also are included among ***current transfers***.

305. A remittance from a resident of a specific economy to finance another resident staying abroad only temporarily is a transaction between residents of the same economy rather than a transfer. The goods and services procured abroad by the traveler or other resident to whom the remittance is made are recorded in the balance of payments under *travel.*

Valuation and Timing

306. Often, the value of transfers may not be readily determined because transfers are not perceived as arising directly from the productive process. Transfer values should be the same as the market values of the real and financial resources to which the transfers are offsets. If no actual market values are in evidence, those resources should be valued on the basis of explicit costs incurred in providing the resources or on the basis of amounts that would be received if the resources were sold. In some cases, the donor and the recipient may view the value quite differently. So that the same values are reflected in the balance of payments statements of both the recipient and the donor, the value assigned by the donor is used as the basis for recording.

307. Various taxes, fines, and other transfers imposed by one party on another are recorded as of the date of occurrence of the underlying transactions or other flows that give rise to the liability to pay. Thus, with regard to taxes on income, all deductions at source and regular prepayments of income taxes are recorded in the periods in which the deductions and prepayments occur. However, any final tax liability on income may be recorded in the accounting period in which the liability is assessed. In a number of countries, the assessment period occurs subsequent to the period when the income is earned. Other transfers are recorded when the resources offset by the transfers change ownership.

XVI. Structure and Characteristics of the Capital and Financial Account

Coverage

308. The standard components of both the **current account** and the **capital and financial account** are discussed in Chapter 8. Coverage of the **capital and financial account** is described in paragraphs 172 through 181, and the classification of components appears at the end of the chapter. Capital and financial account transactions presented in this *Manual* are the same as those reflected in the capital and financial accounts of the SNA external accumulation accounts. However, in the balance of payments, the primary basis for classification of the ***financial account*** is functional category (i.e., *direct investment*, *portfolio investment*, *other investment*, and *reserve assets*) while the SNA classification is primarily by type of instrument: monetary gold, currency and deposits, loans, etc. (See Chapter 3 for details of the relationship between the two sets of accounts.) The structure of the **capital and financial account** also is generally compatible with other statistical systems of the IMF and is consistent with the classification of related income components of the **current account** and with the international investment position.

309. The **capital and financial account** of the balance of payments is divided into two main categories: the ***capital account*** and the ***financial account***. The ***capital account*** covers all transactions that involve the receipt or payment of *capital transfers* and *acquisition or disposal of nonproduced, nonfinancial assets*. The ***financial account*** covers all transactions associated with changes of ownership in the foreign financial assets and liabilities of an economy. Such changes include the creation and liquidation of claims on, or by, the rest of the world.

310. All changes that do not reflect transactions are excluded from the **capital and financial account**. The following changes are among those specifically excluded: valuation changes in, or reclassifications of, reserves; changes resulting from territorial or other changes in classification of existing assets (for example, *portfolio investment* to *direct investment*); allocation or cancellation of SDRs; monetization or demonetization of gold; write-offs (that is, changes resulting from the unwillingness or inability of a debtor who resides in one economy to make full or partial repayment including expropriation without compensation—in settlement of a claim to a creditor who resides in another economy and regards part or all of the claim as unrecoverable); and valuation changes, which reflect exchange rate or price changes, in assets for which there are no changes in ownership. When there is a change in ownership and an asset acquired at one price is disposed of at a different price, both assets are recorded at respective market values and the difference in value—holding (capital) gain or loss—is included in the balance of payments.

Capital Account

311. The ***capital account*** consists of two categories: (i) *capital transfers* and (ii) *acquisition or disposal of nonproduced, nonfinancial assets*. In previous editions of the *Manual*, *capital transfers* were included indistinguishably with ***current transfers*** in the **current account**. (The distinction between ***current transfers*** and *capital transfers* is fully discussed in Chapter 15, and *capital transfers* are covered in detail in Chapter 17). *Capital transfers* are classified primarily by sector (i.e., general government and other sectors). Within each, debt forgiveness is specified as category, while migrants' transfers comprises a category under other sectors.

312. In concept, *acquisition or disposal of nonproduced, nonfinancial assets* comprises transactions associated with tangible assets that may be used or necessary for production of goods and services but are not actually produced (e.g., land and subsoil assets) and transactions associated with nonproduced, intangible assets (e.g., patents, copyrights, trademarks, franchises, etc. and leases or other transferable contracts). However, in the case of resident-nonresident transactions in land (including subsoil assets), all acquisition or disposal is deemed to occur between resident units, and the nonresident acquires a financial claim on a notional resident unit. The only exception concerns land purchased or sold by a foreign embassy when the purchase or sale involves a shift of the land from one economic territory to another. In such instances, a transaction in land between residents and nonresidents is recorded under acquisition or disposal of nonproduced, nonfinancial assets. The changes recorded for all of the assets described in this paragraph consist of the total values of assets acquired during the accounting period by residents of the reporting economy *less* the total values of the assets disposed of by residents to nonresidents.

Financial Account

Coverage

313. The foreign financial assets of an economy consist of holdings of monetary gold, SDRs, and claims on nonresidents. The foreign liabilities of an economy consist of indebtedness to nonresidents.

314. To determine whether financial items constitute claims on, or liabilities to, nonresidents, the creditor and debtor must be identified as residents of different economies. The unit in which the claim or liability is denominated—whether the national currency, a foreign currency, or a unit such as the SDR—is not relevant. Furthermore, assets must represent actual claims that are legally in existence. The authorization, commitment, or extension of an unutilized line of credit or the incurrence of a contingent obligation does not establish such a claim, and the pledging or setting aside of an asset (as in a sinking fund) does not settle a claim or alter the ownership of the asset.

315. However, options and other financial derivatives are included among financial items, in accordance with the treatment of these items in the *SNA*. These instruments can be valued by reference to the market prices of the derivatives or to the market prices of the commitments underlying the derivatives. Thus, both parties to a derivative contract recognize a financial instrument; one party recognizes a liability and the other recognizes a claim. Alternatively, this value could be viewed as the amount that one party must pay to the other party in order to extinguish the contract. As a result, derivatives satisfy the definition (see paragraph 314) of foreign financial assets and liabilities. A full discussion of derivative instruments appears in Chapter 19.

316. The conventions stated in this *Manual* result in ownership of some nonfinancial assets being construed as ownership of financial assets (claims). The following specific cases are examples.

The ownership of immovable assets, such as land and structures, is always attributed to residents of the economies in which the assets are located. (See paragraph 64.) Therefore, when the owner of such assets is a nonresident, he has, in effect, a financial claim on a resident entity that is considered the owner.

An unincorporated enterprise operating in a different economy from the one in which the owner of the enterprise resides is considered a separate entity; that entity is a resident of the economy in which it operates rather than a resident of the economy of the owner. All nonfinancial as well as financial assets attributed to such an enterprise are regarded as foreign financial assets for the owner of the enterprise. (See paragraph 205.)

Any goods transferred under a financial leasing arrangement are presumed to have changed ownership. This change in ownership is financed by a financial claim (i.e., an asset of the lessor and a liability of the lessee). At the time the imputed change in ownership occurs, the market value of the good is recorded under ***goods*** in the **current account**, and an offsetting entry is made in the ***financial account***. In subsequent periods, the actual leasing payment must be divided into interest, which is recorded in the **current account** as *investment income* payable or receivable, and debt repayment, which is recorded in the ***financial account*** and reduces the value of the lessor's asset and the lessee's liability. The financial asset should be classified as a loan. (See paragraph 206.)

Transactions in assets

317. Transactions in assets (specifically, changes of ownership, including the creation and liquidation of claims) most often reflect exchanges of economic values. Financial items may be exchanged for other financial items or for real resources. However, one party to a transaction may provide a financial item and not receive any economic value in exchange. The offset to this latter type of provision of an asset is a transfer.

318. To establish whether a transaction involving a foreign asset is a transaction between a resident and a nonresident, the compiler must know the identities of both parties. The information available on transferable claims constituting foreign assets may not, however, permit identification of the two parties to the transaction. That is, a compiler may not be able to ascertain whether a resident, who acquired or relinquished a transferable claim on a nonresident, conducted the transaction with another resident or with a nonresident, or whether a nonresident dealt with another nonresident or with a resident. Thus, a recommendation that the balance of payments be confined solely to asset transactions between residents and nonresidents would be difficult or impossible to implement. Also, the introduction, in this *Manual*, of a domestic sectoral breakdown for the *portfolio investment* and *other investment* components of the ***financial account*** makes it necessary to record certain transactions between resident sectors within the economy—although such transactions cancel each other for the total economy. As a result, recorded transactions may include not only those that involve assets and liabilities and take place between residents and nonresidents but also those that involve transferable assets of economies and take place between two residents and, to a lesser extent, transactions that take place between nonresidents. (See paragraph 334.)

319. Because the credit and debit entries for most components of the ***financial account*** are—according to the rules of this *Manual* (see paragraphs 324 through 327)—generally net, many transactions between residents and between nonresidents will offset each other and thus will not actually appear as entries in the balance of payments statement. The most prevalent types of transactions that do not cancel each other are, for assets, those transactions between resident creditors classified in different functional categories or domestic sectors. For liabilities, the identity of the nonresident creditor is a factor only in a few instances (for example, in differentiating between *direct investment* and other types of capital and in determining regional allocation).

320. Net recording can also result in a transaction between a resident and a nonresident being offset by a transaction between residents or by a transaction between nonresidents. For instance, a resident may acquire a claim against a nonresident and, during the same recording period, transfer the claim to another resident classified in a different sector. The first resident's transaction with a nonresident is canceled by the same resident's subsequent transaction with another resident (if the value of the claim does not change). So, in the balance of payments, only the increase in the second resident's holdings, which are actually acquired through a transaction with the first resident, are recorded. The effect is the same as if the second resident dealt directly with the nonresident.

Reinvested earnings

321. The reinvested earnings of a direct investment enterprise (which accrue to a direct investor in proportion to participation in the equity of the enterprise) are recorded in the **current account** of the balance of payments as being paid to the direct investor as *investment income*-income on equity and in the ***financial account*** as being reinvested in the enterprise. Thus, these reinvested earnings increase the value of the stock of foreign assets of the direct investor's economy. In a similar way, the distribution to direct investors of earnings (in the form of stock dividends) included in *investment income*-income on equity results in an increase, shown in the ***financial account***, in the investors' equity.

Borderline cases

322. In some cases, questions may arise as to whether transactions have taken place; for example—when the maturity of a debt instrument is extended (and thereby changed from a nominally short-term claim to a nominally long-term claim) or when a government takes over an obligation for liabilities incurred by the private sector and the sector of the domestic debtor is altered. As a change in the original terms of a contract requires the assent of both parties, the existing claim is considered to be satisfied by the creation of a new one. (That is, a pair of transactions between a resident and a nonresident has occurred.) Changes in contractual terms for existing assets are thus construed as constituting transactions to be included in the balance of payments statement.

323. Another borderline case arises when a transactor intends to dispose of a certain asset at virtually the same moment that ownership of the asset is acquired. (Examples are arbitrage and certain other dealings in financial assets.) The issue may be viewed two ways. (i) If two changes of asset ownership have occurred, any profit or loss could be regarded as the realization of a holding (capital) gain or loss and could be entered, like any other realization of a holding gain or loss, in the appropriate component of the ***financial account.*** (ii) If no change of ownership has effectively taken place, the profit or loss could be seen as a fee for a service. It is recommended that the treatment described in (i) be used because entries in the ***financial account*** may reflect, without regard to the fact that some items may have been owned only briefly, the holding gain or loss realized on the purchase and sale of financial items at different market prices.

Net recording

324. Two or more changes in a specific asset, or changes in two or more different assets classified in the same standard component, are consolidated in a single entry. This entry reflects the net effect of all the increases and decreases that occur during the recording period in holdings of that type of asset. For example, purchases (by nonresidents) of securities issued by resident enterprises of an economy are consolidated with sales (by nonresidents) of such securities, and the net change is recorded for that item. Net decreases in claims or other assets and net increases in liabilities are recorded as credits; net increases in assets and net decreases in liabilities are recorded as debits.

325. Net recording for standard components distinguished in the **capital and financial account** is specified partly because gross data for transactions often are not available. Changes derived from records showing amounts outstanding at the beginnings and ends of reporting periods, for example, always represent net changes. In addition, net recording generally is of more interest than gross recording, which would give added prominence to the transactions—between residents and between nonresidents—that are covered in the statement. Nonetheless, gross entries may be a relevant factor in analyzing aspects of the payments positions or financial markets (e.g., securities transactions) of economies, and such data can be utilized in supplementary presentations when appropriate.

326. For *direct investment*, particularly for reasons of analytic usefulness, it is suggested in this *Manual* that separate totals for liabilities to, and claims on, direct investors on the part of affiliated enterprises (and vice versa) be recorded for the appropriate components of *direct investment* (i.e., equity capital and other capital) in addition to the net figures for each.

327. In the totaling of net credits and debits for two or more separate components, the net approach is always favored. For instance, if equity securities and debt securities are combined to show a net figure for these two components, the net for each should be totaled—not net credits and debits separately.

Classification

328. The primary purpose of the classification of items in the ***financial account*** is to facilitate analysis by distinguishing categories that exhibit different patterns of behavior. Changes in financial items recorded in the balance of payments occur for a wide variety of reasons. Such changes may occur to settle actual imbalances or to deal with prospective imbalances; to influence or react to exchange rate movements; to make holding (capital) gains (or avoid losses) on past or future valuation changes, including those resulting from exchange rate changes; to take advantage of interest rate differentials; to establish, acquire, or expand enterprises; to obtain or provide additional real resources in connection with commercial and financial activities; and to diversify investments. In the collection of data, it is usually not feasible to inquire into the underlying causes and motivations for changes in holdings. However, behavior is also associated to a considerable degree with such attributes as type of asset and sector of holder. Characteristics of this kind are readily observable and can thus be used as a basis for developing a classification scheme.

329. In this *Manual*, several bases are utilized for classifying financial items: functional type; assets and liabilities; type of instrument; domestic sector; original contractual maturity; and, in the case of *direct investment*, direction of investment (i.e., inward or outward). The primary basis for the classification of components of the ***financial account*** is functional type. Further classification levels in these categories are based upon factors relating to general analytical usefulness and compatibility with other statistical systems. The components can, of course, be rearranged to meet specific analytic requuirements and to include, when appropriate, subordinate and supplementary classification.

Functional types of investment

330. Four broad categories of investment, each of which is dealt with in a subsequent chapter, are distinguished.

Direct investment

The direct investor seeks a significant voice in the management of an enterprise operating outside his or her resident economy. To achieve this position, the investor must almost invariably provide a certain, often substantial, amount of the equity capital of the enterprise. The direct investor may also decide to supply other capital to further enterprise operations. Because of the direct investor's special relationship to the enterprise, his motives in supplying capital will be somewhat different from those of other investors. Thus, the capital supplied by a direct investor will probably exhibit characteristic behavior. *Direct investment* is classified primarily on a directional basis—resident direct investment abroad and nonresident investment in the reporting economy—and is subdivided into equity capital, reinvested earnings, and other capital. Equity capital and other capital, in turn, are subdivided into asset and liability transactions. (Related income, however, is shown on a net basis in the **current account**.)

Portfolio investment

Cross-border investment in equity and debt securities (other than *direct investment*) is both quantitatively and analytically significant. Such cross-border investment therefore warrants separate recording and coverage, particularly in view of the trend towards free international movement of capital and the growth of new financial instruments and new market participants. Coverage of this category is expanded to reflect these developments and to include money market debt instruments and financial derivatives, as well as longer-term debt and equity securities.

Other investment

This residual group comprises many different kinds of investments. In practice, it is not feasible to draw any further functional distinctions among the various types because the reasons underlying the flows are too numerous and varied. Other breakdowns are therefore used to distinguish behavioral differences among components of this category (i.e., trade credits, loans, currency and deposits, use of Fund credit, loans from the Fund, etc.).

Reserve assets

These are foreign financial assets available to, and controlled by, the monetary authorities for financing or regulating payments imbalances or for other purposes. *Reserve assets* consist of monetary gold, SDRs, reserve position in the Fund, foreign exchange, and other claims. Changes in the holdings of reserves may reflect payments imbalances or responses to them, official exchange market intervention to influence the exchange rate, and/or other actions or influences.

Assets and liabilities

331. The distinction between assets and liabilities is always of interest. Even for financial intermediaries, which in effect borrow and relend abroad the same funds, the terms of the borrowing and lending are usually different. Thus, the two offsetting flows may have different implications for the balance of payments.

Type of instrument

332. For *portfolio investment*, the type of instrument is the primary classification (i.e., equity and debt securities). Debt securities are subdivded into bonds and notes, money market instruments, and financial derivatives. Although the sectoral subdivision for *portfolio investment* is secondary, there is no implication that, in certain instances, it may not be of equal interest to the compiling economy. The same holds true for *other investment*.

Domestic sector

333. For assets, the institutional sector of the domestic (resident) creditor and, for liabilities, that of the domestic debtor often are factors that influence transactions in financial items. The sectoring also improves links with the IMF and other statistical systems, including the SNA. This *Manual* distinguishes four sectors—monetary authorities, general government, banks, and other sectors[8]—for both *portfolio investment* and *other investment*.

334. Because the domestic creditor is always the owner of the asset, the creditor is invariably one party to any change of ownership of the asset. Therefore, for assets, sector attribution by creditor and by transactor coincide. A claim on a domestic debtor, however, may change ownership between a domestic creditor and a foreign creditor so that the domestic sector of the debtor may not coincide with that of the transactor. Nevertheless, the sector of the debtor is the one that determines the classification of the change of ownership that has occurred because the original nature of the liability is generally considered more significant than the identity of the present holder of the claim. However, in those instances in which the nonresident creditor or transactor may be of particular interest (e.g., in the context of international banking and external debt statistics), a supplementary breakdown by nonresident sector would be most useful for the compiling economy.

335. For determination of the domestic sector to which a transaction is attributed, guarantees and financial intermediation in which the intermediary is not actually

[8]See Appendix 2.

the legal creditor or debtor are not taken into account. Although these aspects undoubtedly have an influence on the behavior of investment, they seem unlikely to constitute the main motivation of the financial flow in question. For instance, while the availability of government credit insurance could be a factor in the exten-sion of a trade credit, the private exporter's decision to undertake the underlying transaction in goods and to arrange the financing for it is presumably a more basic consideration. Government-insured trade credits are thus treated as private trade credits rather than as government lending.

Long- and short-term investment

336. For assets and liabilities in the category of *other investment*, this *Manual* retains the traditional distinc-tion, which is based on the formal criterion of original contractual maturity, between long- and short-term investment. Long-term investment is defined as investment with an original contractual maturity of more than one year or with no stated maturity (e.g., equity securities). Short-term investment, which includes currency, is investment payable on demand or with an original contractual maturity of one year or less. These definitions are consistent with those in the *SNA*.

337. Although the traditional maturity distinction has been retained, it is widely recognized that innovations in financial markets (e.g., floating rate notes, rollovers, etc.) have diminished the usefulness of such a distinction for many purposes. In fact, a creditor and a debtor could, for example, have different views as to whether a particular instrument represents access to medium-term financing even though it is nominally a short-term instrument. Also, in many instances, original maturity may have no bearing on the length of time that an investment will be held. (Original maturity does appear to be one factor taken into account by investors and may tend to influence the behavior of the invest-ment concerned.) In any event, the distinction is one that is still widely employed and can be applied without posing major problems of compilation. How-ever, in the *Manual* and the *SNA*, maturity distinction is accorded lesser importance as a classification criterion.

338. Nonetheless, there are examples of the significance that continues to be assigned to the original maturity (e.g., for the analysis of external liabilities, particularly in relation to those of heavily indebted economies). In other instances, such as analyses of banks' liquidity positions, a residual maturity basis may be appropriate and can be accommodated in supplementary disaggregations.

339. In the categories of *direct investment*, *portfolio investment*, and *reserve assets*, long- and short-term investment are not formally distinguished. For *direct investment*, such a distinction is not made because it is essentially determined by arbitrary enterprise decisions and because of the fact that there is no meaningful analytic distinction between the two maturities for intercompany flows. For *portfolio investment* and *reserve assets*, formal maturity is not likely to be a significant factor affecting the behavior of the components of the categories.

Liabilities Constituting Foreign Authorities' Reserves (LCFARs)

340. LCFARs are no longer identified among the financial items of the *portfolio investment* and *other investment* categories of the ***financial account***. Rather, LCFARs are subdivided by instrument and sector in a supplementary presentation and discussed, along with exceptional financing transactions, in Chapter 22.

Valuation and Timing

341. Resources included under *capital transfers* should be valued at the prices that would have been received if the resources had been sold. The value assigned by the donor should be used as the basis for recording. The forgiveness of debts agreed to by the parties concerned are valued in the same way as other changes in financial assets and liabilities. *Acquisition or disposal of nonproduced, nonfinancial assets* is recorded at the actual transaction value of assets acquired less assets disposed of. Changes in financial assets and liabilities that stem from transactions between two parties are valued to reflect the market values of the assets underlying the acquisition or disposition. The concept of market value and the specific application of market value to financial items are discussed in Chapter 5.

342. *Acquisition or disposal of nonproduced, nonfinancial assets* and transactions in financial items are recorded on a change-of-ownership basis. When change of ownership is not obvious, the time at which a transaction is considered to take place is when the parties to the transaction enter the transaction (or, for financial items, the claim and liability) on their books. For many financial transactions, a date (the value date) is actually specified for the very purpose of ensuring that the timing agrees in the books of both parties. (See Chapter 6.) If no precise date can be fixed, the date on which the creditor receives payment or some other financial claim is decisive.

XVII. Capital Transfers and Acquisition or Disposal of Nonproduced, Nonfinancial Assets

Coverage

343. The ***capital account,*** as constituted in this edition of the *Manual,* differs markedly from the capital account in previous editions. (See chapters 8 and 16.) The former capital account has been expanded and redesignated as the **capital and financial account,** which is comprised of those two major categories. This chapter encompasses the first—the ***capital account***, the components of which are *capital transfers* and *acquisition or disposal of nonproduced, nonfinancial assets.*

Capital Transfers

344. The distinction between *capital transfers* and ***current transfers*** is discussed in Chapter 15. A *capital transfer* may be in cash or in kind. If in cash, the transfer is linked to, or conditional on, the acquisition or disposal of a fixed asset by one or both parties to the transaction (e.g., an investment grant). Although one party may regard particular transfers as current rather than capital, a transfer should be classified as a *capital transfer* for both parties even if it is linked to the acquisition or disposal of a fixed asset by only one of the parties. However, if there is serious doubt as to the classification of a cash transfer as current or capital, the transfer should be classified as a ***current transfer***.

345. If in kind, the *capital transfer* consists of (i) the transfer of ownership of a fixed asset or (ii) the forgiveness, by mutual agreement between creditor and debtor, of the debtor's financial liability when no counterpart is received in return by the creditor. Criteria (referred to in previous paragraphs and in Chapter 15) for classification of transfers as current or capital are fully consistent with criteria in the *SNA.*

Classification

346. *Capital transfers* are classified into two sectoral components: (i) general government and (ii) other sectors. Within each of these components, debt forgiveness is separately identified. In other sectors, migrants' transfers also are separately identified.

General government

347. Under general government, the following categories of transfers are to be distinguished for purposes of balance of payments recording.

Debt forgiveness

348. When a government creditor entity in one economy formally agrees—via a contractual arrangement—with a debtor entity in another to forgive (extinguish) all, or part, of the obligations of the debtor entity to that creditor, the amount forgiven is treated as a *capital transfer* from the creditor to the debtor. That is, the balance of payments reflects a reduction of the liability offset by the transfer. Similar treatment is applicable when a government entity's debt is forgiven by agreement with a creditor entity in another economy. (The detailed accounting treatments of debt forgiveness under varying circumstances, of arrears and other aspects of debt reorganization, and of exceptional financing are covered in Chapter 22.)

Other general government

349. Among other *capital transfers* of general government, investment grants are significant. Investment grants consist of *capital transfers*, in cash or in kind, made by governments to nonresident units, or vice versa, to finance all or part of the costs of acquiring fixed assets. The recipients are obliged to use investment grants in cash for purposes of gross fixed capital formation, and the grants are often tied to specific investment projects, such as large construction projects. If the investment project continues over a long period of time, an investment grant in cash may be paid in installments. Installment payments continue to be classified as *capital transfers* even though such payments may be recorded in a succession of different accounting periods. Investment grants in kind consist of transfers of transport equipment, machinery, other equipment, and the direct provision of buildings or other structures by governments to nonresident units. Most structures (such as airfields, docks, roads, hospi-tals, and other buildings) used by military establishments also are treated as *capital transfers*. These structures may be constructed by enterprises owned by the donor government or by other enterprises that are paid directly by the donor government. Investment grants do not include transfers of military equipment in the form of weapons or equipment with the sole function of being fired. Such weapons and equipment are not classified as fixed assets but, by convention, are included under ***current transfers***. (See Chapter 15.)

350. Also included under governmental *capital transfers* are taxes on *capital transfers*; that is, taxes levied, at irregular and infrequent intervals, on the values of assets transferred to nonresidents. These consist largely of inheritance taxes, death duties, and gift taxes. Compensation payments by government to nonresidents for extensive damages to capital assets or serious injuries not covered by insurance policies represent another form of *capital transfers*. These include payments for damages caused by oil spills, major explosions, the side effects of drugs, etc.

Other sectors

351. Among *capital transfers* of sectors other than general government, migrants' transfers, debt forgiveness, and other transfers are distinguished as balance of payments reporting categories.

Migrants' transfers

352. In the strictest sense, these transfers are not transactions between two parties but contra-entries to flows of goods and changes in financial items that arise from the migration (change of residence for at least a year) of individuals from one economy to another. The transfers to be recorded are thus equal to the net worth of the migrants.

353. All the household and personal effects of migrants, together with any movable capital goods actually transferred from the old to the new economy, are included under ***goods****-general merchandise*. Those flows of goods and corresponding offsets should, in principle, be recorded at the time of migration. If the flows are not derived from the trade returns, no timing correction of the figures is suggested, but offsets are recorded in the same period in which exports and imports are recorded.

354. Enterprises (including those that utilize land, structures, and movable capital goods not actually transferred) in which migrants retain ownership after departure become foreign claims of the migrants and, consequently, of the economies to which they have migrated. Migrants' claims on or liabilities to other residents of their former economies or claims on or liabilities to residents of a third economy also become foreign claims or liabilities of the economies to which they have migrated. Migrants' claims on or liabilities to the latter economies become claims between residents of these economies. Changes in the net financial assets of the relevant economies and the offsets thereto are recorded at the times of migration.

355. In practice, it is recognized that few countries are in a position to record all assets (other than possessions and funds accompanying migrants upon entry to new economies) in the balance of payments. Also, some countries treat those possessions and funds as transfers and record the remaining net worth of migrants as changes in the stock of claims in the international investment position. In such cases, the changes should be separately identified in reports made to the IMF.

Debt forgiveness

356. Paragraph 348, with references to "government entity" replaced by "nongovernment entity," is relevant.

Other transfers

357. With references to "government entities" replaced by "nongovernment entities," the discussion on investment grants in paragraph 349 is relevant. Compensation payments detailed in paragraph 350 are relevant, but the payments are made by nongovernment entities. The same applies, for nongovernment entities, to debit-side entries for taxes (i.e., inheritance taxes, death duties, and gift taxes levied at irregular and infrequent intervals) referred to on the credit side for general government. Also recorded under the investment grant portion of other transfers are legacies or large gifts—including legacies to nonresident, nonprofit institutions (NPIs)—and exceptionally large donations made by households or enterprises to nonresident NPIs for financing gross fixed capital formation. (Examples are gifts to universities to cover costs of building new residential quarters, libraries, laboratories, etc.)

Acquisition or Disposal of Nonproduced, Nonfinancial Assets

358. This category of the ***capital account*** is described in Chapter 16. *Acquisition or disposal of* *nonproduced, nonfinancial assets* comprises, in concept, acquisition or disposal of nonproduced, tangible assets (land and subsoil assets) and acquisition or disposal of nonproduced, intangible assets, such as patents, copyrights, trademarks, franchises, etc. and leases or other transferable contracts. (See paragraph 312 for the treatment of such resident/nonresident transactions.) In the balance of payments accounts, it is the intangible assets category that generally would be most applicable. It is necessary to distinguish between the **use** of such assets (recorded under ***services***-*royalties and license fees*) and the **purchase** or **sale** of assets (recorded in the intangible assets category of the ***capital account***) if data are available. (Valuation and timing of *capital transfers* and *acquisition or disposal of nonproduced, nonfinancial assets* are discussed in Chapter 16, paragraphs 341 and 342.)

XVIII. Direct Investment

Concept and Characteristics

359. *Direct investment* is the category of international investment that reflects the objective of a resident entity in one economy obtaining a lasting interest in an enterprise resident in another economy. (The resident entity is the direct investor and the enterprise is the direct investment enterprise.) The lasting interest implies the existence of a long-term relationship between the direct investor and the enterprise and a significant degree of influence by the investor on the management of the enterprise. *Direct investment* comprises not only the initial transaction establishing the relationship between the investor and the enterprise but also all subsequent transactions between them and among affiliated enterprises, both incorporated and unincorporated.

360. The concept of *direct investment* presented in this *Manual* is the basis for that adopted in the second edition of the *OECD Detailed Benchmark Definition of Foreign Direct Investment*. The concept described in this *Manual* is broader than the *SNA* concept of foreign-controlled, as distinguished from domestically controlled, resident enterprises. In the *SNA,* that distinction (as well as the one between public and private enterprises) is made in the compilation of various accounts because of the distinction's potential analytic usefulness in the examination of differences (characteristics such as value added, investment, employment, etc.) between enterprise subsectors. Thus, linkage of the direct investment component of the ***financial account*** with the foreign-controlled sector is by no means a complete one, primarily because the two serve different purposes. As presented in this *Manual*, the primary distinguishing feature of *direct investment* is the significant influence that gives the investor an effective voice in management. For the foreign-controlled sector, the primary distinguishing feature is control.

361. The benefits that direct investors expect to derive from a voice in management are different from those anticipated by portfolio investors having no significant influence over the operations of enterprises. From the viewpoint of direct investors, enterprises often represent units in a multinational operation, the overall profitability of which depends on the advantages to be gained by deploying the various resources available to the investors in units located in different economies. Direct investors are thereby in a position to derive benefits in addition to the investment income that may accrue on the capital that they invest (e.g., the opportunity to earn management fees or other sorts of income). Such extra benefits are likely to be derived from the investors' associations with the enterprises over considerable periods of time. In contrast, portfolio investors are primarily concerned about the safety of their capital, the likelihood of appreciation in value, and the return generated. Portfolio investors will evaluate, on a separate basis, the prospects of each independent unit in which they might invest and may often shift their capital with changes in these prospects, which may be affected by short-term developments in financial markets.

Direct Investment Enterprises

362. Reflecting the difference noted previously, a direct investment enterprise is defined in this *Manual* as an incorporated or unincorporated enterprise in which a direct investor, who is resident in another economy, owns 10 percent or more of the ordinary shares or voting power (for an incorporated enterprise) or the equivalent (for an unincorporated enterprise). Direct investment enterprises comprise those entities that are subsidiaries (a nonresident investor owns more than 50 percent), associates (an investor owns 50 percent or less) and branches (wholly or jointly owned unincorporated enterprises) either directly or indirectly owned by the direct investor. (See the *Guide* for examples of chains of ownership.) Subsidiaries in this connotation also may be identified as majority owned affiliates. As defined in the *SNA*, foreign-controlled enterprises include subsidiaries and branches, but associates may be included or excluded by individual countries according to their qualitative assessments of foreign control. Also, a public enterprise, as defined in the *SNA*, may in some instances be a direct investment enterprise, as defined in this paragraph.

363. Although the 10 percent criterion is specified in the *Manual*, some countries may choose to allow for two qualifications that involve a degree of subjective judgment. First, if the direct investor owns less than 10 percent (or none) of the ordinary shares or voting power of the enterprise but has an effective voice in management, the enterprise may be included. Second, if the investor owns 10 percent or more but does not have an effective voice in management, the enterprise may be excluded. Although the application of these two qualifications is not recommended in this *Manual*, countries that apply such qualifications should identify the aggregate value of transactions in order to facilitate international comparability.

364. Most direct investment enterprises are either (i) branches or (ii) subsidiaries that are wholly or majority owned by nonresidents or in which a clear majority of the voting stock is held by a single direct investor or group. The borderline cases are thus likely to form a rather small proportion of the universe.

365. In this *Manual,* it is recommended that so-called special purpose entities (SPEs) be included as direct investment enterprises if the entities meet the criteria stated in previous paragraphs. Whatever the structure (e.g., holding company, base company, regional headquarters) or purpose (e.g., administration, management of foreign exchange risk, facilitation of financing of investments), SPEs are an integral part of the structure of the direct investment network as are, for the most part, SPE transactions with other members of the group. However, for SPEs with a sole purpose of serving in a financial intermediary capacity (as is the case for banks and other financial intermediaries such as security dealers), transactions recorded under *direct investment* are limited to those associated with permanent debt and equity. (See paragraph 372.) For countries employing other treatments of SPEs and countries employing the recommended treatment (if it is feasible to do so), the value of SPE transactions as a group should be separately identified in terms of standard components to permit consistent international comparisons.

366. Special relationships may exist between or among enterprises operating in different economies. These relationships may involve a common board of directors, a high degree of policy coordination, and/or—in the absence of any ownership of equity interest that signifies *direct investment*—a pooling of resources. If transactions between or among such enterprises are treated by individual countries as *direct investment*, these transactions should be identified as specified in paragraph 365.

Direct Investors

367. Direct investors may be individuals; incorporated or unincorporated private or public enterprises; associated groups of individuals or enterprises; governments or government agencies; or estates, trusts, or other organizations that own (as described previously) direct investment enterprises in economies other than those in which the direct investors reside. The members of an associated group of individuals or enterprises are, through their combined ownership of 10 percent or more, deemed to have an influence on management that is similar to the influence of an individual with the same degree of ownership.

Direct Investment Capital

368. Direct investment capital is (i) capital provided (either directly or through other related enterprises) by a direct investor to a direct investment enterprise or (ii) capital received from a direct investment enterprise by a direct investor. For the economy in which the investment is located, such capital includes funds provided directly by the direct investor and funds provided by other direct investment enterprises associated with the same direct investor. For the economy of the direct investor, such capital includes only funds provided by the resident investor. Direct investment capital does not include funds provided by, or received from, any other sources—including sources of funds for which the direct investor merely makes the arrangements or guarantees repayment (e.g., loans from outside parties to an incorporated direct investment enterprise).

369. The components of direct investment capital transactions, which—as noted in paragraph 330—are recorded on a directional basis (i.e., resident direct investment abroad and nonresident direct investment in the recording economy), are equity capital, reinvested earnings, and other capital associated with various intercompany debt transactions. Equity capital comprises equity in branches, all shares in subsidiaries and associates (except nonparticipating, preferred shares that are treated as debt securities and included under *direct investment*-other capital—see paragraph 370), and other capital contributions. Reinvested earnings consist of the direct investor's share (in proportion to direct equity participation) of earnings not distributed as dividends by subsidiaries or associates and earnings of branches not remitted to the direct investor. If such earnings are not identified, all branch earnings are considered, by convention, to be distributed. Because undistributed (reinvested) earnings result in additions to direct investors' equity in subsidiaries and branches, these earnings are included as direct investment capital transactions in amounts equal to (and with opposite sign) the corresponding entries recorded under direct investment income. (See paragraphs 278, 288, and 321.)

370. Other direct investment capital (or intercompany debt transactions) covers the borrowing and lending of funds—including debt securities and suppliers' credits—between direct investors and subsidiaries, branches, and associates. The borrowing and lending are reflected in intercompany claims and liabilities (receivables and payables), respectively. Both loans to subsidiaries from direct investors and loans from subsidiaries to direct investors are included. In contrast to the treatment of *other investment*, no distinction is made between short- and long-term investment.

371. Instances of reverse investment or cross participation may arise. A direct investment enterprise can have an interest in its direct investor. That interest is regarded as an offset to capital invested by the direct investor (i.e., as disinvestment). For the economy of the direct investment enterprise, such reverse investment in the form of equity is recorded under *direct investment* in reporting economy-equity capital-claims on direct investors. For the economy of the direct investor, reverse investment in the form of equity is recorded under *direct investment* abroad-equity capital-liabilities to affiliated enterprises. Reverse investment in the form of other instruments should be recorded, under *direct investment* in reporting economy-other capital or *direct investment*-abroad-other capital. In cases in which the equity participation is at least 10 percent in both directions, two direct investment relationships are established. Such transactions are recorded as direct investment claims and liabilities in both directions; that is, as *direct investment*-in reporting economy and as *direct investment*-abroad, for each economy as appropriate.

372. Intercompany transactions between affiliated banks (depository institutions) and affiliated financial intermediaries (e.g., security dealers)—including SPEs with the sole purpose of serving as financial intermediaries—recorded under direct investment capital transactions are limited to those transactions associated with permanent debt (loan capital representing a permanent interest) and equity (share capital) investment or, in the case of branches, fixed assets. Deposits and other claims and liabilities related to usual banking transactions of depository institutions and claims and liabilities of other financial intermediaries are classified, as appropriate, under *portfolio investment* or *other investment*. The stock of foreign assets and liabilities of banks and other financial intermediaries (international investment position) should be treated in a parallel manner.

373. Transactions through SPEs (with the exceptions noted in paragraphs 365 and 372) are included in direct investment capital transactions, and the related stocks of assets and liabilities are covered in the direct investment position.

374. Direct investment capital transactions include those that create or dissolve investments as well as those that serve to maintain, expand, or reduce investments. Thus, when a nonresident who previously had no equity in an existing resident enterprise purchases 10 percent or more of the shares or voting power of that enterprise from a resident, the market value of equity holdings acquired and any other capital invested should be recorded as *direct investment*. When a nonresident holds less than 10 percent of the shares of an enterprise as a portfolio investment and subsequently acquires additional shares resulting in a direct investment interest (10 percent or more), only the purchase of additional shares is recorded as a direct investment transaction. The holdings that were acquired previously are not recorded in the balance of payments but are reflected in a reclassification, from *portfolio investment* to *direct investment*, in the international investment position.

Extent of Net Recording

375. *Direct investment* is often referred to as an asset for the economy of the direct investor and as a liability for the economy in which the direct investment enterprise operates. Actually, investor and enterprise have claims on, or liabilities to, each other—although the investor could be expected to have net foreign claims and the enterprise to have net foreign liabilities. It is recommended in this *Manual* that direct transactions in equity capital and other capital (intercompany debt) be recorded for assets (claims) and liabilities. Thus, in addition to a net investment transaction for each of these components, separate entries are made for the change in claims of direct investors on, and the change in liabilities to, affiliated enterprises. These entries are made under *direct investment*-abroad and vice versa for *direct investment*-in reporting economy. For recording of *direct investment* in the international investment position, the same entries are made. See the table presenting the standard components of the international investment position at the end of Chapter 23. However, as noted in Chapter 23, the related direct investment income on equity and debt is shown on a net basis for each direction.

Valuation of Flows and Stocks

376. In concept, market price is the basis for valuation of flows and stocks, including those for direct investment, in the international accounts. (See Chapter 5, particularly paragraphs 97 through 103, for a full discussion covering transfer prices of affiliated enterprises and Chapter 5, paragraphs 107 through 108, together with Chapter 23, for discussions on valuation of stocks.)

377. Although this *Manual*, in concordance with the *SNA,* affirms the principle of using market price as the basis for valuation, it is recognized that, in practice, book values from the balance sheets of direct investment enterprises (or investors) often are used to determine the value of the stock of *direct investment.* This practice reflects the fact that enterprise balance sheet values—whether or not regularly revalued to current market value or recorded on the basis of historical cost or based on some interim but not current revaluation—represent the only source readily available in most countries. (In the first case, the balance sheet value is, in fact, the market value.) Compliers are encouraged to collect data from enterprises on a current market value basis to narrow the gap between principle and practice. To facilitate international comparisons, countries that publish data based on market values derived indirectly should, when it is feasible, also publish data collected on a balance sheet (book value) basis if the two types of data differ. (See paragraph 467.)

Other Special Cases of Direct Investment Enterprises

378. In addition to the SPEs referred to in paragraphs 365 and 372, other types of enterprises—some of which are referred to in earlier chapters—warrant additional discussion.

379. Because of the rather complex operations of insurance enterprises, there may be some difficulties with the availability of data from direct investment branches and subsidiaries. Nonetheless, the transactions of insurance companies are treated in the same manner as transactions of industrial and commercial enterprises, except that the technical reserves (e.g., actuarial reserves against outstanding risks, prepayments of premiums, reserves for with-profits insurance, and reserves against unsettled claims) of insurance enterprises are excluded from the stock of *direct investment.*

380. Construction enterprises involved in work undertaken in other economies may be classified as either direct investment activity or as export of services. The criteria to determine the classification and the attribution of production are linked to the question of residency and are fully discussed in Chapter 4, paragraph 78.

381. The residency of offshore enterprises—including those engaged in the assembly of components manufactured elsewhere, those engaged in trade and financial operations, and those located in special zones—is attributed to the economies in which the enterprises are located. (See paragraph 79.)

382. Private, nonbusiness real estate investment (e.g., holiday and other residences owned by nonresidents for personal use or leased to others) is, in principle, included in *direct investment.*

383. Expenditures of direct investment enterprises established for exploration of minerals and other natural resources in an economy are treated as capital expenditures (fixed capital formation), according to the *SNA.* Inward investment flows from the direct investor abroad for such expenditures are, of course, recorded in the balance of payments. If the exploration proves unsuccessful and results in a shutdown of the enterprise, no further balance of payments entries are recorded. Rather, a negative stock adjustment is made in the direct investment position of the direct investor in the host economy, and an equal reduction is made in the liability position of that economy. (Both adjustments fall under the heading Other Adjustments in the international investment position. (See the table at the end of Chapter 23.)

Selected Supplementary Information

384. There are aspects of *direct investment*—other than those directly related to balance of payments and international investment position data—that may, particularly in the host economy, be of interest from analytical and policy-making points of view. Among such aspects are those pertaining to the financial structure and operations of subsidiaries, associates, branches, and direct investors. Examples are the values of total assets of enterprises, complete balance sheets and income statements, the composition of sales and of external financing, employment, industry activity of direct investment enterprises and of direct investors, geographic allocation of activities (see Chapter 24), the value added or the gross product of subsidiaries in relation to the total GDP of the economies involved, and the country of the ultimate beneficial owner. Information of this type, along with balance of payments and international investment position data, may be collected in enterprise surveys. (See the *Guide*.)

XIX. Portfolio Investment

Coverage

385. *Portfolio investment* includes, in addition to equity securities and debt securities in the form of bonds and notes, money market instruments and financial derivatives such as options. Excluded are any of the aforementioned instruments included in the categories of *direct investment* and *reserve assets*. The expanded coverage in transactions reflects changes in international financial markets in recent years and includes the introduction of many new financial instruments within the framework of continuous innovation.

386. Thus, both the coverage and classification of *portfolio investment* are significantly revised in this *Manual*. The formal distinction between long- and short-term investment—the former referring to original maturity of more than one year or no stated maturity and the latter referring to original maturity of one year or less or on demand—is not made for *portfolio investment* for reasons noted previously. (See paragraphs 336 through 339.) The fact that original maturity is now less important for many market participants in investment and lending activities resulted in the inclusion of additional instruments within *portfolio investment*. (In previous editions of the *Manual,* short-term instruments were excluded and treated as other capital.) The classification scheme reflects financial market developments and efforts to improve links with the SNA and other statistical systems of the IMF.

Classification and Definitions

387. The categories of financial instruments classified and defined in the *Manual* are generally consistent with those in the *SNA*. The major components of *portfolio investment,* which are classified under assets and liabilities, are equity securities and debt securities. Both are usually traded (or tradable) in organized and other financial markets. Debt securities are subdivided into bonds and notes, money market instruments, and financial derivatives that include a variety of new financial instruments.

388. Equity securities covers all instruments and records acknowledging, after the claims of all creditors have been met, claims to the residual values of incorporated enterprises. Shares, stocks, participation, or similar documents (such as American Depositary Receipts) usually denote ownership of equity. Preferred stock or shares, which also provide for participation in the distribution of the residual value on dissolution of an incorporated enterprise, are included. (For preferred shares that do not provide for such participation, see paragraph 390.) Mutual funds and investment trusts also are included.

389. Debt securities cover (i) bonds, debentures, notes, etc.; (ii) money market or negotiable debt instruments; and (iii) financial derivatives or secondary instruments, such as options, that usually do not extend to actual delivery and are utilized for hedging of risks, investment, and trading purposes.

390. Bonds, debentures, notes, etc. usually give the holder the unconditional right to a fixed money income or contractually determined variable money income. (Payment of interest is not dependent upon the earnings of the debtor.) With the exception of perpetual bonds, bonds and debentures also provide the holder with the unconditional right to a fixed sum as a repayment of principal on a specified date or dates. Included are nonparticipating preferred stocks or shares, convertible bonds, and bonds with optional maturity dates, the latest of which is more than one year after issue.[9] This category also includes negotiable certificates of deposit with maturities of more than one year; dual currency bonds; zero coupon and other deep discounted bonds; floating rate bonds; indexed bonds; and asset-backed securities, such as collateralized mortgage obligations and participation certificates. (Mortgages are not classified as bonds but are included under loans.)

391. Money market securities generally give the holder the unconditional right to receive a stated, fixed sum of money on a specified date. These instruments usually are traded, at a discount, in organized markets; the

[9]The conversion (into equities) option may be considered a tradable derivative (i.e., an asset separate from the underlying security). See paragraph 392. Separation of the value of a transaction into the value of the bond and the value of the option may be effected by reference to transactions in similar bonds traded without options.

discount is dependent upon the interest rate and the time remaining to maturity. Included are such instruments as treasury bills, commercial and financial paper, bankers' acceptances, negotiable certificates of deposit (with original maturities of one year or less), and short-term notes issued under note issuance facilities (NIFs)—even though the facility (itself contingent) provided by banks typically is a longer-term arrangement. (Repurchase agreements, which are nonnegotiable and of different character, are classified under loans in *other investment*.)

392. Certain financial instruments give the holder the qualified right to receive an economic benefit in the form of cash, a primary financial instrument, etc. at some future date. These instruments are referred to as derivatives or secondary instruments because of the linkage to specific financial instruments or to indicators (foreign currencies, government bonds, share price indices, interest rates, etc.) or to particular commodities (gold, sugar, coffee, etc.) that may be purchased or sold at a future date. Derivatives also may be linked to a future exchange, according to a contractual arrangement, of one asset for another. The instrument, which is a contract, may be tradable and have a market value. In that case, the characteristics of the instrument as a contingent asset or liability (not to be recorded in the balance of payments or in SNA sectoral balance sheets) change and give rise to treatment of the instrument as an actual financial asset or liability in the ***financial account***. Among derivative instruments are options on currencies, interest rates, commodities, indices, etc.; traded financial futures; warrants; and arrangements such as currency and interest rate swaps.

393. Transactions in derivatives are treated as separate (mainly financial) transactions rather than included as integral parts of underlying transactions to which the derivatives may be linked as hedges. There are several reasons for this treatment, which is consistent with that in the SNA. The counter party to a derivative transaction will be a different transactor than the transactor for the underlying transaction being hedged. Also, the two parties to the derivative transaction may have different motives—hedging, dealing in the instrument involved, or acquiring the derivative as an investment. Even if both parties are hedging, the hedging may be associated with different financial or other assets. If derivative transactions were included as integral parts of underlying transactions, such treatment would lead to asymmetries of measurement in the balance of payments accounts. For example, the counter party to a derivative contract that hedges an underlying position with a resident may also be a resident. In such an instance, the inclusion of the derivative as part of the underlying transaction would result in the incorrect inclusion of transactions in the balance of payments.

394. Equity and debt securities are further subdivided by institutional sector—of the resident creditor for assets and the resident debtor for liabilities. Supplementary subdivisions by nonresident sector also may be of analytical interest, as would subdivisions of securities into new issues, transactions in outstanding issues, redemptions of debt securities, and distinctions between components denominated in domestic and foreign currencies.

Selected Recording Issues

395. The expanded coverage, which includes traditional and new money market and derivative instruments and innovative long-term securities, of *portfolio investment* raises issues concerning the recording of balance of payments entries associated with these instruments. Such issues are discussed, for selected instuments, in subsequent paragraphs.

396. Zero coupon (and other deep discounted) bonds are single payment, long-term securities that do not involve periodic interest payments (or pay little interest) during the life of the bond. Instead, such a bond is sold at a discount from par value and the full return is paid at maturity. Thus, the difference between the discounted issue price and the price at maturity is substantial. This difference is treated as interest income and is recorded as accruing (i.e., converted into a series of monthly quaterly or annual payments) over the life of the bond. The difference (interest income) is not recorded when due for payment. (The offset to the interest income is entered under debt securities in the ***financial account*** and has the effect of the interest being reinvested.) Thus, the cost of providing the capital is matched to the periods for which the capital is provided. If, prior to maturity, a zero coupon or deep discounted bond is traded in the secondary market, the transaction price may include a realized holding gain or loss in addition to accrued interest. That change is included in entries to the ***financial account*** for the purchase and sale of the bond at market prices. Prevailing interest rates reflecting the difference between the new owner's cost and the value of the bond at maturity should be used for the subsequent recording of interest on the bond. (See paragraph 283.)

397. Index-linked securities are instruments for which either the coupon payments or the principal are linked to a specific price index, to the price of a commodity, to an exchange rate index, or the like. The objective, in addition to earning interest income, is to conserve purchasing power during a period of inflation. When coupon payments are index-linked, the payments are treated as interest income, as is the case with any financial asset that has a variable interest rate. When the value of the principal is indexed, the issue price of the security is recorded as the principal, and the change in value resulting from indexation—periodically and at maturity—is treated as interest income. The change in value related to indexation should be estimated and recorded as interest income over the life of the security, and the offset should be recorded under debt securities in the ***financial account***.

398. Among money market and derivative instruments and arrangements, the treatment of short-term notes issued under NIFs, options, warrants, swaps, traded financial futures, and forward rate agreements are noted subsequently.

399. A note issued under an NIF (usually a medium-term arrangement of five to seven years) is a short-term instrument (e.g., three to six months) issued by a borrower in its own name under a contractual commitment with a bank or group of banks either to underwrite the notes and purchase any unsold notes at particular borrowing or roll-over dates or to provide stand-by credits. The facility is a form of revolving credit, and the paper issued often is referred to as a Euronote or promissory note. If the borrower is a bank, the paper is, in effect, a certificate of deposit. (At times, a facility is arranged to issue short-term notes without an underwriting commitment, but usually there is a separate stand-by credit commitment. The notes so issued are referred to as Eurocommercial paper.)

400. As for balance of payments recording, the creation of NIFs does not require entries in the ***financial account*** because the NIFs are contingent. When notes are issued and sold under an NIF, that transaction is recorded with the sale entered as a liability for the borrower and as an asset for the buyer (the bank or other investor). Repayments are entered accordingly. However, any fees associated with the creation and operation of NIFs or bank placements of notes with other investors are entered in *financial services* in the **current account**. As is recommended for other debt securities, the discounts or premiums on the notes purchased by banks or other investors (apart from the fees paid by the latter to banks) are treated as interest income, or negative interest income, respectively, at the times of purchase.

401. Options are contracts that give the purchaser of the option the right, but not the obligation, to buy (a call option) or to sell (a put option) a particular financial instrument or commodity at a predetermined price (strike price) within a specific time span or on a specified date. Some leading types of options are those on foreign currencies, interest rates, equities, commodities, specified indexes, etc. The buyer of the option pays a premium (the option price) to the seller (writer or issuer) for the latter's commitment to sell or purchase the specified amount of the underlying instrument or commodity or to provide, on demand of the buyer, appropriate remuneration. By convention—in this *Manual* and in the *SNA*—that commitment is treated as a liability of the seller and represents the current cost to the seller of buying out his contingent liability.

402. Conceptually, the payment of the premium referred to previously includes two elements: the purchase price of a financial asset and a service charge. In practice, it often is not possible to identify the service element separately. If the latter can be distinguished, it is entered under *financial services*. If not, it is recommended that the full premium be recorded in the balance of payments as the acquisition of a financial asset by the buyer and as an incurrence of a liability by the seller. Subsequent trading (sales) of options is recorded in the ***financial account***, as is the exercise or purchase or sale of the underlying financial instrument. If an option actually proceeds to delivery, which is not the usual case, the acquisition or sale of the underlying asset (real or financial) is recorded at the prevailing market price in the appropriate balance of payments component. Offsetting that entry is the actual amount payable or receivable; the difference between that amount and the prevailing market price is reflected in an entry that extinguishes the option contract. If an option contract is closed out prior to delivery, the actual amount payable or receivable is offset by the entry extinguishing the option contract. When initial margin payments and subsequent increases or decreases are payable by the parties to options, the payments are recorded, both as assets and liabilities, under *others investment*-currency and deposits in the ***financial account***. Payments into, and withdrawals from, these accounts sometimes may be reflected in transactions in the traded options to which the accounts relate and, if so, are recorded under option transactions in the ***financial account***.

403. Warrants (a particular form of option) are tradable instruments giving the holder the right to buy from the issuer of the warrant (usually a corporation) a certain number of shares or bonds under specified conditions for a designated period of time. Warrants can be traded apart from the underlying securities to which the warrants are linked and thus have a market value. The treatment of warrants is the same as that for other options, and the issuer of the warrant is considered, by convention, to have incurred a liability, which is the counterpart of the asset held by the buyer and reflects the current cost of buying out the issuer's contingent liability.

404. Another variety of tradable warrant (usually issued by investment intermediaries) is a currency warrant, the value of which is based on the amount of one currency required to purchase another currency at or before the expiration date of the warrant. Currency warrants and cross-currency warrants with payments denominated in third currencies are treated in a manner similar to the treatment of other warrants.

405. A swap is a contractual arrangement involving two parties who agree to exchange, over time and according to predetermined rules, streams of payment on the same amount of indebtedness. The two most prevalent varieties of swaps are interest rate swaps and currency swaps. An interest rate swap involves an exchange of interest payments of different character (e.g., fixed rate and floating rate, two different floating rates, fixed rate in one currency and floating rate in another, etc.). A currency swap involves an exchange of specified amounts denominated in two different currencies and subsequent repayments reflecting principal and/or interest. (Central bank currency swap arrangements usually undertaken for exchange rate policy purposes and involving the temporary exchange of deposits as of a particular date and the reversal of the transaction at a future date are referred to in paragraph 434.)

406. Balance of payments entries for streams of interest payments associated with swap transactions are recorded, on a net basis, in the **current account**, and streams of principal repayments are recorded in the ***financial account***. Although neither party to a swap arrangement is considered to be the provider of a service to the other, any payment to a third party involved in arranging the swap is recorded under *financial services.*

407. A futures contract is an agreement between two parties to exchange a real asset for a financial asset or to exchange, on a specified date at a predetermined rate, two financial assets. Traded financial futures, including those for interest rates, currencies, commodities, equities, or other indices, are recorded in the ***financial account*** in a manner similar to the recording of options. Transactions associated with nontraded financial futures are likely to occur infrequently and are recorded under the other assets or other liabilities components of *other investment.*

408. A forward rate agreement (FRA) is an arrangement according to which two parties agree on an interest rate to be paid, on a specified settlement date, on a notional amount of principal that is never exchanged. At that time, the settlement payment (i.e., the difference between the rate agreed upon and the prevailing market rate at the time of settlement) is recorded as a transaction in the balance of payments. The buyer of the FRA receives payment from the seller if the prevailing rate exceeds the rate agreed upon; the seller receives payment from the buyer if the prevailing rate is lower than the rate agreed upon. These payments are recorded as interest income in the **current account** of the balance of payments. Because there is only a notional (not an actual) underlying asset, there are no entries in the ***financial account***.

Valuation

409. Transactions in items classified as *portfolio investment* are entered at market prices; any changes in market value while securities are still in the holder's possession (valuation changes) are omitted. Transactions in securities generally take place under the conditions necessary to establish actual market prices (e.g., in an organized market), so the valuation of transactions is not likely to prove very troublesome in practice. However, the elimination of valuation changes from series derived from amounts outstanding may well be difficult to accomplish in practice. The difference between the market values of assets outstanding at the beginning and at the end of a period may include (i) transactions valued at market price during the period and (ii) valuation changes, including those in assets acquired or disposed of (or both), during the period.

410. Changes in holdings classified as *portfolio investment* and reported by transactors or their agents (banks, security dealers, brokers, etc.) may include amounts for service charges on the transactions. Adjustments for such charges are made in entries to *portfolio investment* and the charges are included in *financial services.*

XX. Other Investment

Coverage

411. *Other investment* is a residual category that includes all financial transactions not covered in *direct investment*, *portfolio investment*, or *reserve assets* (discussed in Chapter 21).

Classification

412. As is the case with *portfolio investment*, assets and liabilities for *other investment* are classified primarily on an instrument basis. The sectors of domestic creditor or debtor—the secondary basis for the classification—are monetary authorities, general government, banks, and other sectors. (For the definitions of sectors, see Appendix 2.) In contrast to *direct investment* and *portfolio investment*, the maturity distinction(long- term and short-term) is a third-level basis of classification.

413. The instrument subclassification for *other investment* (as is that for *portfolio investment)* is closely linked to the SNA categories for financial assets. (See Chapter 3.) While the relative importance of types of investment differs considerably among economies, the types reflect most of the financial instruments and channels utilized for the acquisition of assets and incurrence of liabilities—other than for *direct investment, portfolio investment,* and *reserve assets*. The instrument classification comprises trade credits, loans (including the use of Fund credit and loans from the Fund), currency and deposits (both transferable and other), and other assets and liabilities (for example, miscellaneous accounts receivable and payable).

Definitions and Recording

414. Trade credits consist of claims and liabilities arising from the direct extension of credit by suppliers and buyers for transactions in goods and services and advance payments for work in progress (or to be undertaken) that is associated with such transactions. (Loans to finance trade are not included as these are classified under loans. See paragraph 415.) In the absence of actual data, trade credits may be measured by the difference between entries for the underlying transactions in goods and services, which are recorded as of the dates when ownership changes, and the entries for payments related to these transactions. Although frequently short-term in nature, trade credits and advances are subdivided into short- and long-term categories.

415. Loans comprise those financial assets created through the direct lending of funds by a creditor (lender) to a debtor (borrower) through an arrangement in which the lender either receives no security evidencing the transaction or receives a non-negotiable document or instrument. Included are loans to finance trade, other loans and advances (including mortgages), use of Fund credit and loans from the Fund, etc. In addition, financial leases and repurchase agreements (see paragraphs 417 through 418) are covered under loans—even though, from a legal standpoint, these may not be considered loans. Loans are subdivided into long- and short-term categories, which reflect the retention of the maturity structure referred to previously.

416. Long-term loans and trade credits are recorded on a net basis. It is recommended, however, that the recording of gross flows in respect of drawings and repayments on these instruments be provided as supplementary information. Such information is useful for the analysis of debt transactions and for reconciling balance of payments data on debt with other sources of such information.

417. Financial leases are included under loans because such arrangements are taken as presumptive evidence that a change in the ownership of goods has occurred. (See paragraph 206.) The financial lease essentially is a method by which the lessee finances the purchase of goods. The financial lease entails a financial claim, which is the asset of the lessor and the liability of the lessee. At the time the imputed change in ownership occurs, the market value of the goods is recorded and counterpart entries, as assets or liabilities, are made in the ***financial account***. In subsequent periods, the actual lease payment is divided into interest, which is recorded in the **current account** as income payable or receivable, and principal (debt) repayment, which is recorded in the ***financial account*** and reduces the value of the asset of the lessor and the liability of the lessee.

418. A repurchase agreement (repo) is an arrangement involving the sale of securities at a specified price with a commitment to repurchase the same or similar securities at a fixed price on a specified future date (usually very short-term, e.g., overnight or one day) or on a date subject to the discretion of the purchaser. The economic nature of a repo is similar to that of a collateralized loan in that the purchaser of the securities is providing funds backed by the securities to the seller for the period of the agreement and is receiving a return from the fixed price when the repurchase agreement is reversed. The securities often do not change hands, and the buyer does not have the right to sell them. So, even in a legal sense, it is questionable whether or not a change of ownership occurs. As a result, in this *Manual* (and in the *SNA* and IMF money and banking statistics), a repo is treated as a newly created financial asset that is a collateralized loan rather than an asset related to the underlying securities used as collateral. Reflecting that interpretation, repos are classified under loans—unless the repos involve bank liabilities and are classified under national measures of broad money, in which case the repos are classified under currency and deposits. In some instances, because of legal, institutional, and other considerations, national compilers may find it necessary to use an alternative treatment of repos; in such instances, this information should, if it is feasible to do so, be separately identified and reported to the IMF.

419. Use of Fund credit and loans from the Fund comprises a member country's drawings on the Fund—other than those drawn against the country's reserve tranche position. (See paragraph 441.) Use of Fund credit and loans includes purchases and borrowings under stand-by, extended, structural adjustment, enhanced structural adjustment, and Systemic Transformation Facility arrangements, together with Trust Fund loans. A reduction in the Fund's holdings of a member's currency in excess of the member's quota in the Fund minus the member's reserve tranche position reflects a repayment of the use of Fund credit.

420. Currency and deposits are summed as one component, although separate data may be compiled by countries desiring to do so for analytic and other purposes. Currency consists of notes and coin that are in circulation and commonly used to make payments. (Commemorative coins and uncirculated banknotes are excluded.) If both domestic currency (liability) held by nonresidents and foreign currency (asset) held by residents serve that purpose, it would be useful to identify each separately as supplementary information.

421. Deposits comprise both transferable and other deposits. Transferable deposits consist of deposits that are exchangeable on demand at par without restriction or penalty, freely transferable by check or giro order, and otherwise commonly used to make payments. Deposits may be denominated in domestic or foreign currencies. Other deposits include all claims (other than transferable deposits) reflecting evidence of deposit. Typical examples are non-transferable savings deposits; time deposits; and shares (evidence of deposit)—which are legally (or practically) redeemable on demand or on short notice—in savings and loan associations, credit unions, building societies, etc.

422. Other assets and liabilities cover any items other than loans and currency and deposits. For example, capital subscriptions to international nonmonetary organizations are classified under this category, as are miscellaneous accounts receivable and payable.

423. As noted in paragraph 372, transactions, other than those associated with permanent debt and equity investment, of banks and other financial intermediaries that are in a direct investment relationship are included in *portfolio investment* or *other investment*. Thus, loans and deposits of such institutions are included, as described in paragraphs 415 and 421, under those components.

XXI. Reserve Assets

Concept and Coverage

424. *Reserve assets*, the fourth major functional category of the ***financial account***, is an important component of balance of payments statistics and an essential element in the analysis of an economy's external position. *Reserve assets* consist of those external assets that are readily available to and controlled by monetary authorities for direct financing of payments imbalances, for indirectly regulating the magnitude of such imbalances through intervention in exchange markets to affect the currency exchange rate, and/or for other purposes. (See paragraphs 425 and 432.) The category of *reserve assets,* as defined in this *Manual,* comprises monetary gold, SDRs, reserve position in the Fund, foreign exchange assets (consisting of currency and deposits and securities), and other claims. (See paragraph 443.) Securities that do not satisfy the requirements of *reserve assets* are included in *direct investment* and *portfolio investment.*

425. Supplementing *reserve assets* are other substitute external resources, credits, and/or a variety of conditional items—all of which incur liabilities. These are virtually second-line reserves that can be readily mobilized by monetary authorities. As a result, while the significance of *reserve assets* within the total international liquidity framework may have narrowed, such assets still play a key role. On the other hand, authorities may utilize other means to deal with imbalances. For example, authorities may make use of Fund credit and loans from the Fund, encourage other sectors of the economy to engage in foreign borrowing, and/or alter the exchange rate or allow it to float freely, etc. The use or acquisition of *reserve assets*, therefore, does not necessarily reflect the degree or size of the payments imbalance of concern to the authorities. The authorities also may hold reserves for other motives—such as to maintain confidence in the currency and the economy, to satisfy domestic legal requirements, or to serve as a basis for foreign borrowing. In any event, resources that may be available in terms of external liquidity reflect a broader range of items than the components of *reserve assets* listed in this *Manual.*

Identification of Reserve Assets

426. The financial assets comprising reserves cannot unambiguously be identified in a meaningful way simply through the application of objective criteria. The readily observable characteristics of a claim—legal ownership, marketability, currency of denomination, original contractual maturity, etc.—are not sufficient to establish whether a claim is actually available to the monetary authorities to use for the indicated purposes. However, *reserve assets* always refer to assets that actually exist. Claims that could be created under agreements that are in force (e.g., foreign exchange that could be obtained under swap agreements and other lines of credit or through the use of Fund credit under stand-by arrangements) do not constitute existing claims. Conversely, assets that are pledged, committed, earmarked, set aside in sinking funds, sold forward, or otherwise encumbered by the holders are nonetheless existing assets and are not precluded on those grounds alone from being included in *reserve assets.* However, because such arrangements may affect the availability and usability of the assets involved, supplementary information concerning the arrangements would be useful.

427. Two issues must be considered in the identification of *reserve assets.* First, in addition to assets actually owned, which other assets are at the effective disposal of monetary authorities? Second, of the assets controlled by the monetary authorities, which are available for use—should the necessity arise? Decisions on these matters will depend, at least in part, on the exercise of judgment.

Effective control

428. The aspect of control can be appraised only with reference to the institutional framework in individual economies. In the narrowest sense, monetary authorities control absolutely only those assets to which they legally hold title. In the broadest sense, almost any asset owned by a resident of the economy may ultimately be subject to the control of the authorities. Neither of these extreme views is useful for the balance of payments. Instead, the concept of *reserve assets* should encompass those assets over which authorities exercise direct and effective control.

429. The test of such control is to be applied quite strictly. In general, only foreign claims actually owned by monetary authorities would be included as reserves. For example, the acquisition of assets through any statutory power that is maintained solely on a stand-by basis would not be considered an effective exercise of control. Also, the potential for transferring assets to or from the authorities through a change in monetary policy—and thereby inducing banks to change their holdings of foreign assets—would be deemed too indirect. Nevertheless, ownership is not a necessary condition for control. For instance, if banks hold legal title to foreign assets but are permitted to deal in such assets only on the terms specified by monetary authorities or only with their express approval, such assets would be considered subject to the authorities' direct and effective control.

430. Except in unusual circumstances, direct and effective control is not to be construed as extending beyond the assets owned by depository institutions. That is, while certain bank-owned claims on nonresidents could be classified as *reserve assets*, those same claims would cease to be *reserve assets* if the banks sold the claims to private residents other than depository institutions—whatever the institutional arrangements in the economy might be. Authorities should be able to provide data on assets that they control (but do not own) because that information would be prerequisite to effective control.

Availability for use

431. Whether an asset controlled by monetary authorities is available for use is partly dependent on any conditionality that affects the asset—including, as one main aspect, the liquidity or marketability of the asset. Owned assets (such as monetary gold, SDRs, and reserve positions in the Fund) that are immediately available can be viewed as assets in the most unconditional form. Foreign exchange holdings and other claims, in many instances, are equally available. However, a ranking of all available assets according to conditionality is not a feasible undertaking. Furthermore, such a ranking—if made—would be based on two types of judgments: (i) the precise degree of conditionality required for assets to be considered unavailable for use (in accordance with the concept of *reserve assets*) and (ii) the point at which the borderline between *reserve assets* and other assets should be drawn. A more pragmatic approach is to consider, in each case, whether there is an expectation, backed by a reasonable degree of assurance, that the conditions could be satisfied if and when it became necessary to use the asset.

Selected cases

432. Monetary authorities presumably hold or exercise control over foreign assets in order to have such assets available as *reserve assets* or for some other purpose. These objectives may not be mutually exclusive. For example, *reserve assets* in excess of immediate requirements can be invested in World Bank obligations and thus provide development aid. Assets held for both reasons are generally classified as *reserve assets*. In contrast, assets in the form of direct, long-term loans for development and other purposes are not classified as *reserve assets*. Net creditor positions in regional payments arrangements that involve reciprocal lines of credit and that require prompt settlement of outstanding drawings (e.g., monthly or quarterly) are construed as *reserve assets*. However, net asset balances in bilateral payments agreements have much in common with other types of tied loans that authorities make to stimulate exports, provide aid, or further other aspects of government policy. Such payments agreement balances are therefore conventionally excluded from *reserve assets*. Subscriptions to international nonmonetary organizations, assets redeemable only in inconvertible currencies, and assets with uses blocked or otherwise effectively restricted by issuers are examples of assets that are not considered *reserve assets*.

433. Most other foreign assets held by monetary authorities are likely to be appropriate for inclusion in *reserve assets*. Working balances of the government qualify fully as *reserve assets* because, by definition, such balances are available for immediate use. Committed assets cannot be excluded because, like all other *reserve assets*, committed assets exist to meet requirements. An asset is no less a *reserve asset* simply because the specific use to which the asset is to be put is a foreseeable one. A readily repayable loan to the Fund comprises a *reserve asset*. Bank transfers of foreign claims to authorities just prior to certain accounting dates can result in a portion of the assets held by the authorities being committed, in effect, to the reversal of the transfer soon after those dates—whether or not the commitment is a formal one. While such operations undoubtedly distort the statistics on *reserve assets* as of a specified date, the distortion should be interpreted as the result of a seasonal influence, and the omission of such holdings from *reserve assets* may be justified only as a seasonal adjustment.

434. Assets created under reciprocal facilities (swap arrangements) for the temporary exchange of deposits between the central banks of two economies warrant mention. Deposits (in foreign exchange) acquired by the central bank initiating the arrangement are treated as *reserve assets* because the purpose of the exchange is to provide the central bank with assets that can be used to meet the country's balance of payments needs. Reciprocal deposits acquired by the partner central bank also are considered *reserve assets*. Arrangements (gold swaps) involving the temporary exchange of gold for foreign exchange deposits should be treated in a similar manner. When a central bank acquires foreign exchange from a domestic bank in exchange for a deposit (in national currency) at the central bank and there is a commitment to reverse the transaction at a subsequent date, the transaction is treated and recorded as an increase in *reserve assets* of the central bank and an increase in the central bank's liabilities (in national currency) to the domestic bank.

435. Assets not actually owned by monetary authorities do not usually qualify as *reserve assets* under a strict application of the criteria discussed in paragraph 429. Nevertheless, the possibility that such assets may qualify cannot be entirely precluded. Qualification should be apparent to the balance of payments compiler; if monetary authorities are presumed to be exercising effective control over such assets, the assets must possess quite distinctive characteristics. An example would be assets that monetary authorities temporarily transfer to private deposit money banks; the transfers would be accompanied by some special inducements to hold the assets, such as agreements to repurchase the assets at prices that assure the banks of realizing profits.

Exclusion of Valuation Changes and Other Adjustments

436. This fifth edition of the *Manual*, in contrast to the fourth, excludes all changes in *reserve assets* that are not attributable to transactions. Thus, value changes resulting from fluctuations in the prices of *reserve assets*, changes associated with the creation of *reserve assets* (the monetization or demonetization of gold and the allocation or cancellation of SDRs), and counterparts offseting such changes are not recorded in balance of payments statements. Changes resulting from reclassification also are excluded. All these adjustments are reflected in the international investment position. (See Chapter 23.)

Classification

437. Although individual elements of *reserve assets* are largely interchangeable from a functional standpoint, changes in components discussed subsequently may have somewhat differing implications for analyses of global liquidity and the balance of payments adjustment process.

438. Monetary gold is gold owned by the authorities (or by others who are subject to the effective control of the authorities) and held as a *reserve asset*.[10] Other gold (nonmonetary gold, possibly including commercial stocks held for trading purposes by authorities who also own monetary gold) owned by any entity is treated in this *Manual* as any other commodity. Transactions in monetary gold occur only between monetary authorities and their counterparts in other economies or between monetary authorities and international monetary organizations. Like SDRs (see paragraph 440), monetary gold is a *reserve asset* for which there is no outstanding financial liability.

439. Authorities who add to their holdings of monetary gold by acquiring commodity gold (i.e., newly mined gold or existing gold offered on the private market) or release monetary gold from their holdings for nonmonetary purposes (i.e., for sale to private holders or users) have monetized or demonetized the gold, respectively. Any increase or decrease in monetary gold holdings resulting from monetization or demonetization is treated as a reclassification of gold; such an increase or decrease is not shown in the balance of payments but is reflected in the international investment position. If the gold being monetized or demonetized is acquired from or sold to a nonresident, that transaction should be recorded as an import or export under ***goods*** in the **current account** and, in the ***financial account***, as a credit or debit under the financial item that was used or received to finance that import or export.

440. SDRs are international *reserve assets* created by the International Monetary Fund to supplement other *reserve assets* that are periodically allocated to IMF members in proportion to their respective quotas. SDRs are not considered liabilities of the Fund, and IMF members to whom SDRs are allocated do not incur actual (unconditional) liabilities to repay SDR allocations. The Fund determines the value of SDRs daily by summing, in U.S. dollars, the values—which are based on market exchange rates—of a weighted

[10]As defined in this *Manual*, monetary gold is generally construed to be at least 995/1000 pure.

basket of currencies. The basket and weights are subject to revision from time to time. SDRs can be used to acquire other members' currencies (foreign exchange), to settle financial obligations, and to extend loans. Changes in the SDR holdings of monetary authorities can arise through (i) transactions involving SDR payments to or receipts from the Fund, other participants in the SDR Department of the Fund, or other holders or (ii) allocation or cancellation. Transactions such as those enumerated under (i) are included in the balance of payments; allocations or cancellations are not entered in the balance of payments but are reflected in the international investment position.

441. An IMF member may have, in the Fund's General Resources Account, a position that is recorded under the category for *reserve assets*. This position is referred to as the member's reserve position in the Fund. The member's reserve position is the sum of the reserve tranche purchases that a member may draw upon and any indebtedness of the Fund (under a loan agreement) that is readily repayable to the member. Reserve tranche purchases are purchases from the Fund of other currencies that do not cause Fund holdings of a member's currency to exceed the member's quota (minus holdings that reflect the member's use of Fund credit). A purchase from the Fund is recorded as an increase in foreign exchange holdings and a decrease in the member's reserve position in the Fund; a repurchase is recorded as a decrease and an increase, respectively. Purchases in the reserve tranche are not regarded as a use of Fund credit, are not subject to charges, and do not require repurchase. In addition to reserve tranche purchases, members may use Fund resources in connection with compensatory and contingency financing, buffer stock financing, the extended Fund facility, and the credit tranches (including policy on enlarged access) without having those purchases and holdings included in Fund holdings of member currencies for the purpose of defining the reserve tranche. A member's drawing (other than against its reserve tranche position) constitutes the use of Fund credit. (See paragraph 415.)

442. Foreign exchange includes monetary authorities' claims on nonresidents in the forms of ECUs,[11] currency bank deposits, government securities, other bonds and notes, money market instruments, financial derivatives, equity securities, and nonmarketable claims arising from arrangements between central banks or governments. (Foreign exchange covers claims that are shown as the foreign exchange component of the series for international liquidity published by the Fund in *International Financial Statistics*.) The instrument subclassification of the foreign exchange component of *reserve assets* is necessary in the context of the Fund's compilation of global aggregates of the main components of the world financial account and for analyses of the global discrepancy in those aggregates. (The Fund adheres to strict confidentiality requirements concerning instruments.)

443. Other claims is a residual category covering claims that are not included previously and that may constitute *reserve assets* in the form of currency, deposits, or securities. For instance, the foreign exchange component may not invariably cover working balances abroad of government nonmonetary agencies or assets that are held by banks and subject to the control of monetary authorities.

Valuation

444. In principle, all transactions in *reserve assets* are recorded at market prices—that is, market exchange rates in effect at the times of transactions, market prices for claims such as securities, and SDR market rates as determined by the Fund. Monetary gold transactions are valued at the market prices underlying the transactions. For valuation of stocks of *reserve assets* in the international investment position, market prices in effect at the ends of appropriate periods are used.

Interpretation of Changes in Reserve Assets

445. Changes in *reserve assets* (within the context of broader aspects of external liquidity; see paragraph 425) are an important analytic tool for assessing balance of payments adjustment requirements but should not be viewed in isolation. Difficulties may arise, in some instances, in correctly identifying certain items as *reserve assets*. Similar problems pertain to the identification of liabilities constituting foreign authorities' reserves (LCFARs). Reflecting these considerations, this chapter and Chapter 22 (covering LCFARs and exceptional financing transactions) should be considered complementary rather than mutually exclusive.

[11]Countries participating in the European Monetary System were issued ECUs against deposits of gold and U.S. dollars with the European Monetary Cooperation Fund. Those reserves that were deposited are excluded from gold and foreign exchange holdings as published by the Fund, but the equivalent holdings of ECUs are included in foreign exchange.

XXII. Supplementary Financial Account Information

Coverage

446. Several varieties of important transactions are not separately identified in the components of the ***financial account***. This supplementary information is necessary to meet various analytical requirements, including the derivation of certain overall measures of a balance of payments deficit or surplus. The specific items are liabilities constituting foreign authorities' reserves (LCFARs) and exceptional financing transactions; the latter include several forms of debt reorganization related to balance of payments requirements. The fact that these financing items are not separately identified among the standard components does not diminish the importance of such items in the analysis of balance of payments developments. Rather, the absence of separate identification reflects the views of most national balance of payments compilers that inclusion of these items would unduly expand the list of standard components. (A presentation of these and other items appears, together with the list of standard components, at the end of Chapter 8.)

Liabilities Constituting Foreign Authorities' Reserves

447. In this fifth edition of the *Manual*, LCFARs are not separately identified as components of the ***financial account***.[12] In the fourth edition, LCFARs were identified as separate components of each type of financial liability, with the exception of *direct investment*, in the capital account (in this *Manual*, the ***financial account***). Objective criteria to identify LCFARs and the relationships to *reserve assets* remain elusive. It often is difficult for a debtor economy to specifically link certain liabilities to those assets identified as *reserve assets* by a creditor economy. The potential utilization of *reserve assets* to serve varied purposes—as noted in Chapter 21—makes it that much more difficult to match a related liability to a particular function. As a result, it may not be feasible to determine the underlying reasons for changes in such liabilities in many instances.

448. Notwithstanding such difficulties, it is useful for a compiling (debtor) economy to attempt, when possible, to identify as LCFARs those liabilities that are treated as *reserve assets* by the creditor economy—even though the compiling economy may not regard part or all of such liabilities as a means of financing its payments imbalance. (The identification may facilitate cross-checks of bilateral and international comparisons of data on *reserve assets.*) In the table on **Selected Supplementary Information** at the end of Chapter 8, LCFARs are classified primarily by instrument—debt securities, deposits, and other liabilities—and, secondarily, by appropriate sector.

449. In certain analytic presentations (see Appendix 5), including those of the Fund, LCFARs are grouped together with *reserve assets*, use of Fund credit and loans from the Fund, and exceptional financing as below-the-line items; that is, as financing items above the line in the **current account** and the ***financial account***. Interpretation of the behavior of LCFARs depends on the purpose of the analysis and the factors that brought about the changes recorded in the balance of payments. The figures—along with those for *reserve assets*—certainly are not, under all circumstances, a satisfactory measure of the means that may have been employed by monetary authorities to finance a payments imbalance or a satisfactory measure of the size of that imbalance. Also, interpretation of the figures may sometimes be uncertain. For example, in a reserve currency country, a shift—from a foreign central bank to foreign private deposit money banks—in holdings of claims on deposit money banks may or may not indicate strength in the reserve country's payments position. Nevertheless, changes in the liabilities that are the counterparts of another economy's *reserve assets* can be relevant in understanding the global process of reserve creation and neutralization.

450. Identification of certain assets as *reserve assets* is not always a clear-cut matter even for holders of the assets. (See Chapter 21.) The problem of identification

[12]LCFARs are any liabilities that are considered, from the viewpoint of the creditor, to be *reserve assets*—even though the debtor (compiling economy) may not consider such liabilities to be offsets to its reserves or to be financing its payments imbalance.

is likely to be even more complicated from the side of the debtor, who presumably has less access to the facts on which judgment is to be made. General considerations for identifying LCFARs are that a nonresident creditor will probably classify as *reserve assets* any liabilities of the compiling economy (i) that are repayable on demand or in the short run (i.e., marketable) or that the debtor is prepared to redeem on short notice; (ii) that are repayable in assets that the debtor would regard as *reserve assets*; and (iii) that are owed to a central bank or central government.

Exceptional Financing and Balance of Payments Needs

451. The concept of exceptional financing and the related balance of payments accounting treatment have evolved since the fourth edition of the *Manual* was published and have assumed increased importance for IMF operations, statistics, and member countries in recent years. As an alternative to—or in conjunction with the use of *reserve assets*, Fund credit and loans from the Fund (both standard components), and LCFARs to deal with payments imbalances—exceptional financing consists of any other arrangements made by authorities (or by other sectors fostered by authorities) of an economy to meet balance of payments needs.

452. Use of IMF resources is subject to a conceptual requirement of need, which—according to the *Articles of Agreement of the IMF*—is linked to a member's balance of payments, reserve position, or developments concerning reserves. Determination of need involves making a clear distinction between (i) above-the-line transactions deemed to be autonomous or undertaken for the sake of the transactions and thus contributing to or resulting in an overall payments deficit or surplus and (ii) below-the-line items considered to be accommodating or financing the deficit or surplus. While such a distinction between groups of transactions involves a degree of judgment, it nonetheless presents a measure of the deficit or surplus and indicates financing needs and/or policy adjustments required to correct the imbalance. (See Appendix 5.)

453. As is the case with *reserve assets* and LCFARs, the identification of exceptional financing transactions is linked to an analytic concept rather than being based on precise criteria. Among transactions identified as exceptional financing and linked to balance of payments and reserve considerations noted previously are those associated with (i) transfers—such as debt forgiveness, other intergovernmental grants, and grants received from Fund subsidy accounts; (ii) direct or other equity investment—such as debt or equity swaps involved with debt reduction; (iii) borrowing, including bond issues, by the government or central bank (for example, from foreign commercial banks); (iv) borrowing (including bond issues) implemented by other sectors of the economy and induced by authorities—usually with some form of exchange rate or interest subsidy; and (v) other transactions related to debt reorganization, such as rescheduling of existing debt and accumulation and repayments of arrears.

Balance of Payments Accounting for Selected Exceptional Financing Transactions

454. In the balance of payments, treatment of debt reorganization involves entries in several accounts in the standard presentation and entries to indicate below-the-line exceptional financing (see paragraph 449) in an analytic presentation such as the aggregated one in the Fund's *Balance of Payments Statistics Yearbook*. In the case of multi-year arrangements involving certain conditions affecting future periods, no entries are made in the accounts for the current period, although entries may be generated in future periods. The treatment of selected exceptional financing transactions denotes components of balance of payments accounts in which such transactions are entered. For analytical purposes, credit entries for appropriate exceptional financing transactions are construed as satisfying balance of payments needs or as below-the-line items, although associated debit entries may be made above the line. In addition to the transactions highlighted in paragraphs 455 through 458, repayments made in advance of the due dates by the authorities of an economy and considered to be made for balance of payments reasons should be treated as below-the-line items in analytical presentations. If an advance repayment is deemed to be made for other reasons (e.g., to improve a debtor economy's standing in credit markets), the repayment is not classified as exceptional financing.

455. Debt forgiveness (i.e., the voluntary cancellation of all or part of a debt specified by a contractual arrangement between a creditor in one economy and a debtor in another economy that is experiencing balance of payments difficulties) is treated as a *capital transfer* from the creditor to the debtor. (See Chapter 17.) The transfer offsets the reduction of the liability of the debtor in the ***financial account***. For the debtor economy, if the obligations are past due, the forgiveness involves arrears (see paragraph 458), and both entries (i.e., the receipt of the transfer and the reduction in arrears) are reflected under exceptional financing. If obligations are due in the current accounting period, only the entry denoting the transfer is shown under exceptional financing. Entries pertaining to the obligations are shown above the line. If the obligations are not yet due, there are no entries under exceptional financing.

456. Exceptional financing transactions related to *direct investment* (for example, debt or equity swaps) involve the exchange, usually at a discount, of bank claims on, or other debt instruments of, debtor economies for nonresident investors' equity investments in those economies. Although variable in form, such arrangements usually result in the extinction of a fixed-payment liability (e.g., a debt security or loan) denominated in foreign currency and the creation of an equity liability (denominated in domestic currency) to a nonresident. There may be an exchange of a liability of an enterprise for equity in that enterprise, or the central bank may redeem outstanding debt by purchasing the debt, at a discount and in local currency, from a nonresident. The proceeds are then reinvested by the nonresident as equity in the enterprise. A debt or equity swap often reflects a difference between the full value of the debt instrument and the value of the equity obtained. That difference should be construed as a valuation adjustment in the international investment position rather than as a transaction (e.g., a *capital transfer*).

457. Rescheduling or refinancing of existing debt involves a change in an existing contract and replacement by a new contract to extend debt service payments due to lenders. This rescheduling constitutes a formal deferment with new maturities replacing those of the former contract. Interest and amortization obligations due to be paid in the current accounting period are considered paid on time and financed by the rescheduled loan. Thus, there is a reduction of those payments on the old loan and the creation of a new loan. As to balance of payments entries, there are debit entries to interest income in the **current account** and, according to the maturity of the original loan, to short- or long-term loans in *other investment*; there is an offsetting credit entry under long-term loans in that same category. If the rescheduling concerns obligations past due, arrears are involved. (See paragraph 458.) If the rescheduling involves obligations not yet due, entries are made only under short- or long-term loans, as appropriate, in *other investment*. If, under a rescheduling, the monetary authorities or general government sector assume the debt of banks or other sectors of the economy, a credit is entered in the ***financial account*** for the assuming sector and a debit is entered for the other sector.

458. Arrears of interest and amortization (amounts past due and unpaid) are recorded in accordance with the accrual principle as if paid, and a contra entry is made to reflect the new liability. For interest arrears accruing in the reporting period, a debit entry is recorded under ***income*** in the **current account**, and a corresponding credit entry is made (under *other investment*-other liabilities-short-term) in the ***financial account***. For amortization arrears, a debit entry is made in the appropriate component of the ***financial account*** (for example, short- or long-term loans under *other investment*), and a credit contra entry is made under *other investment*-other liabilities-short-term. In analytical presentations, entries for arrears are made below the line (i.e., exceptional financing). When rescheduled interest or interest in arrears includes interest accrued in a previous recording period, the accrual principle for the recording of interest (see paragraph 121) requires a debit entry under ***income*** in that period and an offsetting credit entry (under the appropriate instrument) in the ***financial account***. Subsequently, when the rescheduling is effected or the interest is in arrears, only the interest accrued in the current period is debited under ***income***. Interest accrued in the previous period is debited to the appropriate instrument in the ***financial account*** (to offset the credit entry made in the previous period for the interest accrued).

459. A detailed summary of entries required in balance of payments accounts for various forms and aspects of exceptional financing transactions is presented in Appendix 4.

Foreign Sources of Financing

460. Financial flows in the balance of payments are generally compiled on a domestic transactor basis and in concordance with related statistical systems (e.g., the SNA and flows of funds accounts). However, for certain analytical purposes—such as analyses of debtor economies' sources of external borrowings by type of lender (official, bank, or other) and data comparisons for individual or groups of economies—identification of the nonresident party to a transaction is of significance. Because such uses are made of the data, it is recommended that statistics on foreign sources of financing by sector (i.e., monetary authorities, general government, banks, and other) be collected as supplementary information.

XXIII. International Investment Position

Concept and Coverage

461. Together, the balance of payments transactions and international investment position covered in this *Manual* constitute the set of international accounts for an economy. The international investment position is the balance sheet of the stock of external financial assets and liabilities. The financial items that comprise the position consist of claims on nonresidents, liabilities to nonresidents, monetary gold, and SDRs. By convention, land and other immovable tangibles (except those owned by extraterritorial units; see paragraph 64) are treated as the property of economic entities of the economies in which the immovable tangibles are located. Therefore, a nonresident owner has a financial claim on the resident entity to which the ownership of such an asset is attributed rather than ownership of the actual nonfinancial asset.

462. In relation to the balance sheet (as delineated in the *SNA*) of an economy, the net international investment position (the stock of external financial assets minus the stock of external liabilities) combined with an economy's stock of nonfinancial assets comprises the net worth of that economy. (See Chapter 3.)

463. The position at the end of a specific period reflects financial transactions, valuation changes, and other adjustments that occurred during the period and affected the level of assets and/or liabilities. Because stock levels often are utilized in the determination of investment income receipts and payments in balance of payments accounts, consistent classification throughout the ***income*** category of the **current account**, the ***financial account***, and the position components is essential for reconciliation of stocks and flows and for meaningful analysis of yields and rates of return on external investments. (See paragraphs 475 through 477.)

Classification

464. Classification of the international investment position (and of changes to the IIP) has two dimensions. (See the table at the end of this chapter.) In the rows of the table, the primary distinction is between assets and liabilities; the difference between the two represents the net position. Fully consistent with the balance of payments ***financial account***, the first IIP subclassification is by function. Assets are divided into *direct investment*, *portfolio investment*, *other investment*, and *reserve assets*; liabilities are divided the same way (except for *reserve assets*).

465. Within the functional categories and in concordance with the ***income*** component of the **current account** and with the ***financial account*** of the balance of payments, *direct investment* is subdivided into equity capital, reinvested earnings, and other capital (intercompany debt). Claims on and liabilities to affiliated enterprises are shown separately. *Portfolio investment* is classified primarily by instrument—equity securities, debt securities, and financial derivatives—and secondarily by appropriate sectors. *Other investment* also is classified first by instrument and then by sector. Included are trade credits, loans, currency and deposits, and other assets and liabilities (such as capital subscriptions to international, nonmonetary organizations and miscellaneous accounts receivable and payable). *Reserve assets* are largely interchangeable from a functional standpoint. (See paragraphs 437 through 443.)

466. In the columns of the table at the end of this chapter, the factors accounting for the change in the position from the beginning to the end of a period are recorded. Listed first are the transactions associated with the various components (e.g., for *direct investment*, *portfolio investment*, etc.). The next two items—price changes and exchange rate changes—affect the valuation of components such as equity and debt securities, *direct investment*, and *reserve assets*. (Price and exchange rate changes assume greater importance with increased volatility of securities and exchange markets.) Before the position at the end of the period is recorded, a fourth item (other adjustments) must be included. Among such adjustments (equivalent to "other changes in volume of assets" in the SNA) are changes resulting from the allocation or cancellation of SDRs and changes resulting from gold monetization or demonetization, reclassifications (such as from *portfolio investment* to *direct investment* when the 10 percent equity threshold is reached), unilateral cancellation of debt by a creditor, and expropriations or uncompensated seizures.

Valuation of Components

467. In principle, all external financial assets and liabilities should be measured at current market prices as of the dates involved (i.e., beginnings or ends of reference periods).[13] In practice, however, there may be some departures from the market price principle. For *direct investment*, book values from the balance sheets of direct investment enterprises (or of direct investors) generally are utilized to determine the value of the stock of direct investments. These balance sheet values, if recorded on the basis of current market value, would be in general accordance with the principle. If based on historical cost or on an interim but not current revaluation, such balance sheet values would not conform to the principle. Consequently, it would be desirable to have data collected and made available on a current-market-value basis to eliminate the gap between principle and practice. Those countries that compile data on the basis of market values derived indirectly should, if the two types of data differ, also compile data from that provided by enterprises on a balance sheet (book value) basis to facilitate international comparability. (See paragraph 377.)

468. *Portfolio investment* (equity securities, debt securities, and financial derivatives) is valued at current market prices at the appropriate reference dates. For equities that are listed in organized markets or are readily tradable, the value of outstanding stocks should be based on actual prices. The value of equities that are not quoted on stock exchanges or otherwise traded regularly should be estimated by using the prices of quoted shares that are comparable as to past, current, and prospective earnings and dividends. Alternatively, the net asset values of enterprises to which the equities relate could be used to estimate market values if the balance sheets of the enterprises are available on a current value basis. For debt securities that are listed in organized markets or are readily tradable, the outstanding value of stocks also should be determined on the basis of current market prices. For debt securities that are not readily tradable, the net present value of the expected stream of future payments or receipts associated with the securities could be used to estimate market value. (The net present value of any future receipt is equal to the value of that receipt when discounted at an appropriate interest rate.)

469. Principles for valuation of financial derivatives in the investment position are, in some respects, less definitive than those for other portfolio investment instruments. There are ongoing efforts by national and international accounting bodies to define standards for the measurement and recording of derivatives. Thus, in the *Manual*, a thorough treatment of derivative valuation is not attempted—particularly in view of continued innovations in this area. Rather, brief valuation guidelines that are consistent with those in the *SNA* and applicable to a number of existing derivatives are presented subsequently.

470. Traded options, warrants, and traded financial futures—all of which are treated as financial assets—are included in the position at market values on the appropriate accounting dates. For an option, the market value recorded is either the current value of the option—that is, the prevailing market rate—or the amount of the premium paid as a proxy. The counterpart liability is attributable, by convention, to the writer of the option and is valued at the current value of buying out the rights of the option holder. For a warrant, the counterpart liability of the issuer is the current value of buying out the exercise rights of the holder. A contract for a currency swap is recorded at market value; when payments are effected, the value of the asset and associated liability is amortized and subsequently reflected in the position on the appropriate accounting date.

471. Among other investment items, those that are not readily transferable among transactors (e.g., loans, deposits, miscellaneous accounts receivable and payable) are recorded in the investment position at nominal or face value (as is the case for currency). In general, that value is an acceptable proxy for market value. However, in recent years, loans to a number of heavily-indebted countries have been subject to significant discounts in secondary markets that emerged for the trading of such debt and brought the valuation of such debt into question. To conform with the market value principle, secondary market quotations should be the basis of valuation for transactions. As to recording the value of such debt in the position, the issue is not as clear. In principle, values recorded in the position should also be based on secondary market quotations. This presents no problem on the creditor side where

[13]Market price may have to be approximated in some instances. For example, for direct investment branches and most subsidiaries, the market valuation of the parent enterprise's equity is approximated as the net asset value of the resident enterprise; that is, the difference between the market value of assets and liabilities to third parties (including the market value of shares held by minority or portfolio investors) and nonequity liabilities to shareholders.

claims are valued on the basis of the transaction (secondary market) price. However, on the debtor side, the amounts of principal that debtors are contractually obliged to repay creditors when loans mature are used as the basis of valuation, and this practice represents a departure from the market price principle. In this particular case, the departure is associated with contractual restrictions that are usually applicable to such loans and that prohibit the debtor from buying back the loans in secondary markets unless the restrictions are waived. (These limitations usually do not apply to bonds or other securities.) The use of market values on the creditor side and nominal values on the debtor side results in an asymmetry between debtor and creditor positions. To deal with that asymmetry, creditors should, if it is feasible, provide supplementary data on nominal values of discounted loans, and debtors should provide such data on market values.

472. The effects of selected, debt-related arrangements on the position include (i) exchange of debt for equity (debt/equity swap—see paragraph 456), in which case the difference between the nominal value of a loan and the (lesser) value of the equity obtained is treated as a valuation adjustment in the position; (ii) forgiveness of a loan, in which case a capital transfer offsets the reduction of the debtor's liability in the balance of payments accounts and the transactions column of the position reflects the reduction in the debtor's liability and creditor's asset; (iii) rescheduling of a loan, in which case a new loan in effect replaces an old loan and the nominal value of the new loan is the basis of valuation; or (iv) unilateral cancellation of a loan by the creditor, which is recorded under other adjustments to the position. (See paragraph 466.)

473. *Reserve assets* are valued at current market prices at the appropriate reference dates. Monetary gold is valued at the prevailing market price; SDRs are valued at market rates calculated by the Fund; and reserve position in the Fund is valued on the basis of Fund calculation. Foreign exchange assets and other claims are valued at market prices prevailing at the reference dates.

Relationship of the International Investment Position to External Debt

474. The net international investment position of an economy—that is, external financial assets minus external liabilities—often is used to analyze developments and trends in the performance of an economy vis-à-vis the rest of the world as of a specific date. The net position shows what the economy owns in relation to what it owes in much the same way that a corporate or national balance sheet does. Sometimes the labels *net creditor* or *net debtor*, according to algebraic sign, are used to describe the net position. Although useful for some purposes, such labels are not appropriate as a depiction of the net position. Rather, it is more relevant to view only the nonequity components of the position as debt (i.e., all recorded liabilities other than equity securities and direct investment equity capital, including reinvested earnings). Such a view is in general concordance with the core definition of gross external debt in the joint study *External Debt: Definition, Statistical Coverage, and Methodology* (1988) by the IMF, World Bank, OECD, and Bank for International Settlements.[14]

Investment Income, Rates of Return, and the International Investment Position

475. The links between *investment income* in the balance of payments accounts and the international investment position—particularly those between net investment income and the net position—are complex and underline the importance of consistent classification of transactions and stocks and of viewing the two as an integrated set of accounts.

476. A number of factors can contribute to apparent anomalies between net investment income, on the one hand, and the net investment position on the other. For instance, the former can be positive and the latter negative as a reflection of a higher net rate of return on external assets than on liabilities. That higher rate of return could reflect a greater risk factor abroad; more mature, outward direct investments with higher returns than less mature, inward investments; and/or the relative magnitude of components of the position. In regard to the latter, for example, there might be a large net positive position for the banking sector. As banks earn more on loans than they pay on deposits, their net income would probably more than offset a net negative position (e.g., in equity investment on which dividend payments generally are low in relation to the value of the equity involved). In association with the stock of direct investment, another factor that could result in an artificially high rate of return is the use of historical cost balance sheet values, which may be substantially less than current market values, as the denominator in calculating the rate of return.

[14]Gross external debt is the amount, at any specific time, of disbursed and outstanding contractual liabilities of residents of a country to repay principal, with or without interest, or to pay interest, with or without principal, to nonresidents.

477. The utilization of stocks to derive income flow estimates, as opposed to direct reporting of the latter, may present measurement problems. In cases in which various interest rate and yield assumptions are applied to stocks to estimate income flows (e.g. for securities holdings), the quality of estimates of dividend and interest flows depends not only on the assumptions but on the stock estimates. Estimates based on outdated sources or surveys may well be unreliable. In contrast, income estimates based on direct reporting (e.g., in direct investment surveys) are subject to fewer errors. In any event, both stock and flow estimates can serve as cross-checks on each other. When problems arise, such checks can indicate that up-to-date surveys on stocks of the assets in question are necessary, that methods of collecting data on transactions should be improved, and/or that other avenues to improve estimates be explored. (See the *Guide*.) Finally, the interrelationship between the international investment position and cumulative balance of payments flows and the effects of these on the net lender or net borrower status of an economy have important analytical and policy implications for matters such as the formulation and implementation of adjustment programs, the relative costs and financing requirements of these programs, and the role of the IMF in these matters. (See Appendix 5.)

International Investment Position: Standard Components

	Position at Beginning of Year	Changes in Position Reflecting: Trans-actions	Price Changes	Exchange Rate Changes	Other Adjust-ments	Position at End of Year
A. Assets						
*1. Direct investment abroad**						
1.1 Equity capital and reinvested earnings						
1.1.1 Claims on affiliated enterprises						
1.1.2 Liabilities to affiliated enterprises						
1.2 Other capital						
1.2.1 Claims on affiliated enterprises						
1.2.2 Liabilities to affiliated enterprises						
2. Portfolio investment						
2.1 Equity securities						
2.1.1 Monetary authorities						
2.1.2 General government						
2.1.3 Banks						
2.1.4 Other sectors						
2.2 Debt securities						
2.2.1 Bonds and notes						
2.2.1.1 Monetary authorities						
2.2.1.2 General government						
2.2.1.3 Banks						
2.2.1.4 Other sectors						
2.2.2 Money market instruments						
2.2.2.1 Monetary authorities						
2.2.2.2 General government						
2.2.2.3 Banks						
2.2.2.4 Other sectors						
2.2.3 Financial derivatives						
2.2.3.1 Monetary authorities						
2.2.3.2 General government						
2.2.3.3 Banks						
2.2.3.4 Other sectors						
3. Other investment						
3.1 Trade credits						
3.1.1 General government						
3.1.1.1 Long-term						
3.1.1.2 Short-term						
3.1.2 Other sectors						
3.1.2.1 Long-term						
3.1.2.2 Short-term						

*Because direct investment is classified primarily on a directional basis—abroad under the heading **Assets** and in the reporting economy under the heading **Liabilities**—claim/liability breakdowns are shown for the components of each, although these sub-items do not strictly conform to the overall headings of **Assets** and **Liabilities**.

International Investment Position: Standard Components ***(continued)***

	Position at Beginning of Year	Changes in Position Reflecting:				Position at End of Year
		Trans-actions	Price Changes	Exchange Rate Changes	Other Adjust-ments	
3.2 Loans						
3.2.1 Monetary authorities						
3.2.1.1 Long-term						
3.2.1.2 Short-term						
3.2.2 General government						
3.2.2.1 Long-term						
3.2.2.2 Short-term						
3.2.3 Banks						
3.2.3.1 Long-term						
3.2.3.2 Short-term						
3.2.4 Other sectors						
3.2.4.1 Long-term						
3.2.4.2 Short-term						
3.3 Currency and deposits						
3.3.1 Monetary authorities						
3.3.2 General government						
3.3.3 Banks						
3.3.4 Other sectors						
3.4 Other assets						
3.4.1 Monetary authorities						
3.4.1.1 Long-term						
3.4.1.2 Short-ter m						
3.4.2 General government						
3.4.2.1 Long-term						
3.4.2.2 Short-term						
3.4.3 Banks						
3.4.3.1 Long-term						
3.4.3.2 Short-term						
3.4.4 Other sectors						
3.4.4.1 Long-term						
3.4.4.2 Short-term						
4. Reserve assets						
4.1 Monetary gold						
4.2 Special drawing rights						
4.3 Reserve position in the Fund						
4.4 Foreign exchange						
4.4.1 Currency and deposits						
4.4.1.1 With monetary authorities						
4.4.1.2 With banks						
4.4.2 Securities						
4.4.2.1 Equities						

International Investment Position: Standard Components *(continued)*

	Position at Beginning of Year	Changes in Position Reflecting: Trans-actions	Price Changes	Exchange Rate Changes	Other Adjust-ments	Position at End of Year
4.4.2.2 Bonds and notes						
4.4.2.3 Money market instruments and financial derivatives						
4.5 Other claims						
B. Liabilities						
*1. Direct investment in reporting economy**						
1.1 Equity capital and reinvested earnings						
1.1.1 Claims on direct investors						
1.1.2 Liabilities to direct investors						
1.2 Other capital						
1.2.1 Claims on direct investors						
1.2.2 Liabilities to direct investors						
2. Portfolio investment						
2.1 Equity securities						
2.1.1 Banks						
2.1.2 Other sectors						
2.2 Debt securities						
2.2.1 Bonds and notes						
2.2.1.1 Monetary authorities						
2.2.1.2 General government						
2.2.1.3 Banks						
2.2.1.4 Other sectors						
2.2.2 Money market instruments						
2.2.2.1 Monetary authorities						
2.2.2.2 General government						
2.2.2.3 Banks						
2.2.2.4 Other sectors						
2.2.3 Financial derivatives						
2.2.3.1 Monetary authorities						
2.2.3.2 General government						
2.2.3.3 Banks						
2.2.3.4 Other sectors						
3. Other investment						
3.1 Trade credits						
3.1.1 General government						
3.1.1.1 Long-term						
3.1.1.2 Short-term						

*Because direct investment is classified primarily on a directional basis—abroad under the heading **Assets** and in the reporting economy under the heading **Liabilities**—claim/liability breakdowns are shown for the components of each, although these sub-items do not strictly conform to the overall headings of **Assets** and **Liabilities**.

International Investment Position: Standard Components *(concluded)*

	Position at Beginning of Year	Changes in Position Reflecting: Transactions	Price Changes	Exchange Rate Changes	Other Adjustments	Position at End of Year
3.1.2 Other sectors						
3.1.2.1 Long-term						
3.1.2.2 Short-term						
3.2 Loans						
3.2.1 Monetary authorities						
3.2.1.1 Use of Fund credit and loans from the Fund						
3.2.1.2 Other long-term						
3.2.1.3 Short-term						
3.2.2 General government						
3.2.2.1 Long-term						
3.2.2.2 Short-term						
3.2.3 Banks						
3.2.3.1 Long-term						
3.2.3.2 Short-term						
3.2.4 Other sectors						
3.2.4.1 Long-term						
3.2.4.2 Short-term						
3.3 Currency and deposits						
3.3.1 Monetary authorities						
3.3.2 Banks						
3.4 Other liabilities						
3.4.1 Monetary authorities						
3.4.1.1 Long-term						
3.4.1.2 Short-term						
3.4.2 General government						
3.4.2.1 Long-term						
3.4.2.2 Short-term						
3.4.3 Banks						
3.4.3.1 Long-term						
3.4.3.2 Short-term						
3.4.4 Other sectors						
3.4.4.1 Long-term						
3.4.4.2 Short-term						

Balance of Payments

Regional Allocation

XXIV. Regional Statements

478. Part three of the *Manual* contains a discussion of conceptual and practical issues concerning regional allocation of transactions and stocks of external assets and liabilities.

479. Previous chapters have covered the compilation of global balance of payments and international investment position statements (i.e., statistics concerning the external transactions and the stock of external financial assets and liabilities of an economy in relation to the rest of the world). Similar statements can be compiled on a regional or bilateral basis to show—for a selected group of economies or a particular economy—the external transactions with, or position vis-à-vis, another selected group of economies or a particular economy. Regional compilations have assumed increased importance for statistical, analytical, and policy purposes since the fourth edition of the *Manual* was published. The increased importance of regional compilations reflects developments such as the emergence of large payments imbalances between and among certain individual economies and groups of economies and the transition towards economic and monetary integration, particularly in the European Community but also in other areas. Indeed, if and when such integration is fully achieved, regional balance of payments and position statements will become even more important while statistics for indivi-dual member countries of the integrated areas may become less important. In any event, harmonization of concepts, methodology, and data collection for global and regional balance of payments and position statements will mutually reinforce and improve the quality of international economic accounts.

480. Concepts and recommendations noted in earlier chapters for the compilation of global statements also apply to regional statements, but specific references to residents of the relevant foreign economy or group of economies should be substituted for general references to nonresidents or the rest of the world. This substitution should be made for the compiling economy's payments statements of transactions in goods, services, and income; transactions involving financial claims and liabilities; transactions, which are classified as transfers, with a particular economy or group of economies; and for the position vis-à-vis those economies.

Regional Allocation Principles

481. As for major components of the classifications noted in previous paragraphs, trade in goods generally shows—as a reflection of the change of ownership principle associated with coverage of this item—exports allocated to the region of residence of the new owner and imports allocated to the region of residence of the former owner.[15] When there is no change in ownership (e.g., processing and financial leases), exports and imports of goods are treated as if such a change occurs. For trade in services, allocation is to the region where the provider or acquirer of the service is resident and, for income, to the region where the resident receives or pays the income. For transfers, allocation is to the region of the donor or recipient, as appropriate.

482. In regard to financial flows, there are two principles that may serve as the basis for regional allocation: the debtor/creditor principle and the transactor principle. Under the debtor/creditor principle, changes in financial claims of the compiling economy are allocated to the country of residence of the nonresident debtor, and changes in liabilities are allocated to the country of residence of the nonresident creditor. Under the transactor principle, changes in the claims and liabilities are allocated to the country of residence of the nonresident party to the transaction (the transactor).

483. In many instances, regional allocation of transactions on either basis will coincide (e.g., for bank deposit claims and liabilities, trade credits, and most direct investment transactions). However, in others (i.e., tradable claims), quite different regional allocations may arise, according to which one of the two principles is used. Examples are (portfolio) securities transactions and direct investment acquisitions involving third parties.

484. As concerns the international investment position, data compiled on a regional basis for stocks of financial assets and liabilities are geographically allocated on the

[15] See the *Guide* for a full discussion of the allocation aspects of trade in goods—in particular those aspects related to country of shipment versus country of origin for imports and country shipped to versus country of ultimate destination for exports.

basis of the debtor/creditor principle. Financial claims of the compiling economy are allocated to the country of residence of the nonresident debtor, and liabilities are allocated to the country of residence of the nonresident creditor.

Problems and Limitations

Securities transactions

485. The regional allocation of securities transactions illustrates the dissimilar results produced by, and the limitations of, the debtor/creditor and the transactor principles. Broad secondary markets and the participation of a variety of financial intermediaries characterize international securities transactions. In broad secondary markets, when the debtor/creditor principle is applied to cross-border transactions in domestic securities (those issued by the compiling economy), the resident issuer (debtor) may not be aware of the results of secondary market trading. That is, the issuer may not know the identity or residence of the nonresident buyer (creditor). If financial intermediaries are not acting for their own accounts (if that can be determined), issuers would not usually be aware of the identities or residence of creditors who purchase securities through intermediaries—particularly in an international financial center to which many transactions are directed. Thus, although the debtor/creditor principle is effective on one side the (creditor knows the residency of the debtor), it is not effective on the other; the debtor does not necessarily know, unless such information can be obtained from the intermediary or the creditor, the residency of the creditor. As a result, one could characterize such a situation as the operation of a debtor/transactor principle.[16]

486. However, for transactions in foreign securities, the debtor/creditor principle is effective on both sides because the buyer or seller knows the identity and residence of the issuer (debtor) and can allocate the transaction to the economy of the debtor.[17]

[16]As an example, if a resident in country A sells a domestic security (issued by country A) to a country B intermediary acting on behalf of a buyer resident in country C, compilers in country A (the debtor) generally would not know that the creditor (buyer) is a resident of country C. Only if that information were provided by country B or C to country A could the debtor/creditor principle be implemented, and that is usually not the case. In practice, the sale of the security would most often be recorded by country A as a transaction, equivalent to one made on a debtor/transactor basis, with country B.

[17]For instance, if a resident in country A sells or buys a foreign security issued by country C to or from a resident of country B, the transaction, which is based on the debtor/creditor principle, could be allocated by country A to country C because the identity of country C as the debtor is known to country A.

487. Under the transactor principle, as applied to transactions in domestic securities, the sale of a security issued by country A to an intermediary acting for its own account in country B would be allocated by country A to country B because country B is the nonresident counter party (transactor) to the transaction. If the intermediary in country B were acting on behalf of a resident in country C (if that can be determined), country A would allocate the transaction to country C. No transaction would be recorded between countries A and B. Similarly, a sale of a foreign security (issued by country B) by country A to a country C intermediary acting on behalf of a resident in country D (if that can be determined) would be allocated by country A to country D. No transactions would be recorded by country A with country B or with country C. If the intermediary in country C were acting for its own account, country A would allocate the transaction to country C. No transactions would be recorded, on the basis of the transactor principle, by country A with country B.

488. In practice, whether a foreign intermediary is acting for its own account or on behalf of a resident of another country is seldom known, and information is difficult to obtain. Also, there may be differing interpretations as to whether or not the intermediary actually assumes ownership of the securities before engaging in subsequent transactions. As a result, in practice, allocation of securities transactions on the basis of the transactor principle often is attributed, by the compiling economy, to the financial intermediary's country of residence rather than to the economy of residence of the party on whose behalf the intermediary is acting.

Monetary gold and SDRs

489. Transactions in, or holdings of, monetary gold and SDRs cannot be allocated to any particular region on the basis of the debtor/creditor principle because the two are financial assets for which there are no outstanding liabilities. Thus, such transactions can only be attributed to an unallocated or residual, regional category. On the basis of the transactor principle, purchases or sales of monetary gold are recorded as increases or decreases in *reserve assets* for the compiling economy and vice versa for the counterpart economy. As for SDRs, which are not considered liabilities of the Fund, transactions are recorded in a manner similar to those recorded for monetary gold.

Direct investment transactions involving third parties

490. For *direct investment*, there also may be difficulties concerning the regional allocation of transactions. For instance, a direct investor in country A acquires, from a resident of country C, a direct investment enterprise (or shares in that enterprise) located in country B. Under the debtor/creditor principle, from the standpoint of country A, such a transaction should be recorded between country A and country B because the direct investment position of country A in country B is affected. Under the transactor principle, the transaction should be recorded between country A and country C, which is the residence of the other party to the transaction. A reconciliation item then would be required to bridge the difference between the balance of payments entries and the position because the latter is compiled on the basis of the debtor/creditor principle. (See paragraph 484.)

Multilateral settlements

491. Regional allocation may not necessarily result in a balanced statement for a region. For instance, a resident in the compiling economy may make payment to, or accept payment from, a nonresident (resident of country A) in the form of a claim on another nonresident (resident of country B). Such a situation may arise when claims on a reserve currency country are used by other economies as media for making settlements. The inconsistencies resulting from the allocation of transactions in real resources to the region of the nonresident owner/transactor and changes in financial items to the region of the nonresident creditor or debtor, however, are explicitly recognized by presenting a regional statement compiled in that way. Thus, an item for multilateral settlements restores an accounting balance by serving as an offset to the inconsistencies in the regional statement. That item may be seen to represent, in concept, the settlement of an imbalance in the compiling economy's transactions with one region by a transfer to or from that region of claims on, or liabilities to, some other region or regions.

492. The data on multilateral settlements, however, are seldom available. In practice, therefore, the item is usually derived as a residual; however, it can be calculated only in combination with the item for net errors and omissions, which is also a residual or balancing item. Inconsistencies or errors of this or any other kind in classifying entries regionally should not have any effect on a global statement, which represents the sum total of all regional statements, because multilateral settlements appearing in individual regional statements cancel each other when all regions are combined.

Analytical Implications

493. As noted in paragraph 484, data reflected in the international investment position are geographically allocated on the basis of the debtor/creditor principle. Therefore, adherence to that principle—although it is often difficult to implement—for the allocation of transactions results in a complete and conceptually consistent set of flows and stocks data at a country or regional level. Use of the transactor principle for flows requires a reconciliation to be effected between stocks and flows data.

494. From an analytical perspective, both the debtor/creditor principle and the transactor principle are of interest. The debtor/creditor basis facilitates analyses concerned with such issues as whose securities are being purchased and sold; the relative importance of securities transactions attributable to individual countries (and entities within them) and to regional groups; types of offerings, etc. The transactor basis allows for analysis of where residents engage in securities transactions with nonresidents, changes in the relative importance and growth of international financial centers, etc. In practice, both principles have limitations for assessment of regional and bilateral portfolio transactions.

495. If it is feasible for countries to exchange position data on stocks of appropriate assets and liabilities, the data exchange is helpful for developing more consistent and useful regional allocations of such stocks. Such data provide better information about the identities of nonresident creditors holding the liabilities of the compiling economies.

Selection of Regions

496. Regional statements generally refer to classification of entries by a compiling economy according to the residence of a foreign economic entity, which is either the owner/transactor or the creditor/debtor. The rules on residence presented in this *Manual* (see Chapter 4) are applicable for determining the residence of the entity. A region would then comprise an economic territory or a group of economic territories, as the residence of any entity is based on its association with a specific economic territory. The methods of allocation discussed previously are concerned principally with a regional classification of that sort. A regional statement, however, is sometimes viewed in other ways. A statement may be prepared that shows, for example, those transactions that were originally denominated in a certain currency or undertaken with the residents of a particular currency area, rather than an economic territory.

497. A special case is presented by an international organization that is not included in the economic territory of the country of location or considered resident in that economy. Thus, a separate region for international organizations would be appropriate for allocation purposes.

498. The regional subclassification relevant for a particular economy or group of economies depends primarily on how the statement is to be utilized. This *Manual* does not contain a standard list of countries or regions for which the reporting economy or group should compile separate statements.

Balance of Payments

Appendices

I. Relationship of the Rest of the World Account to the Balance of Payments Accounts and the International Investment Position

Introduction

499. Balance of payments accounts and related data on the international investment position (stocks of external financial assets and liabilities) are closely linked to the SNA. This linkage is reinforced by the fact that, in most countries, data on the balance of payments and the international investment position (IIP) are compiled first and subsequently incorporated in relevant external account components of the SNA rest of the world account. There is virtually complete concordance between the *SNA* and the *Manual* with respect to the delineation of resident units (either producers or consumers); valuation of transactions and of the stock of external assets and liabilities; time of recording of transactions; conversion procedures; coverage of international transactions in goods and services, income flows, current transfers, capital transfers, and foreign financial assets and liabilities; and coverage of the IIP. Differences in classification or level of detail exist, however, between the rest of the world account and the balance of payments accounts. These reflect, inter alia, differences in analytical requirements and the necessity of using, in the SNA, a uniform classification scheme for all sectors of the economy. The bulk of the discussion in this appendix focuses on the relationship between aggregates and details contained in the rest of the world account and corresponding items in balance of payments accounts.

Resident units

500. In the *SNA* and the *Manual,* resident producers and consumers are identified in the same fashion. Chapter 4 of the *Manual,* which contains a discussion on residence, is entirely consistent with Chapter XIV of the *SNA*. In both the SNA and in balance of payments accounts, resident units are identified on the basis of the center of economic interest concept and the definition of economic territory. (These definitions are contained in Chapter 4.)

Valuation

501. In both the SNA and the balance of payments accounts, market price is used as the primary basis of valuation. For transactions accounts, market price refers to the actual price agreed upon by transactors (that is, the amount that a willing buyer pays to acquire something from a willing seller when the exchange is one that occurs between independent parties and one into which nothing but commercial considerations enter). It is noted in Chapter 5 of the *Manual* that market price proxies or equivalents should be used in situations in which market prices in the literal sense cannot be determined (for example, transfer pricing that significantly distorts measurement in resource transfers between affiliated enterprises, barter transactions, grants in kind, etc.). The use of end-of-period market (current) prices or proxies is advocated for both systems in balance sheet accounts affecting external claims and liabilities.

Time of Recording

502. For both systems, the time of recording transactions is the same as that for accrual accounting (that is, when economic value is created, transformed, exchanged, transferred, or extinguished). Claims and liabilities are deemed to arise when there are changes in ownership. Application of the accrual basis is essentially identical in specific categories of transactions in both systems. For example, exports and imports of goods are, in principle, recorded on the basis of changes of ownership although, in both systems, there are specific exceptions with regard to goods under financial lease, goods shipped between affiliated enterprises, goods for processing, and goods underlying merchanting transactions. Services are recorded when actually rendered—times that often coincide with the times at which the services are produced. Interest is recorded on an accrual basis; dividends are recorded as of the dates payable. Reinvested earnings on direct investment are recorded in the periods in which the earnings are generated. Transfers (taxes, fines, etc.) imposed by one party on another are recorded as of the dates of occurrence of the transactions giving rise to the liabilities to pay; other transfers are recorded at the times that the resources to which the transfers are offsets change ownership. Transactions in financial claims and liabilities are recorded on the basis of changes of ownership (that is, when both the creditor and debtor enter the claim and liability, respectively, on their books). Chapter 6 contains a full discussion of the application of the accrual basis underlying the balance of payments accounts.

Conversion Procedures

503. Consistent procedures are employed for converting transactions denominated in a variety of currencies or units of account into the unit of account (usually the national currency) used for compiling the balance of payments statement and the national accounts. Under a single exchange rate system, use of the market exchange rate prevailing at the time the transaction takes place is suggested in the *SNA* and the *Manual.* This rate is defined as the midpoint between buying and selling rates applicable to the transaction or, alternatively, as the average rate for the shortest period applicable. When parallel markets are in existence, the appropriate conversion rate is the rate (midpoint spot rate) applying to foreign currencies purchased or sold in parallel markets.

504. A system of multiple official exchange rates gives rise to implicit taxes and subsidies. In the *SNA,* it is recommended that transactions be converted at the actual (multiple) rates applicable. However, global adjustments reflecting the amount of taxes or subsidies should be shown in the rest of the world account, and counterpart entries should be made under *capital transfers*. Taxes and subsidies are calculated as the difference between (i) the values of transactions at the actual multiple rates applicable to specific transactions and (ii) the values at a unitary rate, which is calculated as a weighted average of all official rates used for external transactions. When multiple rates exist, the use of a unitary or principal rate—that is, the actual (multiple) exchange rate that applies to the largest part of external transactions—is suggested in the *Manual*.

505. For conversion of balance sheet items (stocks of external financial assets and liabilities), the use of actual market exchange rates applicable to specific assets and liabilities on the date to which the balance sheet relates is suggested in the *Manual.*

Classification and Linkages

506. Although harmonization of the coverage of major aggregates has been attained between the two systems, differences in level of detail reflect differences in analytical requirements, the relative quantitative significance of some items in international transactions, and constraints imposed by the internal structures of the respective systems. Nonetheless, bridges can be constructed to derive relevant national accounting flows and stocks from balance of payments accounts and the IIP.

507. In terms of transactions, these accounts are distinguished in the SNA rest of the world account (external transactions account): V.I External account of goods and services, V.II External account of primary incomes and current transfers, V.III.1 Capital account, and V.III.2 Financial account. The latter two are components of V.III External accumulation accounts. In balance of payments accounts, the transactions reflected in accounts V.I and V.II are contained in the **current account;** those reflected in account V.III.1 are contained in the ***capital account*** of the **capital and financial account**. Flows reflected in account V.III.2 are shown in the ***financial account*** of the **capital and financial account**. Account V.III.3.1 Other changes in volume of assets and V.III.3.2 Revaluation account are separate subdivisions of the IIP statement. Thus, account V.III.3.1 corresponds to the column for other adjustments in the IIP, while account V.III.3.2 corresponds to the columns for valuation changes (that is, price changes and exchange rate changes) in the IIP. Account V.IV External assets and liabilities is equivalent to the IIP, which is that part of the national wealth statement representing the stock of external financial assets and liabilities. Located at the end of this appendix, tables 1 through 6 provide a reconciliation between categories shown in relevant external accounts of the SNA and corresponding items in balance of payments accounts and the IIP; tables 7 through 9 refer to the classification scheme that is reflected in the *Manual* and underlies balance of payments accounts and the IIP statement. Items marked with asterisks (*) denote additional details necessary to derive relevant national accounting flows from balance of payments and IIP data.

508. As indicated in Table 1, SNA coverage of exports and imports of goods and exports and imports of services is identical to balance of payments coverage of corresponding items—with the exception of the item "financial intermediation charge indirectly measured." According to the *Manual,* this service is included under *investment income* as an indistinguishable part of interest income. In balance of payments accounts, exports and imports of services are disaggregated in considerable detail to provide data for analysis and policy decisions—particularly for negotiations in international trade in services within the framework of the *General Agreement on Tariffs and Trade.* Categories

of services identified in the balance of payments are consistent with those of the Central Product Classification (CPC)—except for *travel* and *government services n.i.e.*, which have no counterparts.

509. For account V.II, external account of primary incomes and current transfers, comparable categories in the balance of payments are ***1. B. Income*** and ***1. C. Current transfers***. Account V.II coverage of compensation of employees and property income is virtually identical with that of ***1. B. Income*** except that the latter includes "financial intermediation charge indirectly measured" indistinguishably under *investment income*-direct investment-interest. This treatment was adopted because of the practical difficulties of deriving—by sector, instrument, currency, and term structure—a multiplicity of reference rates for interest and appropriate asset or liability positions to estimate the imputed financial intermediary service charge.

510. The major elements of account V.III.1, the capital account of the external accumulation accounts, are identical with the ***capital account*** of the **capital and financial account** of the balance of payments. Although the balancing item net lending/net borrowing in account V.III.1 is not explicitly identified in the balance of payments, this item can be derived by adding the balance of the **current account** and the balance of the transactions reflected in the ***capital account***.

511. Coverage of account V.III.2, the SNA financial account, is identical with that of the ***financial account*** of the **capital and financial account** in the balance of payments, although the level of detail is different. (See Table 4 at the end of this appendix.) In the SNA, financial assets are classified primarily by type of instrument. In the balance of payments, financial items are classified primarily by function—*direct investment, portfolio investment, other investment* (including loans), and *reserve assets*. In addition to categories identifying types of financial instruments (insurance technical reserves being an exception), the balance of payments contains an abbreviated sector breakdown (monetary authorities, general government, banks, and other sectors) to provide links with other bodies of economic and financial statistics such as money and banking, government finance, international banking, and external debt. Furthermore, to conform with the *SNA,* the *Manual* states that entries in the ***financial account*** of the balance of payments are recorded, in principle, on a net basis (increases less decreases in assets or liabilities). However, gross recording is included as supplementary information (for example, in the case of drawings and repayments on long-term loans).

Reconciliation of Rest of the World Accounts with Balance of Payments Accounts

Table 1
Account V.I External Account of Goods and Services

SNA categories		*Correspond to*	*Balance of Payments Standard Components (items), Additional Details, and Aggregates*
USES			**CREDIT**
P.6	Exports of goods and services		Item 1.A.a and 1.A.b.1 through 11, as noted subsequently
P.61	Exports of goods		Item 1.A.a goods
P.62	Exports of services		Sum of items 1.A.b.1 through 11 services plus items 1.B.2.2.2.1.1 and 1.B.2.3.1 financial intermediation charge indirectly measured
RESOURCES			**DEBIT**
P.7	Imports of goods and services		Items 1.A.a and 1.A.b.1 through 11, as noted subsequently
P.71	Imports of goods		Item 1.A.a goods
P.72	Imports of services		Sum of items 1.a.b.1 through 11 services plus items 1.B.2.2.2.1.1 and 1.B.2.3.1 financial intermediation charge indirectly measured
B.11	EXTERNAL BALANCE OF GOODS AND SERVICES		Item 1.A

Table 2
Account V.II External Account of Primary Incomes and Current Transfers

SNA categories		*Correspond to*	*Balance of Payments Standard Components (items), Additional Details, and Aggregates*
USES			**CREDIT**
D.1	Compensation of employees		Item 1.B.1 compensation of employees
D.29	Other taxes on production		Item 1.C.1.2 other taxes on production
D.39	Other subsidies on production		Item 1.C.1.3 other subsidies on production
D.4	Property income		Item 1.B.2 investment income minus items 1.B.2.2.2.1.1 and 1.B.2.3.1 financial intermediation charge indirectly measured
D.5	Current taxes on income, wealth, etc.		Item 1.C.1.1 current taxes on income, wealth, etc.
D.61	Social contributions		Item 1.C.1.4 social contributions

Table 2 ***(concluded)***

Account V.II External Account of Primary Incomes and Current Transfers

SNA categories		*Correspond to*	*Balance of Payments Standard Components (items), Additional Details, and Aggregates*
USES			**CREDIT**
D.62	Social benefits		Item 1.C.2.2.5 social benefits
D.7	Other current transfers		Item 1.C.2.1 workers' remittances plus item 1.C.1.6 other current transfers of general government plus item 1.C.2.2.6 other current transfers of other sectors
D.8	Adjustment for the change in net equity of households in pension funds*		
RESOURCES			**DEBIT**
D.1	Compensation of employees		Item 1.B.1 compensation of employees
D.29	Other taxes on production		Item 1.C.2.2.2 other taxes on production
D.39	Other subsidies on production		Item 1.C.2.2.3 other subsidies on production
D.4	Property income		Item 1.B.2 investment income minus items 1.B.2.2.2.1.1 and 1.B.2.3.1 financial intermediation charge indirectly measured
D.5	Current taxes on income, wealth, etc.		Item 1.C.2.2.1 current taxes on income, wealth etc.
D.61	Social contributions		Item 1.C.2.2.4 social contributions
D.62	Social benefits		Item 1.C.1.5 social benefits
D.7	Other current transfers		Item 1.C.2.1 workers' remittances plus item 1.C.1.6 other current transfers of general government plus item 1.C.2.2.6 other current transfers of other sectors
B.12	CURRENT EXTERNAL BALANCE		Item 1. current account

*Item D.8 is not included in the current account in the balance of payments, nor are the receipts of pensions from, or net contributions to, (funded) pension funds.

Table 3

Account V.III.1 Capital Account [of Account V.III External Accumulation Accounts]

SNA categories		*Correspond to*	*Balance of Payments Components (items), Additional Details, and Aggregates*
CHANGES IN ASSETS			**TRANSACTIONS IN ASSETS**
K.2	Acquisitions less disposals of nonproduced, nonfinancial assets		Item 2.A.2 acquisition/disposal of nonproduced, nonfinancial assets
B.9	NET LENDING (+)/NET BORROWING (–)		Item 1. current account balance plus item 2. A capital account balance

Table 3 ***(concluded)***

Account V.III.1 Capital Account [of Account V.III External Accumulation Accounts]

SNA categories		*Correspond to*	*Balance of Payments Components (items), Additional Details, and Aggregates*
CHANGES IN LIABILITIES AND NET WORTH			TRANSACTIONS IN LIABILITIES
B.12	CURRENT EXTERNAL BALANCE		Item 1. current account
D.9	Capital transfers receivable		Item 2.A.1 capital transfers
D.9	Capital transfers payable		Item 2.A.1 capital transfers
B.10.1	CHANGES IN NET WORTH DUE TO SAVING AND NET CAPITAL TRANSFERS		Item 1. current account balance plus item 2.A.1 net capital transfers

Table 4

Account V.III.2 Financial Account [of Account V.III External Accumulation Accounts]

SNA categories		*Correspond to*	*Balance of Payments Standard Components (items), Additional Details, and Aggregates*
CHANGES IN ASSETS			TRANSACTIONS IN ASSETS
F.1	Monetary gold and SDRs		Sum of items 2.B.4.1 monetary gold and 2.B.4.2 special drawing rights
F.2	Currency and deposits		Sum of items 2.B.3.1.3 currency and deposits (part of other investment) and 2.B.4.3.1 deposits (part of reserve position in the Fund), 2.B.4.4.1 currency and deposits (part of foreign exchange), and 2.B.4.5.1 currency and deposits (part of other reserve claims)
F.3	Securities other than shares		Sum of items 2.B.2.1.2 debt securities (part of portfolio investment), 2.B.4.4.2.2 bonds and notes (part of foreign exchange), 2.B.4.4.2.3 money market instruments and financial derivatives (part of foreign exchange), 2.B.4.5.2.2 debt securities (part of other reserve claims), 2.B.1.2.3.1.1 debt securities issued by direct investors (part of direct investment in the reporting economy), and 2.B.1.1.3.1.1 debt securities issued by affiliated enterprises (part of direct investment abroad)
F.4	Loans		Sum of items 2.B.3.1.2 loans (part of other investment) and 2.B.4.3.2 loans (part of reserve position in the Fund)

Table 4 ***(continued)***
Account V.III.2 Financial Account [of Account V.III External Accumulation Accounts]

SNA categories		*Correspond to*	*Balance of Payments Standard Components (items), Additional Details, and Aggregates*
F.5	Shares and other equity		Sum of items 2.B.1.1.1.1 equity capital-claims on affiliated enterprises (part of direct investment abroad), 2.B.1.1.2 reinvested earnings (part of direct investment abroad), 2.B.1.2.1.1 equity capital-claims on direct investors (part of direct investment in the reporting economy), 2.B.2.1.1 equity securities (part of portfolio investment), and 2.B.4.4.2.1 and 2.B.4.5.2.1 equities (part of foreign exchange and other reserve claims)
F.6	Insurance technical reserves		Sum of items 2.B.3.1.4.4.1.1 net equity of households in life insurance reserves and in pension funds and 2.B.3.1.4.1.1.1, 2.B.3.1.4.2.1.1, 2.B.3.1.4.3.1.1, and 2.B.3.1.4.4.1.2 prepayments of premiums and reserves against outstanding claims (all part of other investment)
F.7	Other accounts receivable		Sum of items 2.B.1.1.3.1.2 other claims on affiliated enterprises (part of direct investment abroad), 2.B.1.2.3.1.2 other claims on direct investors (part of direct investment in the reporting economy), 2.B.3.1.1 trade credits (part of other investment), and 2.B.3.1.4 other assets minus items 2.B.3.1.4.4.1.1, net equity of households in life insurance reserves and in pension funds, and 2.B.3.1.4.1.1.1, 2.B.3.1.4.2.1.1, 2.B.3.1.4.3.1.1, and 2.B.3.1.4.4.1.2 prepayments of premiums and reserves against outstanding claims (all part of other investment)
CHANGES IN LIABILITIES AND NET WORTH			TRANSACTIONS IN LIABILITIES
F.2	Currency and deposits		Item 2.B.3.2.3 currency and deposits
F.3	Securities other than shares		Item 2.B.1.1.3.2.1 debt securities issued by direct investors plus item 2.B.1.2.3.2.1 debt securities issued by affiliated enterprises plus item 2.B.2.2.2 debt securities (part of portfolio investment)
F.4	Loans		Item 2.B.3.2.2 loans

Table 4 ***(concluded)***

Account V.III.2 Financial Account [of Account V.III External Accumulation Accounts]

SNA categories		*Correspond to*	*Balance of Payments Standard Components (items), Additional Details, and Aggregates*
F.5	Shares and other equity		Sum of items 2.B.1.1.1.2 equity capital-liabilities to affiliated enterprises (part of direct investment abroad), item 2.B.1.2.1.2 equity capital-liabilities to direct investors (part of direct investment in the reporting economy), item 2.B.1.2.2 reinvested earnings (part of direct investment in the reporting economy), and item 2.B.2.2.1 equity securities (part of portfolio investment)
F.6	Insurance technical reserves		Sum of items 2.B.3.2.4.4.1.1 net equity of households in life insurance reserves and in pension funds and 2.B.3.2.4.4.1.2 prepayments of premiums and reserves against outstanding claims
F.7	Other accounts payable		Sum of items 2.B.1.1.3.2.2 other liabilities of direct investors (part of direct investment abroad), 2.B.1.2.3.2.2 other liabilities to direct investors (part of direct investment in the reporting economy), item 2.B.3.2.1 trade credits (part of other investment), and item 2.B.3.2.4 other liabilities
			minus items 2.B.3.2.4.4.1.1 net equity of households in life insurance reserves and in pension funds, and 2.B.3.2.4.4.1.2 prepayments of premiums and reserves against outstanding claims (all part of other investment)
B.9	NET LENDING (+)/NET BORROWING (–)		

Table 5

Account V.III.3.1 Other Changes in Volume of Assets Account

SNA Categories		*Correspond to*	*IIP Standard Components and Additional Details*
CHANGES IN ASSETS			CHANGES IN ASSETS
K.7	Catastrophic losses		Catastrophic losses (part of other adjustments)
K.8	Uncompensated seizures		Uncompensated seizures (part of other adjustments)
K.10	Other volume changes in financial assets and liabilities n.e.c.		Other volume changes (part of other adjustments)

Table 5 ***(concluded)***

Account V.III.3.1 Other Changes in Volume of Assets Account

SNA Categories		*Correspond to*	*IIP Standard Components and Additional Details*
K.12	Changes in classifications and structure		Change in classifications and structure (part of other adjustments)
CHANGES IN LIABILITIES AND NET WORTH			CHANGES IN LIABILITIES
K.7	Catastrophic losses		Catastrophic losses (part of other adjustments)
K.12	Changes in classifications and structure		Changes in classifications and structure (part of other adjustments)
B.10.2	CHANGES IN NET WORTH DUE TO OTHER CHANGES IN VOLUME OF ASSETS		

Account V.III.3.2 Revaluation Account

SNA Categories		*Correspond to*	*IIP Standard Components and Additional Details*
CHANGES IN ASSETS			CHANGES IN ASSETS
K.11	Nominal holding gains/losses in financial assets		Sum of entries in the columns for price and exchange rate changes
K.11.1	Neutral holding gains/losses in financial assets		Sum of entries in the columns for neutral holding gains/losses
K.11.2	Real holding gains/losses in financial assets		Sum of entries in the columns for real holding gains/losses
CHANGES IN LIABILITIES AND NET WORTH			CHANGES IN LIABILITIES
K.11	Nominal holding gains/losses in liabilities		Sum of entries in the columns for price and exchange rate changes
K.11.1	Neutral holding gains/losses in liabilties		Sum of entries in the columns for neutral holding gains/losses in liabilities
K.11.2	Real holding gains/losses in liabilities		Sum of entries in the columns for real holding gains/ losses in liabilities
B.10.3	CHANGES IN NET WORTH DUE TO NOMINAL HOLDING GAINS/LOSSES		Price and exchange rate changes in assets less price and exchange rate changes in liabilities
B.10.31	CHANGES IN NET WORTH DUE TO NEUTRAL HOLDING GAINS/LOSSES		Neutral holding gains/losses in assets less neutral holding gains/losses in liabilities
B.10.32	CHANGES IN NET WORTH DUE TO REAL HOLDING GAINS/LOSSES		Real holding gains/losses in assets less real holding gains/losses in liabilities

Table 6

Account V.IV External Assets and Liabilities
Account V.IV.1 Opening Balance Sheet

SNA Categories		Correspond to	IIP Standard Components and Additional Details
AF	Financial assets		ASSETS Sum of items A.1.1.1 claims (equity capital and reinvested earnings) on affiliated enterprises (part of direct investment abroad), A.1.2.1 claims (other capital) on affiliated enterprises (part of direct investment abroad), B.1.1.1 claims (equity capital and reinvested earnings) on direct investors (part of direct investment in the reporting economy), B.1.2.1 claims (other capital) on direct investors (part of direct investment in the reporting economy), A.2 portfolio investment, A.3 other investment, and A.4 reserve assets
AF	Liabilities		LIABILITIES Sum of items B.1.1.2 liabilities (equity capital and reinvested earnings) to direct investors (part of direct investment in the reporting economy), B.1.2.2 liabilities (other capital) to direct investors (part of direct investment in the reporting economy), A.1.1.2 liabilities (equity capital and reinvested earnings) to affiliated enterprises (part of direct investment abroad), A.1.2.2 liabilities (other capital) to affiliated enterprises (part of direct investment abroad), B.2 portfolio investment, and B.3 other investment
B.90	NET WORTH		

Account V.IV.2 Changes Between Balance Sheets

SNA categories		Correspond to	IIP Standard Components and Additional Details
AF	Total changes in financial assets		Sum of transactions, price and exchange rate changes, and other adjustments in respect of the corresponding IIP items identified in account V.IV.1 of the SNA
AF	Total changes in liabilities		Sum of transactions, price and exchange rate changes, and other adjustments in respect of corresponding IIP items identified in account V.IV.I of the SNA

Table 6 ***(concluded)***
Account V.IV.1 Opening Balance Sheet

SNA Categories		Correspond to	IIP Standard Components and Additional Details
			ASSETS
B.10	CHANGES IN NET WORTH, TOTAL		Total changes in item A (assets) minus total changes in item B (liabilities)

Account V.IV.3 Closing Balance Sheet

SNA Categories		Correspond to	IIP Standard Components and Additional Details
AF	Financial assets		Sum of end-of-period values of corresponding items contained in the IIP and identified in account V.IV.I of the SNA
AF	Liabilities		Sum of end-of-period values of corresponding items contained in the IIP and identified in account V.I.V.I of the SNA

Table 7

Balance of Payments: Standard Components and Additional Detail

	Credit	Debit
1. Current account		
A. Goods and services		
a. Goods		
1. General merchandise		
2. Goods for processing		
3. Repairs on goods		
4. Goods procured in ports by carriers		
5. Nonmonetary gold		
5.1 Held as a store of value		
5.2 Other		
b. Services		
1. Transportation		
1.1 Sea transport		
1.1.1 Passenger		
1.1.2 Freight		
1.1.3 Other		
1.2 Air transport		
1.2.1 Passenger		
1.2.2 Freight		
1.2.3 Other		
1.3 Other transport		
1.3.1 Passenger		
1.3.2 Freight		
1.3.3 Other		
2. Travel		
2.1 Business		
2.2 Personal[a]		
3. Communications services		
4. Construction services		
5. Insurance services[b]		
6. Financial services		
7. Computer and information services		
8. Royalties and license fees		
9. Other business services		
9.1 Merchanting and other trade-related services		
9.2 Operational leasing services		
9.3 Miscellaneous business, professional, and technical services[a]		
10. Personal, cultural, and recreational services		
10.1 Audiovisual and related services		
10.2 Other cultural and recreational services		
11. Government services n.i.e.		

[a]See **Selected Supplementary Information** table on page 139 for components.
[b]Memorandum items: 5.1 Gross premiums; 5.2 Gross claims

Table 7 ***(continued)***
Balance of Payments: Standard Components and Additional Detail

	Credit	Debit
B. Income		
1. Compensation of employees		
2. Investment income		
2.1 Direct investment		
2.1.1 Income on equity		
2.1.1.1 Dividends and distributed branch profits[c]		
2.1.1.2 Reinvested earnings and undistributed branch profits[c]		
2.1.2 Income on debt (interest)		
2.2 Portfolio investment		
2.2.1 Income on equity (dividends)		
2.2.2 Income on debt (interest)		
2.2.2.1 Bonds and notes		
2.2.2.1.1 Financial intermediation charge indirectly measured*		
2.2.2.1.2 Other interest		
2.2.2.2 Money market instruments and financial derivatives		
2.3 Other investment		
2.3.1 Financial intermediation charge indirectly measured*		
2.3.2 Other interest		
2.3.3 Imputed income to households from net equity in life insurance reserves and in pension funds*		
C. Current transfers		
1. General government		
1.1 Current taxes on income, wealth etc.*	XXX	
1.2 Other taxes on production*	XXX	
1.3 Other subsidies on production*		XXX
1.4 Social contributions*	XXX	
1.5 Social benefits*		XXX
1.6 Other current transfers of general government*		
2. Other sectors		
2.1 Workers' remittances		
2.2 Other transfers		
2.2.1 Current taxes on income, wealth, etc.*		XXX
2.2.2 Other taxes on production*		XXX
2.2.3 Other subsidies on production*	XXX	
2.2.4 Social contributions*		XXX
2.2.5 Social benefits*	XXX	
2.2.6 Other current transfers of other sectors*		

[c]If distributed branch profits are not identified, all branch profits are considered to be distributed.
*Details necessary for reconciliation with classifications used in the SNA Rest of the World Account

Table 7 ***(continued)***
Balance of Payments: Standard Components and Additional Detail

	Credit	Debit
2. Capital and Financial Account		
A. Capital account		
1. Capital transfers		
1.1 General government		
1.1.1 Debt forgiveness		
1.1.2 Other		
1.2 Other		
1.2.1 Migrants' transfers		
1.2.2 Debt forgiveness		
1.2.3 Other		
2. Acquisition/disposal of nonproduced, nonfinancial assets		
B. Financial account		
1. Direct investment		
1.1 Abroad		
1.1.1 Equity capital		
1.1.1.1 Claims on affiliated enterprises		
1.1.1.2 Liabilities to affiliated enterprises		
1.1.2 Reinvested earnings		
1.1.3 Other capital		
1.1.3.1 Claims on affiliated enterprises		
1.1.3.1.1 Debt securities issued by affiliated enterprises*		
1.1.3.1.2 Other claims on affiliated enterprises*		
1.1.3.2 Liabilities to affiliated enterprises		
1.1.3.2.1 Debt securities issued by direct investors*		
1.1.3.2.2 Other liabilities of direct investors*		
1.2 In reporting economy		
1.2.1 Equity capital		
1.2.1.1 Claims on direct investors		
1.2.1.2 Liabilities to direct investors		
1.2.2 Reinvested earnings		
1.2.3 Other capital		
1.2.3.1 Claims on direct investors		
1.2.3.1.1 Debt securities issued by direct investors*		
1.2.3.1.2 Other claims on direct investors*		
1.2.3.2 Liabilities to direct investors		
1.2.3.2.1 Debt securities issued by affiliated enterprises*		
1.2.3.2.2 Other liabilities to direct investors*		
2. Portfolio investment		
2.1 Assets		
2.1.1 Equity securities		
2.1.1.1 Monetary authorities		
2.1.1.2 General government		
2.1.1.3 Banks		
2.1.1.4 Other sectors		

*Details necessary for reconciliation with classifications used in the SNA Rest of the World Account

Table 7 ***(continued)***

Balance of Payments: Standard Components and Additional Detail

	Credit	Debit
2.1.2 Debt securities		
2.1.2.1 Bonds and notes		
2.1.2.1.1 Monetary authorities		
2.1.2.1.2 General government		
2.1.2.1.3 Banks		
2.1.2.1.4 Other sectors		
2.1.2.2 Money market instruments		
2.1.2.2.1 Monetary authorities		
2.1.2.2.2 General government		
2.1.2.2.3 Banks		
2.1.2.2.4 Other sectors		
2.1.2.3 Financial derivatives		
2.1.2.3.1 Monetary authorities		
2.1.2.3.2 General government		
2.1.2.3.3 Banks		
2.1.2.3.4 Other sectors		
2.2 Liabilities		
2.2.1 Equity securities		
2.2.1.1 Banks		
2.2.1.2 Other sectors		
2.2.2 Debt securities		
2.2.2.1 Bonds and notes		
2.2.2.1.1 Monetary authorities		
2.2.2.1.2 General government		
2.2.2.1.3 Banks		
2.2.2.1.4 Other sectors		
2.2.2.2 Money market instruments		
2.2.2.2.1 Monetary authorities		
2.2.2.2.2 General government		
2.2.2.2.3 Banks		
2.2.2.2.4 Other sectors		
2.2.2.3 Financial derivatives		
2.2.2.3.1 Banks		
2.2.2.3.2 Other sectors		
3. Other investment		
3.1 Assets		
3.1.1 Trade credits		
3.1.1.1 General government		
3.1.1.1.1 Long-term		
3.1.1.1.2 Short-term		
3.1.1.2 Other sectors		
3.1.1.3.1 Long-term		
3.1.1.3.2 Short-term		
3.1.2 Loans		
3.1.2.1 Monetary authorities		
3.1.2.1.1 Long-term		
3.1.2.1.2 Short-term		

Table 7 ***(continued)***

Balance of Payments: Standard Components and Additional Detail

	Credit	Debit
3.1.2.2 General government		
3.1.2.2.1 Long-term		
3.1.2.2.2 Short-term		
3.1.2.3 Banks		
3.1.2.3.1 Long-term		
3.1.2.3.2 Short -term		
3.1.2.4 Other sectors		
3.1.2.4.1 Long-term		
3.1.2.4.2 Short-term		
3.1.3 Currency and deposits		
3.1.3.1 Monetary authorities		
3.1.3.2 General government		
3.1.3.3 Banks		
3.1.3.4 Other sectors		
3.1.4 Other assets		
3.1.4.1 Monetary authorities		
3.1.4.1.1 Long-term		
3.1.4.1.1.1 Prepayments of premiums and reserves against outstanding claims*		
3.1.4.1.1.2 Other assets*		
3.1.4.1.2 Short-term		
3.1.4.2 General government		
3.1.4.2.1 Long-term		
3.1.4.2.1.1 Prepayments of premiums and reserves against outstanding claims*		
3.1.4.2.1.2 Other assets*		
3.1.4.2.2 Short-term		
3.1.4.3 Banks		
3.1.4.3.1 Long-term		
3.1.4.3.1.1 Prepayments of premiums and reserves against outstanding claims*		
3.1.4.3.1.2 Other assets*		
3.1.4.3.2 Short-term		
3.1.4.4 Other sectors		
3.1.4.4.1 Long-term		
3.1.4.4.1.1 Net equity of households in life insurance reserves and in pension funds*		
3.1.4.4.1.2 Prepayments of premiums and reserves against outstanding claims*		
3.1.4.4.1.3 Other assets*		
3.1.4.4.2 Short-term		

*Details necessary for reconciliation with classifications used in the SNA Rest of the World Account

Table 7 ***(continued)***

Balance of Payments: Standard Components and Additional Detail

	Credit	Debit
3.2 Liabilities		
3.2.1 Trade credits		
3.2.1.1 General government		
3.2.1.1.1 Long-term		
3.2.1.1.2 Short-term		
3.2.1.2 Other sectors		
3.2.1.3.1 Long-term		
3.2.1.3.2 Short-term		
3.2.2 Loans		
3.2.2.1 Monetary authorities		
3.2.2.1.1 Use of Fund credit and loans from the Fund		
3.2.2.1.2 Other long-term		
3.2.2.1.3 Short-term		
3.2.2.2 General government		
3.2.2.2.1 Long-term		
3.2.2.2.2 Short-term		
3.2.2.3 Banks		
3.2.2.3.1 Long-term		
3.2.2.3.2 Short -term		
3.2.2.4 Other sectors		
3.2.2.4.1 Long-term		
3.2.2.4.2 Short-term		
3.2.3 Currency and deposits		
3.2.3.1 Monetary authorities		
3.2.3.2 Banks		
3.2.4 Other liabilities		
3.2.4.1 Monetary authorities		
3.2.4.1.1 Long-term		
3.2.4.1.2 Short-term		
3.2.4.2 General government		
3.2.4.2.1 Long-term		
3.2.4.2.2 Short-term		
3.2.4.3 Banks		
3.2.4.3.1 Long-term		
3.2.4.3.2 Short -term		
3.2.4.4 Other sectors		
3.2.4.4.1 Long-term		
3.2.4.4.1.1 Net equity of households in life insurance reserves and in pension funds*		
3.2.4.4.1.2 Prepayments of premiums and reserves against outstanding claims*		
3.2.4.4.1.3 Other liabilities*		
3.2.4.4.2 Short-term		

*Details necessary for reconciliation with classifications used in the SNA Rest of the World Account

Table 7 ***(concluded)***
Balance of Payments: Standard Components and Additional Detail

	Credit	Debit
4. Reserve assets		
4.1 Monetary gold		
4.2 Special drawing rights		
4.3 Reserve position in the Fund		
4.3.1 Deposits*		
4.3.2 Loans*		
4.4 Foreign exchange		
4.4.1 Currency and deposits		
4.4.1.1 With monetary authorities		
4.4.1.2 With banks		
4.4.2 Securities		
4.4.2.1 Equities		
4.4.2.2 Bonds and notes		
4.4.2.3 Money market instruments and financial derivatives		
4.5 Other claims		
4.5.1 Currency and deposits*		
4.5.2 Securities*		
4.5.2.1 Equities*		
4.5.2.2 Debt securities*		

*Details necessary for reconciliation with classifications used in the SNA Rest of the World Account

Table 8
Selected Supplementary Information

1. *Liabilities constituting foreign authorities' reserves*
    1.1 Bonds and other securities
        1.1.1 Monetary authorities
        1.1.2 General government
        1.1.3 Banks
        1.1.4 Other sectors
    1.2 Deposits
        1.2.1 Monetary authorities
        1.2.2 Banks
    1.3 Other liabilities
        1.3.1 Monetary authorities
        1.3.2 General government
        1.3.3 Banks
        1.3.4 Other sectors
2. *Exceptional financing transactions*
    2.1 Transfers
        2.1.1 Debt forgiveness
        2.1.2 Other intergovernmental grants
        2.1.3 Grants received from Fund subsidy accounts
    2.2 Direct investment
        2.2.1 Investment associated with debt reduction
        2.2.2 Other
    2.3 Portfolio investment: borrowing by authorities or by other sectors on behalf of authorities—liabilities*
    2.4 Other investment—liabilities*
        2.4.1 Drawings on new loans by authorities or by other sectors on behalf of authorities
        2.4.2 Rescheduling of existing debt
        2.4.3 Accumulation of arrears
            2.4.3.1 Principal on short-term debt
            2.4.3.2 Principal on long-term debt
            2.4.3.3 Original interest
            2.4.3.4 Penalty interest
        2.4.4 Repayments of arrears
            2.4.4.1 Principal
            2.4.4.2 Interest
        2.4.5 Rescheduling of arrears
            2.4.5.1 Principal
            2.4.5.2 Interest
        2.4.6 Cancellation of arrears
            2.4.6.1 Principal
            2.4.6.2 Interest
3. *Other transactions*
    3.1 Portfolio investment income
        3.1.1 Monetary authorities

*Specify sector involved and standard component in which the item is included.

Table 8 *(concluded)*
Selected Supplementary Information

- 3.1.2 General government
- 3.1.3 Banks
- 3.1.4 Other sectors
- 3.2 Other (than direct investment) income
  - 3.2.1 Monetary authorities
  - 3.2.2 General government
  - 3.2.3 Banks
  - 3.2.4 Other sectors
- 3.3 Other investment (liabilities)
  - 3.3.1 Drawings on long-term trade credits
  - 3.3.2 Repayments of long-term trade credits
  - 3.3.3 Drawings on long-term loans
  - 3.3.4 Repayments of long-term loans

4. Services sub-items

- 4.1 Travel (personal)
  - 4.1.1 Health-related
  - 4.1.2 Education-related
  - 4.1.3 Other
- 4.2 Miscellaneous business, professional, and technical services
  - 4.2.1 Legal, accounting, management consulting, and public relations
  - 4.2.2 Advertising, market research, and public opinion polling
  - 4.2.3 Research and development
  - 4.2.4 Architectural, engineering, and other technical services
  - 4.2.5 Agricultural, mining, and on-site processing
  - 4.2.6 Other

Table 9

International Investment Position: Standard Components and Additional Details

	Position at Beginning of Year	Changes in Position Reflecting						Position at End of Year
		Transactions	Price Changes *a	Price Changes *b	Exchange Rate Changes *a	Exchange Rate Changes *b	Other Adjustments	
A. Assets								
1. Direct investment abroad♦								
1.1 Equity capital and reinvested earnings								
1.1.1 Claims on affiliated enterprises								
1.1.2 Liabilities to affiliated enterprises								
1.2 Other capital								
1.2.1 Claims on affiliated enterprises								
1.2.2 Liabilities to affiliated enterprises								
2. Portfolio investment								
2.1 Equity securities								
2.1.1 Monetary authorities								
2.1.2 General government								
2.1.3 Banks								
2.1.4 Other sectors								
2.2 Debt securities								
2.2.1 Bonds and notes								
2.2.1.1 Monetary authorities								
2.2.1.2 General government								
2.2.1.3 Banks								
2.2.1.4 Other sectors								
2.2.2 Money market instruments								
2.2.2.1 Monetary authorities								
2.2.2.2 General government								
2.2.2.3 Banks								
2.2.2.4 Other sectors								
2.2.3 Financial derivatives								
2.2.3.1 Monetary authorities								
2.2.3.2 General government								
2.2.3.3 Banks								
2.2.3.4 Other sectors								
3. Other investment								
3.1 Trade credits								
3.1.1 General government								
3.1.1.1 Long-term								
3.1.1.2 Short-term								
3.1.2 Other sectors								
3.1.2.1 Long-term								
3.1.2.2 Short-term								

♦Because direct investment is classified primarily on a directional basis—abroad under the heading ***Assets*** and in the reporting economy under the heading ***Liabilities***—disaggregations of claims/liabilities are shown for the components of each, although these sub-items do not strictly conform to the overall headings of ***Assets*** and ***Liabilities.***

*Details necessary for reconciliation with classifications used in the SNA Rest of the World Account: a = neutral holding gains/losses; b = real holding gains/losses

Table 9 *(continued)*
International Investment Position: Standard Components and Additional Details

	Position at Beginning of Year	Changes in Position Reflecting: Trans-actions	Price Changes *a	Price Changes *b	Exchange Rate Changes *a	Exchange Rate Changes *b	Other Adjust-ments	Position at End of Year
3.2 Loans								
3.2.1 Monetary authorities								
3.2.1.1 Long-term								
3.2.1.2 Short-term								
3.2.2 General government								
3.2.2.1 Long-term								
3.2.2.2 Short-term								
3.2.3 Banks								
3.2.3.1 Long-term								
3.2.3.2 Short-term								
3.2.4 Other sectors								
3.2.4.1 Long-term								
3.2.4.2 Short-term								
3.3 Currency and deposits								
3.3.1 Monetary authorities								
3.3.2 General government								
3.3.3 Banks								
3.3.4 Other sectors								
3.4 Other assets								
3.4.1 Monetary authorities								
3.4.1.1 Long-term								
3.4.1.2 Short-term								
3.4.2 General government								
3.4.2.1 Long-term								
3.4.2.2 Short-term								
3.4.3 Banks								
3.4.3.1 Long-term								
3.4.3.2 Short-term								
3.4.4 Other sectors								
3.4.4.1 Long-term								
3.4.4.2 Short-term								
4. Reserve assets								
4.1 Monetary gold								
4.2 Special drawing rights								
4.3 Reserve position in the Fund								
4.4 Foreign exchange								
4.4.1 Currency and deposits								
4.4.1.1 With monetary authorities								
4.4.1.2 With banks								
4.4.2 Securities								
4.4.2.1 Equities								

*Details necessary for reconciliation with classifications used in the SNA Rest of the World Account: a = neutral holding gains/losses; b = real holding gains/losses

Table 9 *(continued)*

International Investment Position: Standard Components and Additional Details

	Position at Beginning of Year	Changes in Position Reflecting Trans- actions	Price Changes *a	Price Changes *b	Exchange Rate Changes *a	Exchange Rate Changes *b	Other Adjust- ments	Position at End of Year
4.4.2.2 Bonds and notes								
4.4.2.3 Money market instruments and financial derivatives								
4.5 Other claims								
B. Liabilities								
1. *Direct investment in reporting economy*♦								
1.1 Equity capital and reinvested earnings								
1.1.1 Claims on direct investors								
1.1.2 Liabilities to direct investors								
1.2 Other capital								
1.2.1 Claims on direct investors								
1.2.2 Liabilities to direct investors								
2. *Portfolio investment*								
2.1 Equity securities								
2.1.1 Banks								
2.1.2 Other sectors								
2.2 Debt securities								
2.2.1 Bonds and notes								
2.2.1.1 Monetary authorities								
2.2.1.2 General government								
2.2.1.3 Banks								
2.2.1.4 Other sectors								
2.2.2 Money market instruments								
2.2.2.1 Monetary authorities								
2.2.2.2 General government								
2.2.2.3 Banks								
2.2.2.4 Other sectors								
2.2.3 Financial derivatives								
2.2.3.1 Monetary authorities								
2.2.3.2 General government								
2.2.3.3 Banks								
2.2.3.4 Other sectors								
3. *Other investment*								
3.1 Trade credits								
3.1.1 General government								
3.1.1.1 Long-term								
3.1.1.2 Short-term								

♦Because direct investment is classified primarily on a directional basis—abroad under the heading ***Assets*** and in the reporting economy under the heading ***Liabilities***—disaggregations of claims/liabilities are shown for the components of each, although these sub-items do not strictly conform to the overall headings of ***Assets*** and ***Liabilities.***

*Details necessary for reconciliation with classifications used in the SNA Rest of the World Account: a = neutral holding gains/losses; b = real holding gains/losses

Table 9 ***(concluded)***

International Investment Position: Standard Components and Additional Details

	Position at Beginning of Year	Changes in Position Reflecting						Position at End of Year
		Trans- actions	Price Changes		Exchange Rate Changes		Other Adjust- ments	
			*a	*b	*a	*b		
3.1.2 Other sectors								
3.1.2.1 Long-term								
3.1.2.2 Short-term								
3.2 Loans								
3.2.1 Monetary authorities								
3.2.1.1 Use of Fund credit and loans from the Fund								
3.2.1.2 Other long-term								
3.2.1.3 Short-term								
3.2.2 General government								
3.2.2.1 Long-term								
3.2.2.2 Short-term								
3.2.3 Banks								
3.2.3.1 Long-term								
3.2.3.2 Short-term								
3.2.4 Other sectors								
3.2.4.1 Long-term								
3.2.4.2 Short-term								
3.3 Currency and deposits								
3.3.1 Monetary authorities								
3.3.2 Banks								
3.4 Other liabilities								
3.4.1 Monetary authorities								
3.4.1.1 Long-term								
3.4.1.2 Short-term								
3.4.2 General government								
3.4.2.1 Long-term								
3.4.2.2 Short-term								
3.4.3 Banks								
3.4.3.1 Long-term								
3.4.3.2 Short-term								
3.4.4 Other sectors								
3.4.4.1 Long-term								
3.4.4.2 Short-term								

*Details necessary for reconciliation with classifications used in the SNA Rest of the World Account: a = neutral holding gains/losses; b = real holding gains/losses

II. A Note on Sectors

512. As presented in this *Manual*, sectorization of the balance of payments *portfolio investment* and *other investment* accounts and related components of the international investment position strengthens the links between the international accounts, the SNA, and IMF statistical systems such as money and banking, government finance, and international banking. In addition, the sectorization enhances the analytic usefulness of the accounts.

513. Identification of four sectors—monetary authorities, general government, banks, and other sectors—of the compiling economy provides a combined functional and institutional approach to sectorization. Although the sectors do not comprise institutional units as in the SNA, there is a significant degree of concordance with that system. Specific differences are noted subsequently.

514. The monetary authorities sector, which is based on a functional concept, includes the central bank (or currency board, monetary agency, etc.) and certain operations that are usually attributed to the central bank but are sometimes carried out by other government institutions or commercial banks. Such operations include the issuance of currency; maintenance and management of international reserves, including those resulting from transactions with the IMF; and the operation of exchange stabilization funds. Such transactions are, in effect, rerouted through the central bank. This coverage of monetary authorities is consistent with that described in the IMF draft of the *Manual on Monetary and Financial Statistics*. In the SNA, the central bank is a subsector of the financial corporate sector.

515. The general government sector, with the exception noted in the previous paragraph, is consistent with that sector in the SNA. General government consists of (i) government units that exist at each level—central, state, or local—of government within the national economy; (ii) social security funds operated at each level of government; (iii) nonprofit institutions that are majority financed and controlled by government units; and (iv) unincorporated enterprises that are owned and operated by government units and that produce goods and services, including collective services or public goods. (However, if it is appropriate under *SNA* guidelines to treat unincorporated enterprises as quasi-corporations, such enterprises are allocated to the financial or nonfinancial corporate sectors.)

516. The banking sector is identical with the "other (than the central bank) depository corporations" subsector of the financial corporate sector in the SNA and the "other (than the central bank) depository institutions" subsector of the financial institutions sector in IMF money and banking statistics. Included are all resident units engaging in financial intermediation as a principal activity and having liabilities in the form of deposits or financial instruments (such as short-term certificates of deposit) that are close substitutes for deposits. Deposits include those payable on demand and transferable by check or otherwise usable for making payments and those that, while not readily transferable, may be viewed as substitutes for transferable deposits. Thus, in addition to commercial banks, the banking sector encompasses institutions such as savings banks, savings and loan associations, credit unions or cooperatives, building societies, and post office savings banks or other government-controlled savings banks (if such banks are institutional units separate from government).

517. The other sectors category is comprised of nonfinancial corporations (private, public, and quasi-corporations), insurance companies, pension funds, other nondepository financial intermediaries, private nonprofit institutions, and households.

III. Balance of Payments Classification of International Services and the Central Product Classification

Classification of International Transactions in Services

Scope

518. The classification of international transactions in services, which is included among the standard components of the balance of payments, provides for the recording of all international trade in services. The classification is not as detailed as the Central Product Classification (CPC), mainly because the CPC applies to the structure of total production and encompasses domestic as well as international transactions. Meaningful analytical categories are formed by combining appropriate items that may be comparatively insignificant in international transactions, although such items may be important in domestic transactions.

Structure and coding system of the classification

519. The structure of the classification is hierarchical, and the related coding system is decimal—as is the CPC. The categories were developed from the subclasses (five-digit codes), classes (four-digit codes), groups (three-digit codes), and divisions (two-digit codes) of the CPC, although the classification corresponds with the CPC mostly at the three-digit level. Other differences from the CPC are discussed subsequently in this appendix.

520. The classification is flexible in that each three-digit category (the most detailed in the classification) can be expanded by the addition of another decimal place. Conversely, if less detail is available, one- or two-digit categories are appropriate.

Central Product Classification

Objectives

521. The main objective of the CPC is to provide a framework for international comparison of various kinds of statistics on goods, services, and assets. The CPC is a useful guide for countries and international organizations that are developing new systems or revising existing schemes in order to make such systems or schemes compatible with the international standard.

Scope

522. The CPC covers categories for all products that can be the objects of domestic or international transactions or entered into stocks. In addition to products that are the output of economic activity, nonproduced assets—including land and intangible assets such as patents, licenses, trademarks, and copyrights—that arise from legal contracts are also covered.

Structure and coding system

523. The structure of the CPC is hierarchical, and the coding system is purely decimal. The classification consists of sections (identified by the first digit), divisions (identified by the first and second digits), groups (identified by the first three digits), classes (identified by the first four digits), and subclasses (identified by five digits). Codes for the sections range from zero through nine, and each section may be divided into nine divisions. At the third digit of the code, each division may, in turn, be divided into nine groups, which may be further divided into nine classes and into nine subclasses.

Differences Between the CPC and the Balance of Payments Classification

524. Although the balance of payments classification closely follows the CPC, there are a number of differences in coverage and classification between the two systems:

Two categories, *travel* and *government services n.i.e.*, in the balance of payments classification of services do not have analogues in the CPC.

Travel is covered as a balance of payments category because it subsumes a number of related services such as appropriate transportation, catering, entertainment, etc. Also, data for this item are collected from the consumers of these services, and most countries present data in this form in balance of payments statements.

Government services n.i.e., includes the consumption of goods and services by embassies, consulates, military, and other establishments of foreign governments; of diplomatic and consular staff and their dependents in the countries where they are stationed; and of international and regional organizations. This category also includes public administration and other services provided by governments and extraterritorial organizations.

Whereas the CPC treats all processing and repairs as service items, the balance of payments classification treats only the value of on-site processing and certain repairs (e.g., on computers, construction, and transport equipment maintenance performed in ports and airports) as ***services*** to be reported under the appropriate category. All other processing and the value of all other repairs are included in the balance of payments under ***goods*** on the practical grounds that most processing involves transformation of the goods and most repairs are made to investment goods.

525. The table on pages 148 and 149 shows the correspondence of balance of payments standard components to various CPC categories.

Comparison of the Balance of Payments Classification of International Transactions in Services and the Central Product Classification (CPC)[1]

	Central Product Classification[2]			
	Section	Division	Group	Class
1. *Transportation*	7			
1.1 Sea transport			721+part	
1.1.1 Passenger			of 745	7211
1.1.2 Freight				7212
1.1.3 Other				7213+7214+part of sea-going vessels in 745
1.2 Air transport		73		
1.2.1 Passenger			731	7311+7312
1.2.2 Freight			732	7321+7322+7329
1.2.3 Other			734+746	
1.3 Other transport[3]				
1.3.1 Passenger				
1.3.2 Freight				
1.3.3 Other				
2. *Travel*[4]				
2.1 Business				
2.2 Personal[5]				
2.2.1 Health-related*				
2.2.2 Education-related*				
2.2.3 Other				
3. *Communications services*		756	7511+7512	
4. *Construction services*		51	511 through 518	
5. *Insurance services*[7]			812+814	
6. *Financial services*		part of 81	811	8111 through 8113
7. *Computer and information services*		84	+ 962	9621
8. *Royalties and license fees*			892	8921+8922
9. *Other business services*[8]				
9.1 Merchanting and other trade-related services		62	621	6211
9.2 Operational leasing services		83	831	8310
9.3 Miscellaneous business, professional, and technical services*				

	Central Product Classification[2]			
	Section	Division	Group	Class
10. *Personal, cultural, and recreational services*		96+97	(excluding 962)	
10.1 Audiovisual and related services			961	9611 through 9613
10.2 Other cultural and recreational services			963, 964, 970, 9619	

[1]Categories left blank have no direct correspondence with the Central Product Classification (CPC).
[2]Section = one-digit; division = two-digit; group = three-digit; class = four-digit
[3]Comprises CPC groups 711, 712, 713, 722, 733, 741 through 744, part of 745, 748, and 749
[4]Includes CPC classes 7471 and 7472
[5]Includes CPC divisions 92 and 93
[6]Excludes classes 7541 and 7542
[7]Memorandum items: 5.1 Gross premiums and 5.2 Gross claims
[8]Comprises CPC divisions 62, 83, and 85 through 88
*These subdivisions are not included among the standard components of the balance of payments but are included under selected supplementary information.

		Central Product Classification			
		Section	**Division**	**Group**	**Class**
9.3.1	Research and Development		85	851 through 853	8510 through 8530
9.3.2	Legal, accounting, management consulting, and public relations			861+862 +865+part of 864	8611 through 8613+8619 +8621 through 8622
9.3.3	Advertising, market research, and public opinion polling			871+864	8711 through 8712+8719
9.3.4	Architectural, engineering, and other technical services			867	8671 through 8676
9.3.5	Agricultural, mining, and on-site processing		88°	881 through 883	8811 through 8830
9.3.6	Other		82	863+866+ 872 through 879	8720+8730+8740+ 8750+8760+8790

°Part of 88 relates to maintenance of transportation equipment.

IV. Accounting for Exceptional Financing Transactions

526. The accounting procedures for recording exceptional financing transactions in the balance of payments are relevant in the context of an analytic presentation such as the IMF's aggregated presentation in the *Balance of Payments Statistics Yearbook* (*BOPSY*). In an analytic presentation, exceptional financing transactions that accommodate balance of payments needs are shown below the line in the appropriate accounts; credit entries and corresponding debit entries are shown above the line. However, there are some cases in which below-the-line debit entries are also recorded under exceptional financing (e.g., when payments arrears are extinguished by way of repayment, forgiveness, refinancing, rescheduling, or other arrangements and when the authorities—for balance of payments reasons—make loan repayments in advance of the due dates).

527. The table at the end of Appendix 4 summarizes (in both analytic and standard presentations) appropriate balance of payments entries for recording selected exceptional financing transactions for debtor countries. Entries for creditor countries should be fully symmetrical. However, for creditor countries, there should be no below-the-line entries under exceptional financing. The table, for illustrative purposes, shows separate credit and debit entries for each relevant item of the ***financial account***, although net recording is generally recomended in the *Manual* for the ***financial account***. In practice, credit and debit entries affecting the same item of the ***financial account*** will cancel each other and thus will not appear as separate entries in the balance of payments statement.

Accumulation of Arrears

528. In the standard presentation of the balance of payments, arrears of interest and amortization—that is, amounts that are past due and unpaid—are recorded as if the amounts had been paid on schedule. An offsetting entry is made to reflect the associated new short-term liability. For arrears of interest accrued in the current recording period, a debit entry is recorded under *investment income* in the **current account**, and a corresponding credit entry is made under *other investment*-other liabilities (short-term) in the ***financial account*** for the accrual of arrears. For arears of interest accrued in a previous recording period, the entries are somewhat different. The accrual principle for recording interest requires a debit entry under *investment income* in the period in which interest was accrued and an offsetting credit entry in the ***financial account*** under the appropriate instrument. Subsequently, when arrears are incurred on interest accrued in a previous period, a debit entry is recorded under the appropriate instrument in the ***financial account*** and a credit contra entry is recorded for the accrual of arrears under *other investment*-other liabilities (short-term). For amortization arrears, a debit entry is made in the appropriate component of the ***financial account*** (for example, short- or long-term loans under *other investment*) and a credit contra entry is made under *other investment*-other liabilities (short-term) for the accrual of arrears.

529. In the analytic presentation, only payments arrears resulting from balance of payments difficulties (that is, arrears resulting from the inability of the authorities to provide foreign exchange and not from the inability of the original debtor to provide national currency) are included under exceptional financing. Such payments arrears are recorded below the line as credit entries under exceptional financing, and offsetting debit entries are recorded above the line under the appropriate account.

Repayment of Arrears

530. In the standard presentation of the balance of payments, the repayment of arrears—cash settlements (only) of both interest and amortization—is recorded as a debit entry under *other investment*-other liabilities (short-term), and a corresponding credit entry is recorded under *reserve assets*.

531. In the analytic presentation, repayments of arrears arising from balance of payments needs are recorded below the line as debit entries under exceptional financing (for the reduction of liabilities), and corresponding credit contra entries are recorded under *reserve assets*.

Debt Forgiveness

532. In the standard presentation of the balance of payments, debt forgiveness—the voluntary cancellation of all or part of a debt within a contractual arrangement between a creditor in one economy and a debtor in another economy that is experiencing balance of payments difficulties—is recorded by the debtor as a credit entry under *capital transfers*. An offsetting debit entry is recorded for the reduction of the liability in the ***financial account***. The appropriate debit entries depend upon the recording period in which the forgiven debt service obligations fall due. For forgiveness of obligations past due (that is, arrears of interest and amortization), a debit entry is recorded under *other investment*-other liabilities (short-term). For forgiveness of obligations due in the current recording period, a debit entry is recorded, under the appropriate debt instrument in the ***financial account***, for the reduction of the principal and for any interest accrued in the previous period. For interest accruing in the current recording period, a debit entry is recorded under *investment income* in the **current account**. For forgiveness of an obligation not yet due, a debit entry is recorded under the appropriate debt instrument in the ***financial account***. No entry is made for interest not yet due.

533. In the analytic presentation, debt forgiveness for obligations falling due in the current recording period and in arrears is recorded below the line as a credit entry under exceptional financing. Corresponding debit entries are recorded above the line—except when arrears are forgiven, in which case the debit entry is recorded below the line. In contrast, for the forgiveness of debt not yet due, credit and debit entries are recorded above the line so that entries are the same in both the analytic and standard presentations.

534. For valuation of debts forgiven, it is recomended in the *Manual* that, in principle, market prices be used as the valuation basis for both flows and stocks. Because typical debt forgiveness agreements are usually restricted to debt that is owed to official creditors and not traded in organized markets, the value recorded for such nonmarketable debt instruments is nominal or face value, which—in this case—is an acceptable proxy for market value.

Other Intergovernmental Grants

535. Grants (including grants from Fund subsidy accounts) provided for the purpose of satisfying balance of payments needs in the recipient country are part of exceptional financing. In the analytic presentation, the grants are recorded below the line as credit entries under exceptional financing, and a corresponding debit entry is recorded under *reserve assets*.

Debt/Bond Swaps

536. In the standard balance of payments presentation, a debt/bond swap (the exchange, usually at a discount, of an existing debt instrument such as a loan for another form of debt instrument such as a bond) is recorded by the debtor as a credit entry under *portfolio investment* to show the creation of the new obligation. An offsetting debit entry is made under the appropriate debt instrument for the reduction in liabilities. Appropriate debit entries are shown in the table at the end of Appendix 4.

537. In the analytic presentation, debt/bond swaps of obligations falling due in the reporting period and in arrears are recorded below the line as credit entries under exceptional financing; corresponding debit entries are made above the line. However, when arrears are canceled as a result of debt/bond swaps, debit entries are recorded below the line. For obligations not yet due, appropriate entries are recorded above the line.

538. A debt/bond swap often involves a difference between the nominal or face value of the debt swapped and the face value of the bond being issued. In the balance of payments, such swaps are recorded at market prices. If the bond is similar to other bonds being traded, the market price of a traded bond would be an appropriate proxy for the value of the new bond. If the debt being swapped was recently acquired by the creditor, the acquisition price would be an appropriate proxy. Alternatively, if the coupon interest rate on the new bond is below the prevailing interest rate, the discounted value of the bond could serve as a proxy. If such information is not available, the face value of the bond being issued may be used as a proxy. The difference between the face value of the old debt and the market price of the new bond represents a realized holding (capital) loss for the creditor.

Debt/Equity Swaps

539. Debt/equity swaps consist of the exchange, usually at a discount, of bank claims on, or other debt instruments of, debtor economies for nonresident investors' equity investments in those economies.

540. For debt exchanged directly for equity investment, the recording is similar to that for debt/bond swaps (discussed in paragraphs 536 through 538). In this case, however, the credit entries should be made under *direct investment*-equity capital. These transactions should be recorded at the prices at which the equity investors acquired the claims in the secondary market.

541. Under a second modality, a fixed-payment liability denominated in foreign currency (e.g., a debt security or loan) is exchanged at a discount for a financial instrument denominated in domestic or foreign currency or exchanged directly for a domestic deposit. In the standard presentation, this transaction is recorded by the debtor as an increase in liabilities (credit) under the appropriate financial instrument exchanged for the debt being redeemed; corresponding debit entries depend on the classification of the obligation (liability) being redeemed. Subsequently, the nonresident investor exchanges the financial instrument received for equity investment in an enterprise of the debtor economy. At this point, a credit entry is recorded under *direct investment*-equity capital, and an offsetting debit entry is made under the appropriate financial instrument being exchanged. Specific entries are shown in the table at the end of Appendix 4.

542. In the analytic presentation, only the initial transaction associated with a debt/equity swap is relevant. Swaps of obligations falling due in the reporting period and in arrears are recorded below the line as credit entries under exceptional financing; corresponding debit entries are made above the line. A debit entry is also recorded below the line if arrears are canceled as a result of the debt/equity swap agreement. For obligations not yet due, no entries are recorded below the line as exceptional financing.

543. Debt/equity swaps are valued at market prices in the balance of payments. If the balance of payments is compiled in foreign currency, the market value in foreign currency of the first transaction—the exchange of the debt instrument for another type of financial instrument—is the price at which the claim on the debtor country was acquired from the original creditor by the nonresident equity investor. The second transaction associated with the debt/equity swap is recorded on the basis of the price (paid in domestic currency and converted into foreign currency at the market exchange rate) for the equity acquired by the nonresident investor. If the balance of payments is compiled in domestic currency, the value for the first transaction is the amount received by the equity investor in exchange for the debt instrument.[18] For the second transaction, the value is the domestic currency value of the equity acquired by the nonresident investor.

Borrowing for Balance of Payments Support

544. Borrowing for balance of payments support refers to borrowing (including bond issues) by the government or central bank (or by other sectors on behalf of the authorities) to meet balance of payments needs. In the analytical presentation, the drawing of such a loan or the issue of such a bond is recorded below the line as a credit entry under exceptional financing; subsequent repayments are recorded above the line. Advance repayments for balance of payments purposes are also recorded under exceptional financing.

Rescheduling and Refinancing

545. Debt rescheduling refers to the formal deferment of debt service payments and the application of new and extened maturities to the deferred amounts; debt refinancing refers to the conversion of an original debt, including any arrears, into a new loan. In the standard balance of payments presentation, appropriate debit entries for debt rescheduling depend upon the recording period in which the debt obligations fall due. Corresponding credit contra entries are recorded under *other investment*-liabilities-loans (long-term) in the ***financial account*** to reflect the drawing of a new loan. For rescheduling of obligations past due (that is, arrears of interest and amortization), a debit entry is recorded under *other investment*-other liabilities (short-term). For rescheduling or refinancing of obligations due in the current recording period, debit entries are recorded under the appropriate debt instruments in the ***financial account*** for the reduction of principal and for any interest accrued in the previous recording period. For interest accruing in the current recording period, a debit entry is recorded in the **current account** under *investment income*. For rescheduling of obligations not yet due, debit entries are recorded under the appropriate debt instruments in the ***financial account***. No entry is made for interest not yet due.

[18] There will be a discrepancy, in terms of domestic currency, between the value of the financial instrument received by the investor and the value at which he acquired the debt instrument from the original creditor when the debt instrument is converted into domestic currency at the market exchange rate. This discrepancy should be viewed as a favorable exchange rate involving an implicit subsidy granted by the authorities to the equity investor.

546. Some debt restructuring agreements link the rescheduling of obligations due beyond the current recording period to the fulfillment of certain conditions by the time that the obligations fall due. In such cases, entries are recorded in the balance of payments only in the period in which the specified conditions are met.

547. In the analytic presentation, only rescheduling or refinancing arising from balance of payments needs is recorded. Reschedulings or refinancings of debt falling due in current recording periods and in arrears are recorded below the line as credit entries under exceptional financing; offsetting debit entries are made above the line, except when arrears are rescheduled or refinanced. In this case, debit entries are also recorded below the line. For rescheduling or refinancing of obligations not yet due, there are only entries above the line under the appropriate debt instrument.

New Money Facilities

548. Some debt restructurings feature new money facilities (new loan facilities that may be used for the payment of existing debt service obligations). In the standard balance of payments presentation, successive drawings on new money facilities are recorded, usually under *other investment*-liabilities-loans-monetary authorities (long-term), in the current recording period as a credit for the debtor. Offsetting debit entries are made under *reserve assets*. As debt service payments are made on the loans included in the debt restructuring, debit entries are recorded under *investment income* in the **current account**; the repayment of principal, interest accrued in the previous recording period, and arrears (if any) are recorded under the appropriate liability.

549. In the analytic presentation, the entries are the same as those described in paragraph 547.

Balance of Payments Accounting for Selected Exceptional Financing Transactions[1]

	Analytic		Standard	
Type of Transaction[2]	Credit	Debit	Credit	Debit
ACCUMULATION OF ARREARS				
Interest	Exceptional financing	*Investment income*, other investment[3]	*Other investment*, other liabilities (short-term)	*Investment income, other investment*[3]
		Other investment, liabilities, loans (long-term)[4]		*Other investment*, liabilities, loans (long-term)[4]
Amortization	Exceptional financing	*Other investment*, liabilities, loans (long-term)	*Other investment*, other liabilities (short-term)	*Other investment*, liabilities, loans (long-term)
REPAYMENT OF ARREARS[5]				
Interest	*Reserve assets*	Exceptional financing	*Reserve assets*	*Other investment*, other liabilities (short-term)
Amortization	*Reserve assets*	Exceptional financing	*Reserve assets*	*Other investment*, other liabilities (short-term)
DEBT FORGIVENESS				
Payments falling due in the current recording period				
Interest	Exceptional financing	*Investment income*, other investment[3]	*Capital transfers*, debt forgiveness	*Investment income*, other investment[3]
		Other investment, liabilities, loans (long-term)[4]		*Other investment*, liabilities, loans (long-term)[4]
Amortization	Exceptional financing	*Other investment*, liabilities, loans (long-term)	*Capital transfers*, debt forgiveness	*Other investment*, liabilities, loans (long-term)
Payments in arrears				
Interest	Exceptional financing	Exceptional financing	*Capital transfers*, debt forgiveness	*Other investment*, other liabilities (short-term)
Amortization	Exceptional financing	Exceptional financing	*Capital transfers*, debt forgiveness	*Other investment*, other liabilities (short-term)
Payments not yet due in the current recording period				
Amortization	*Capital transfers*, debt forgiveness	*Other investment*, liabilities, loans (long-term)	*Capital transfers*, debt forgiveness	*Other investment*, liabilities, loans (long-term)

Balance of Payments Accounting for Selected Exceptional Financing Transactions[1] *(continued)*

	Analytic		Standard	
Type of Transaction[2]	Credit	Debit	Credit	Debit
OTHER INTERGOVERNMENTAL GRANTS[6]				
	Exceptional financing	*Reserve assets*	*Current transfers*, general government	*Reserve assets*
DEBT/BOND SWAPS				
Payments falling due in the current recording period[7]				
Amortization	Exceptional financing	*Other investment*, liabilities, loans (long-term)	*Portfolio investment*, liabilities, debt securities	*Other investment*, liabilities, loans (long-term)
Payments in arrears[7]				
Interest	Exceptional financing	Exceptional financing	*Portfolio investment*, liabilities, debt securities	*Other investment*, other liabilities (short-term)
Amortization[7]	Exceptional financing	Exceptional financing	*Portfolio investment*, liabilities, debt securities	*Other investment*, other liabilities (short-term)
Payments not yet due				
Amortization	*Portfolio investment*, liabilities, debt securities	*Other investment*, liabilities, loans (long-term)	*Portfolio investment*, liabilities, debt securities	*Other investment*, liabilities, loans (long-term)
DEBT/EQUITY SWAPS				
Direct swaps				
Payments falling due in the current recording period[8]				
Amortization	Exceptional financing	*Other investment*, liabilities, loans (long-term)	*Direct investment*, equity capital	*Other investment*, liabilities, loans (long-term)
Payments in arrears[8]				
Interest	Exceptional financing	Exceptional financing	*Direct investment*, equity capital`	*Other investment*, other liabilities (short-term)
Amortization	Exceptional financing	Exceptional financing	*Direct investment*, equity capital	*Other investment*, other liabilities (short-term)
Payments not yet due				
Amortization	*Direct investment*, equity capital	*Other investment*, liabilities, loans (long-term)	*Direct investment*, equity capital	*Other investment*, liabilities, loans (long-term)

Balance of Payments Accounting for Selected Exceptional Financing Transactions[1] *(continued)*

	Analytic		Standard	
Type of Transaction[2]	Credit	Debit	Credit	Debit
Indirect swaps				
Exchange of a fixed-payment liability denominated in foreign currency for a security denominated in domestic currency[9]				
Payments falling due in the current recording period[8]				
Amortization	Exceptional financing	*Other investment*, liabilities, loans (long-term)	*Portfolio investment*, liabilities, debt securities	*Other investment*, liabilities, loans (long-term)
Payments in arrears[8]				
Interest	Exceptional financing	Exceptional financing	*Portfolio investment*, liabilities, debt securities	*Other investment*, other liabilities (short-term)
Amortization	Except ional financing	Exceptional financing	*Portfolio investment*, liabilities, debt securities	*Other investment*, other liabilities (short-term)
Payments not yet due[8]				
Amortization	*Portfolio investment*, liabilities, debt securities	*Other investment*, liabilities, loans (long-term)	*Portfolio investment*, liabilities, debt securities	*Other investment*, liabilities, loans (long-term)
Exchange of a liability denominated in domestic currency for equity investment				
	Direct investment, equity capital	*Portfolio investment*, liabilities, debt securites	*Direct investment*, equity capital	*Portfolio investment*, liabilities, debt securities
BORROWING FOR BALANCE OF PAYMENTS SUPPORT[10]				
Drawings on new loans	Exceptional financing	*Reserve assets*	*Other investment*, liabilities, loans (long- /short-term)	*Reserve assets*
Bond issues	Exceptional financing	*Reserve assets*	*Portfolio investment*, liabilities, debt securities	*Reserve assets*

Balance of Payments Accounting for Selected Exceptional Financing Transactions[1] *(concluded)*

	Analytic		Standard	
Type of Transaction[2]	Credit	Debit	Credit	Debit
RESCHEDULING AND REFINANCING				
Payments falling due in the current recording period				
Interest	Exceptional financing	*Investment income*, other investment[3]	*Other investment*, liabilities, loans (long-term)	*Investment income*, other investment[3]
		Other investment, liabilities, loans (long-term)[4]		*Other investment*, liabilities, loans (long-term)[4]
Amortization	Exceptional financing	*Other investment*, liabilities, loans (long-term)	*Other investment*, liabilities, loans (long-term)	*Other investment*, liabilities, loans (long-term)
Payments in arrears				
Interest	Exceptional financing	Exceptional financing	*Other investment*, liabilities, loans (long-term)	*Other investment*, other liabilities (short-term)
Amortization	Exceptional financing	Exceptional financing	*Other investment*, liabilities, loans (long-term)	*Other investment*, other liabilities (short-term)
Payments not yet due in the current recording period				
Amortization	*Other investment*, liabilities, loans (long-term)	*Other investment*, liabilities, loans (long-term)	*Other investment*, liabilities, loans (long-term)	*Other investment*, liabilities, loans (long-term)

[1]For debt rescheduled or refinanced, swapped into equity or bonds, or canceled before maturity, the reduction in the liability should be attributed to the appropriate debt instrument in the financial account. In this table, it has been assumed that long-term loans are the instrument.
[2]This presentation, for illustrative purposes, shows separate debit and credit entries for financial account items. In practice, because net recording is recommended for financial account items, entries affecting the same item will be offsetting and thus will not appear as separate entries in a balance of payments statement.
[3]For interest accrued in the current recoding period
[4]For interest accrued in the previous period
[5]Cash settlement only
[6]Only intergovernmental grants received to finance balance of payments need (Grants received from Fund subsidy accounts are included since such grants are considered exceptional financing transactions.)
[7]These payments are recorded by using the market price of the new security issued.
[8]These payments are recorded by using the price at which the claim on the debtor country was acquired by the nonresident equity investor.
[9]Initially, the debtor country can exchange the liability denominated in a foreign currency for a security denominated in domestic currency, a security denominated in foreign currency, or domestic deposits. Therefore, the appropriate debit entry depends on the type of liability for which the liability that is denominated in foreign currency is exchanged.
[10]Borrowing (including bond issues) by authorities or other sectors on the authorities' behalf to finance balance of payments need

V. Selected Issues in Balance of Payments Analysis

Introduction

550. Preceding sections of the *Manual* present, in considerable detail, concepts underlying the standard components of the balance of payments and the international investment position of an economy. The importance of this accounting and statistical reporting framework describing a country's international transactions derives primarily from the links between these transactions and the domestic economy. These links go in two directions: (i) from the external to the internal side of the economy and (ii) from changes in domestic economic conditions to changes in a country's transactions with the rest of the world. This section discusses some of these major links and a number of important connections between the major components of the balance of payments and between these components and a country's international investment position. This discussion directs particular emphasis to the factors influencing external transactions and the extent to which such factors are sustainable. Finally, some of the implications of balance of payments adjustments for economic policy are considered. In this appendix, it is assumed, by and large, that international and domestic transactions are not constrained by formal or informal administrative controls and that market participants are free to respond to price signals and macroeconomic policies.

General Framework

551. The relationship between the balance of payments and the domestic economy has already been described (in Chapter 3 and Appendix 1) in terms of the SNA and the **current account**. Embodied in an identity derived in Chapter 3, this relationship shows that the current account balance is equal to the difference between gross domestic saving (**S)** and investment (**I**):

(1) $\mathbf{CAB = X - M + NY + NCT = S - I}$

when

X = exports of goods and services
M = imports of goods and services
NY = net income from abroad
NCT = net current transfers

Thus the **current account** balance mirrors the saving and investment behavior of the domestic economy. In analyzing changes in the **current account** position of a country, it is therefore important to understand the manner in which these changes reflect movements in saving and investment. For example, an increase in domestic investment relative to domestic saving will have the same impact on the **current account**—at least in the short run—as a decline in saving relative to investment. However, the longer-run implications for the external position of the country may be quite different. More generally, equation (1) shows that any change in a country's current account position (e.g., a larger surplus or smaller deficit) must necessarily be matched by an increase in domestic saving relative to investment. This highlights the importance of ascertaining the extent to which any policy measures designed to alter the current account balance directly (e.g., changes in tariffs, quotas, and exchange rates) will affect domestic saving and investment behavior in such a way as to achieve the intended effects of the policy measures on the external sector.

552. This link between the domestic and external sectors of an economy can be expressed alternatively in terms of the difference between gross national disposable income (**GNDY**) and expenditure on goods and services by domestic residents (**A**). These two variables are defined as:

(2) $\mathbf{GNDY = C + I + G + CAB}$

(3) $\mathbf{A = C + I + G =}$ domestic absorption or expenditure

From these two equations, it follows that the balance on goods, services, and net income plus net current transfers is equal to the difference between gross national disposable income and the use or absorption of this income through expenditures by residents:

(4) $\mathbf{CAB = GNDY - A}$

The implication of this relationship for balance of payments analysis is the same as that already noted: improvement in a country's **current account** requires that resources must be released through a fall in domestic absorption (i.e., a reduction in expenditure relative to income). Alternatively, it may be possible to achieve an improvement in the external position by means of an increase in national income that is not matched by a commensurate rise in absorption. Implementation of structural measures that reduce distortions and increase the efficiency of the economy would be one way to achieve this objective.

553. This last point highlights an important aspect of the equations shown previously; these are identities that define relationships among variables rather than describe the behavior of economic agents. By themselves, the equations cannot provide a full analysis of the factors determining developments in the **current account**. For example, total spending on goods and services by domestic residents (**A**) is likely to be influenced in part by their income (**GNDY**). Thus it would be inappropriate to use equation (4) to analyze the impact of a change in **GNDY** on the balance of goods and services without taking full account of the induced response in **A** of such a change. In particular, if an increase in income were spent by domestic residents entirely on additional goods and services (foreign and domestically produced), higher income would have no impact on the external balance. This example illustrates the necessity for understanding the spending propensities of domestic residents when analyzing the balance of payments.

554. The interrelationship between the internal and external sectors of an economy can be seen in greater detail by distinguishing between the private and government sectors. Private saving and investment (**Sp** and **Ip**) and government saving and investment (**Sg** and **Ig**) are identified:

(5) $\mathbf{S-I = Sp+Sg-Ip-Ig}$

Use of the definition of the **current account** from equation (1) then gives:

(6) $\mathbf{CAB = (Sp-Ip)+(Sg-Ig) = S-I}$

This equation shows that, if government sector dissaving is not offset by net saving on the part of the private sector, the **current account** will be in deficit. More specifically, the equation shows that the budgetary position of the government (**Sg-Ig**) may be an important factor influencing the current account balance. In particular, a sustained current account deficit may reflect persistent government spending in excess of receipts, and such excess spending suggests that fiscal tightening is the appropriate policy action.

555. To reiterate an important point, however, equation (6) cannot be used by itself to analyze developments in the foreign sector in terms of investment and saving on the part of the private and government sectors because there are links between the variables on the right-hand side of equation (6). For example, an increase in taxes could be considered the appropriate policy measure both to raise government saving (or reduce dissaving) and to contribute to an improvement in a country's current account position. In analyzing the impact of higher taxes, it is necessary to take account of the behavioral response of private saving and private investment. Private investment could be positively or negatively affected by higher taxes. The effect would depend, in part, on whether the taxes were levied on consumption, an action that would release domestic resources and thereby tend to "crowd in" domestic investment, or on returns to capital. In addition, private saving would tend to fall because of the decline in disposable income caused by taxes on consumption. Thus equation (6) provides only a starting point for an analysis of the interaction between domestic saving and investment decisions and the external sector; the equation must be supplemented by specific information about the factors that determine the behavior of both the private sector and the government before the effect of policy measures on a country's **current account** can be ascertained.

556. In addition to current transactions (i.e., those involving the exchange of goods, the provision of services, and the receipt and payment of income and transfers), the flow of financial transactions (i.e., those involving changes in financial claims on, and liabilities to, the rest of the world) must be analyzed. As noted in chapters 8 and 16, these transactions have two main components: (i) narrowly defined financial transactions in *direct investment*, *portfolio investment*, and *other investment* (including trade credits, loans, and deposits) and (ii) transactions in *reserve assets*. There are direct linkages between these components of a country's international transactions. For example, imports of goods are often financed by nonresident suppliers so that an increase in imports will typically be matched by a financial inflow. At the expiration of the financing period, the payment to the nonresident supplier will involve either a drawdown of foreign assets (e.g., foreign deposits held by domestic banks) or the replacement of the liability to the nonresident supplier by another liability to nonresidents. There are also close connections between many financial account transactions. For example, the proceeds from the sale of bonds in foreign capital markets (a financial inflow) may be invested temporarily in short-term assets abroad (a financial outflow).

557. As noted in Chapter 2, the basic principle of double-entry bookkeeping used in constructing the balance of payments implies that the sum of all international transactions—current and capital and financial, including *reserve assets*—is in principle equal to zero. However, because data for balance of payments entries often are derived independently from different sources, implementation of the double-entry recording system is not perfect. As a result, there typically are net credits or net debits (i.e., net errors and omissions in the accounts). To simplify the exposition in this section, it is assumed that there are no recording errors or omissions and that the sum of all current and capital and financial account items, including *reserve assets*, is equal to zero. This property of the entire set of a country's international transactions, which is called the balance of payments identity, is stated by equation (7), in which (again for simplicity) it is assumed that net capital transfers are equal to zero.

(7) $\mathbf{CAB = NKA + RT}$

when

NKA = net capital and financial account (i.e., all capital and financial transactions excluding *reserve assets*)

RT = reserve asset transactions

558. This equation shows that the current account balance is necessarily equal (with sign reversed) to the net capital and financial account balance plus reserve asset transactions. This relationship shows that the net provision, as measured by the current account balance, of resources to or from the rest of the world must—by definition—be matched by a change in net claims on the rest of the world. For example, a current account surplus is reflected in an increase in net claims, which may be in the form of official or private claims, on nonresidents or in the acquisition of *reserve assets* on the part of the monetary authorities. Alternatively, a deficit implies that the net acquisition of resources from the rest of the world must be paid for by either liquidating foreign assets or increasing liabilities to nonresidents. Seen in this light, the balance of payments identity constitutes the budget constraint for the entire economy.

559. The previously described framework for analysis of the balance of payments is applicable, irrespective of the exchange rate regime adopted by a country. For example, if the exchange rate is pegged, then transactions in *reserve assets* will be determined by the net demand or supply of foreign exchange at that exchange rate (i.e., $\mathbf{RT = CAB - NKA}$). At the other extreme, if the exchange rate arrangement involves a pure float so that no exchange market intervention takes place, then $\mathbf{CAB = NKA}$. In the intermediate case of a managed float, purchases and sales of *reserve assets* are typically undertaken to achieve a desired exchange rate path for the domestic currency in terms of one or more foreign currencies. (This section does not cover the advantages and disadvantages of particular exchange rate arrangements and policies. However, the exchange rate is an important instrument of balance of payments adjustment, and a subsequent section includes information on this topic.)

The Capital and Financial Account and Balance of Payments Financing

560. The **capital and financial account** measures net foreign investment or net lending/net borrowing vis-à-vis the rest of the world. This account is one channel through which a country invests its net wealth; the other is primarily tangible domestic capital. The wealth accumulation aspect of the **capital and financial account** can be seen more clearly by recalling that the **current account** is equal to the difference between total domestic saving and investment. Hence equation (7) can be rewritten as:

(8) $\mathbf{S - I = NKA + RT}$

Thus, to the extent that domestic saving is not matched by an increase in domestic capital accumulation, there will be an increase in private or official assets held in the rest of the world.

561. Equation (8) describes flows of resources and capital over time. The summation, over an extended period of time, of a country's saving provides a picture of the stock of its total wealth. As defined in Chapter 3, a nation's stock of assets consists of nonfinancial and financial assets. As the financial assets and liabilities of domestic sectors cancel each other, a country's balance sheet consists of its stock of domestic nonfinancial assets plus its net international investment position (the stock of external financial assets minus the stock of external liabilities).

562. Concepts and measurement issues related to a country's international investment position are discussed in Chapter 23. As noted there, the net international investment position of a country at the end of a specific period reflects not only financial flows, which are given by the right-hand side of equation (8), but also valuation changes and other adjustments during the period, all of which affect the current value of a country's total (private and official) claims on nonresidents and its total liabilities to nonresidents. (Valuation and other adjustments are omitted as the primary focus of this discussion of the balance of payments is on links between stocks of claims and liabilities vis-à-vis nonresidents, changes in these stocks, and the **current account**.)

563. There is another connection between the ***financial account*** and the **current account**. Financial flows generate changes in foreign claims and liabilities. In nearly all cases, these financial stocks earn a rate of return (interest, dividends, or profits) that appears in the **current accoun**t as *investment income*. This link between the accounts is particularly relevant in the case of a country running a current account deficit because there is an important dynamic relationship between an existing deficit and the future current account position. A deficit in the **current account** must be financed by some combination of an increase in liabilities to nonresidents and a reduction in claims on nonresidents so that the net result is a decline in net foreign assets. As a consequence, there will be a reduction in net investment income (unless rates of return adjust in an offsetting manner), and this reduction will increase the current account deficit. This interaction between the **current account** and the ***financial account*** can lead to a destabilizing situation in which the current account position progressively worsens unless changes in economic policies or adjustments in certain variables (e.g., exchange rates) are made to arrest the deterioration.

564. In analyzing the balance of payments and, in particular, the sustainability of any specific current account situation, it is important to consider the determinants of financial flows. These relate mainly to factors affecting the rate of return and risk on foreign and domestic assets. Such factors include interest rates, the profitability of direct and other investments, expected changes in exchange rates, and tax considerations. These factors are embodied in the expected real (i.e., adjusted for exchange rates and inflation) after-tax rate of return on the stock of foreign assets held by residents and on the stock of claims held by nonresidents. Residents and nonresidents are subject to different legal and tax considerations, which affect the rates of return on asset holdings. However, both are similarly affected by economic conditions external to the countries in which they are resident. Moreover, these external conditions are exogenous to an individual country. Therefore (for the purposes of this discussion), it seems reasonable to assume that these conditions are constant and to focus on the domestic economic situation affecting rates of return on investments in the relevant country.

565. In addition, domestic and nonresident investors appear to be influenced largely by the same set of factors affecting rates of return on domestic investments. In other words, irrespective of whether the investor's residence is in the home country or abroad, the decision of whether to invest in the home country or another country will be influenced—for the most part—by the same set of considerations relating to expected returns on domestic assets. Changes (such as interest rates, rate of profit, inflation, and the exchange rate) in domestic variables are therefore likely to have similar effects on residents deciding to invest at home or abroad and on nonresidents choosing to invest in their home countries rather than in other, worldwide investment opportunities. Consequently, when one views the net ***financial account***, one may plausibly assume that the stock of claims on nonresidents and the stock of liabilities to nonresidents are influenced by the same array of considerations.[19]

566. On the basis of this background, it is possible to examine a key aspect of balance of payments analysis (namely, the financing of a current account deficit by means of net financial inflows and *reserve assets*) and some of the economic policy issues involved.[20] For such an analysis, it would be helpful to use equation (7), the balance of payments identity, and to assume that initially **S = I** (i.e., that the **current account** is zero and that net capital and financial account and reserve asset account transactions are also zero). From this initial situation, it is instructive to trace the effects,

[19]This perspective includes the assumption that there are no controls on international capital flows. As such controls are not typically applied in the same manner to transactions involving residents and to those undertaken by nonresidents, the presence of such controls implies that the same factors are likely to affect residents and nonresidents in different ways.

[20]Balance of payments presentations sometimes show an overall balance, which has been variously defined according to the perspectives of the analyst. This measure involves distinguishing transactions recorded above the line from those recorded below the line. This procedure is linked to the double-entry system of recording balance of payments entries because the two groups must be numerically equal with opposite signs. Drawing the line involves making certain analytical distinctions. In many instances, the overall balance is equal, with the exclusion of transactions in *reserve assets* and exceptional financing, to the sum of current and capital and financial account transactions. According to this definition of the overall balance, below-the-line transactions are considered to be accommodating or financing the net result of above-the-line transactions, which are considered autonomous. In other balance of payments presentations, the overall balance is equal, with the exclusion of transactions (including those in *reserve assets*) of the domestic banking sector, to the sum of current and capital and financial account transactions. In such a presentation, the below-the-line transactions correspond to the net foreign assets of the banking system (including the central bank). This presentation may be helpful in analyzing the impact of such transactions on the creation of domestic liquidity.

on the **current account** and the ***financial account***, of an autonomous increase, which is generated by a rise in the productivity of capital, in domestic investment. If this additional investment is not matched by a corresponding rise in domestic saving, interest rates will tend to rise as long as the monetary authorities do not peg the rates. The excess of investment over domestic saving will be reflected in a current account deficit, which may be financed by a net financial inflow induced by the rise (in comparison to interest rates abroad) in domestic interest rates.

567. Whether there is spontaneous financial account financing of a current account deficit depends on a number of considerations. First, the financial inflow may be directly related to increased domestic capital spending in the form of foreign direct investment, loans obtained from foreign banks, or bonds issued in international capital markets. The foreign financing can be for the purchase of foreign goods and services required for an investment project and for the purchase of domestic inputs. Alternatively, additional investment may be financed domestically by means of bank loans or issues of equities and bonds. In this case, there is no direct link between increased domestic expenditures and foreign financing. However, the tendency for domestic interest rates to rise (in comparison with rates abroad) because of the increased investment will provide an incentive for funds to flow into the country. Whether or not funds do so depends largely on how investors view the economic prospects of the country. The prevalence of stable economic and political conditions—particularly if it is not likely that the higher interest rate will be offset by a continuing depreciation of the exchange rate of the country—will increase the spontaneous movement of funds into the country.

568. The financial inflow associated with the excess of investment over saving involves a reduction in the net foreign asset position of the country and the reduction, in turn, will change the net investment income flow of the country. The key analytical issue is whether the country will be able to service the change in the net foreign investment position without undertaking significant modifications in economic policies or without incurring undesirable changes in interest rates or exchange rates. Servicing is likely to occur without changes if the investment makes a significant contribution to the productivity of the economy. Such a contribution can be manifested in two ways: first, the firm or government enterprise undertaking the investment must be sufficiently profitable to pay the rate of return that will attract the funds to finance the investment; second, the additional investment must enhance the debt-servicing capacity of the economy. As long as funds imported from abroad are invested productively in the domestic economy, external financing for a current account deficit is likely to be forthcoming for a considerable period of time. In this situation, the capital-importing country's current account deficit manifests an efficient allocation of resources.

569. Alternatively, it is useful to consider a case in which investment is unchanged but domestic saving declines—either because of an increase in government spending not matched by a rise in tax and other revenue or because of an increase in private consumption not matched by an offsetting change in government saving. In this situation, domestic interest rates would also tend to rise. However, unlike the previous case, the shift to a current account deficit is not paralleled by an increase in productivity in the economy. Under these conditions, there may not be a spontaneous inflow of funds if investors view the deterioration in the **current account** as reflecting inappropriate and unsustainable government policies. For example, the decline in domestic saving may reflect an enlarged public sector deficit that is not associated with increased investment. Alternatively, the rise in absorption may be due to higher private spending generated by an expansionary monetary policy. Under these circumstances, investors may not wish to increase their net claims on the country.

570. In the absence of a spontaneous financial inflow, some combination of the following will be necessary: policy actions to attract private funds, the use of *reserve assets* for balance of payments financing, and/or the implementation of balance of payments adjustment measures. From the balance of payments identity (equation (7), it can be seen that, if the **current account** shifts into deficit, financing must take place either by drawing down the country's international *reserve assets* or by increasing incentives for attracting private funds. The latter can be achieved by enhancing the domestic economic environment for long-term investment. The adoption of monetary and fiscal policies that support stable economic conditions and encourage direct and other investment would tend to induce financial inflows on a sustained basis. Funds may also be induced to flow in from abroad—and to provide balance of payments financing—by the raising of domestic interest rates. Such a policy may well be appropriate if the current account deficit is caused by aggregate demand pressures; a restrictive monetary policy would have the effect of dampening excess demand and providing short-term financing. However, such financing may not be dependable from a long-term perspective as, for example, changes in foreign monetary conditions may make investment of liquid assets in the domestic economy appear unattractive. Therefore, it is necessary to look at the underlying causes of a current account deficit requiring fundamental balance of payments adjustment to such an extent that the deficit cannot be financed by financial inflows on a sustained basis.

571. The appropriateness of using *reserve assets* to finance a gap between domestic expenditure and income, rather than undertaking adjustment measures to reduce or eliminate this gap, depends on the extent to which the gap is temporary or reversible. As a country's stock of owned *reserve assets* (as well as the resources it can borrow to supplement its *reserve assets)* are limited, the use of *reserve assets* to finance a current account deficit is confined within these limits. However, by mitigating the necessity for balance of payments adjustment, official financing can perform a useful buffer function. For example, temporary shocks, such as poor harvests or other temporary supply disruptions, to domestic output do not necessarily require comparable changes in the domestic absorption of goods and services. Thus the financing, through the use of *reserve assets,* of a temporary excess of consumption and investment over national income can provide a desirable smoothing of the path of expenditures by residents. The *reserve assets* can also be used to finance seasonal swings in foreign payments and receipts. While the financing of temporary shocks is appropriate, recourse—although it can make the adjustment path smoother and more gradual—to owned or borrowed *reserve assets* does not obviate the necessity for adjustment if deterioration in the **current account** persists.

572. There are limits on the extent to which private funds and official resources can finance a current account deficit. The willingness of the private sector to invest in the country may be directly influenced by ongoing changes in *reserve assets*. If the existing stock of *reserve assets* is relatively low in comparison with the current account deficit and the monetary authorities are expected to exhaust the country's *reserve assets* within the investment horizon of the investors, then the probability of a depreciation of the exchange rate or the introduction of other policy measures adversely affecting the rate of return expected by investors would tend to increase significantly. Under these circumstances, any private funds from abroad that are financing all or part of a current account deficit could quickly switch from a net inflow to a net outflow. As can be seen from equation (8), unless adjustment measures are implemented to reverse both the current account deficit and the financial account outflow, *reserve assets* would be required to finance both an excess of domestic investment over saving and a net increase in claims on nonresidents. Such a situation would probably result in a loss of confidence in the currency, exacerbation of the financial outflow, and a rapid exhaustion of *reserve assets*.

Balance of Payments Adjustment

573. There are many situations in which it may not be feasible to rely on private and official resources to finance a current account deficit on a sustained basis. For balance of payments analysis, it is therefore important to consider the possible introduction of adjustment measures to achieve a viable external payments position (i.e., conditions under which a deficit on goods and services can be financed by private and official transfers, private capital inflows, and some recourse to *reserve assets*). The subsequent discussion examines briefly the roles of exchange rate changes, fiscal measures, and monetary policy in achieving balance of payments adjustment.

574. In this analysis, it is useful to rewrite equation (8) as:

(9) $\mathbf{S-I = CAB = TB+SIB+TRANB = NKA+RT}$

when

TB = trade balance

SIB = service and income balance

TRANB = current transfer balance

The magnitude of the necessary adjustment in the balance of payments depends, to some extent, on the nature of the components of the current account balance. For example, a country may have been running a persistent trade deficit that was financed, in part, by borrowing from private and official sources. In this situation, the country is also likely to be running a deficit on the service and income balance that reflects the servicing of this debt. Part of the deficit arising from trade, service, and income transactions may, however, be offset by a surplus from ***current transfers***, which could reflect both official and private transfers. If such inward transfers are expected to be of a long-term nature and can confidently be relied upon to finance all or part of the deficit in other components of the **current account**, then the extent of the necessary balance of payments adjustment may be rather small.

575. However, even in the case of a small adjustment, it is nonetheless important to be fully cognizant of the fact that foreign debts must be paid in the future. Thus the amortization schedule of the country is an important factor for judging the sustainability of a particular balance of payments position. If large amortization payments are due in the near future and expected financial inflows are not sufficient to cover payments falling due, it may be necessary to undertake adjustment measures beforehand to avoid more drastic measures required for dealing with a subsequent balance of payments crisis.

576. In the face of an unsustainable current account deficit, one adjustment measure that should be considered is a depreciation of the exchange rate of the domestic currency. Such a depreciation may be necessary to offset a domestic price rise (relative to prices abroad) that—by penalizing exports and encouraging imports—worsens the trade balance. To the extent that the depreciation raises the prices of traded goods (i.e., exports and imports) in comparison with the prices of non-traded goods and services, depreciation will promote the substitution of domestic products for imported goods and stimulate foreign demand for domestic output. However, as the depreciation will be accompanied by a rise in domestic prices in response to the increase in the cost of imported goods and services and the rise in demand for exports and domestically produced import substitutes, the improvement in international competitiveness generated by the exchange rate change will be partially or fully eroded. Such a development underscores the importance of supplementing the exchange rate adjustment with restrictive monetary and fiscal policies to facilitate the shift in resources signaled by the change (caused by the depreciation) in relative prices. Thus, an expenditure-switching policy in the form of exchange rate depreciation must generally be supported by expenditure-reducing measures; indeed, such measures are essential if there is no excess capacity in the economy.

577. The need for such action can be seen from equation (9), which shows that any improvement in the **current account** must be matched by a corresponding positive change in the difference between domestic saving and investment. An exchange rate depreciation by itself may generate such a change in the desired direction. In particular, if there is no change in the stance of monetary policy, the increase in demand generated by the depreciation will raise the demand for money. With an unchanged money supply, the greater demand for money will tend to increase nominal and real domestic interest rates. As a result, interest-sensitive expenditures will be dampened, and there could be a positive impact on domestic saving. However, it is unlikely that this induced effect on the gap between savings and investment will itself be sufficient, particularly if the economy is at full employment, to achieve the desired improvement in the **current account**. Therefore, in all likelihood, it will be necessary to accompany the adjustment in the exchange rate with measures to reduce the level of domestic expenditure through tighter monetary and fiscal policies that release resources to expand output in the exporting and import-substitution industries.

578. The discussion of equation (6) pointed to fiscal deficits as one potential cause of external imbalances. Changes in government spending and taxation may therefore be mandated to achieve the required reduction in the saving/investment gap—to the extent that an exchange rate depreciation does not induce a sufficient response in the difference between total domestic saving and investment. However, it is important that fiscal policy measures be designed to achieve the desired objective and not exacerbate the adjustment problem. For example, cuts in infrastructure investment may have the desired short-run balance of payments effect, but such cuts could have, particularly if the spending reductions are in such areas as transportation, a long-run adverse impact on the supply potential of the country and the generation and supply of energy designed to relieve bottlenecks. Moreover, tax measures that result in very high marginal tax rates or that are aimed particularly at capital income could have the undesired side effect of inducing offsetting reductions in private saving and reducing incentives to invest in the country. Such disincentive effects can be avoided by implementing fiscal action aimed at reducing or eliminating subsidies to inefficient government enterprises and the private sector and by cutting back on government activity that can be performed equally well, if not better, by the private sector.

579. The stance of monetary policy plays an important role in balance of payments adjustment. The existing external imbalance may reflect an excess of domestic investment over saving (or what is the same thing—an excess of domestic spending over income) that results from an excessively expansionary monetary policy. It is, first of all, important to adjust the stance of monetary policy so that interest rates are generally positive in real terms and provide an incentive to savers and so that domestic economic conditions are sufficiently stable to encourage investment. From the perspective of aggregate supply and demand, it can be seen from equation (4) that monetary policy should ensure that the level of domestic expenditure is in line with the productive capacity of the economy. Thus, from the point of view of balance of payments analysis, the objective of monetary and fiscal policies is to limit domestic spending to what is available from domestic resources and foreign financing.

580. One important aspect of monetary policy in balance of payments adjustment is the link between reserve asset transactions and domestic monetary conditions. A decline in *reserve assets* may be associated with a current account deficit and/or a net financial outflow caused by an expansionary monetary policy. The reserve asset decline can lead to a reduction in the monetary base and therefore to a tightening in the stance of monetary policy. A more restrictive monetary policy tends to correct the payments imbalance through higher interest rates that dampen domestic demand and make domestic assets more attractive to investors. However, this built-in adjustment mechanism can be short-circuited if the monetary authorities offset the effect of the loss of *reserve assets* on the monetary base by increasing the domestic component of the base (e.g., through open market purchases of securities held by the banking system). Such offsetting action tends to prevent domestic interest rates from rising and thereby contributes to the persistence of the balance of payments deficit.

581. The foregoing discussion focuses entirely on an economy that faces an actual or incipient balance of payments problem in the form of a persistent current account deficit or financial outflow that may also be accompanied by a loss of *reserve assets*. This concentration on external deficits reflects the more prevalent tendency for domestic expenditure to exceed available income and the frequent necessity of formulating policies to deal with the financing or adjustment of a balance of payments deficit.[21] The opposite situation (namely, a persistent current account surplus, inflow of capital, and substantial accumulation of *reserve assets*) occurs less often and generally does not pose as severe a problem for economic policy.

582. Nonetheless, an analysis of some aspects of a surplus balance of payments situation is useful. As can be seen from equation (7), the balance of payments identity, a surplus in the **current account** is reflected in an increase in net claims held by the private sector or government (**NKA**) on nonresidents and/or an increase in official *reserve assets* (**RT**). The change in the net foreign asset position may be due to a reduction in liabilities to nonresidents rather than to an increase in gross claims. Such a reduction may well be a desirable development if a previous large buildup of liabilities has imposed a severe debt service burden on the country. In this case, a current account surplus can be an appropriate step toward achieving a viable balance of payments position.

583. The case of an economy with no recent deficits of payments and an increase in its gross private claims on the rest of the world reflects an excess of aggregate domestic saving over domestic investment. If the government's fiscal position is in deficit, private sector saving will exceed domestic investment. The allocation of part of domestic saving to foreign assets presumably reflects the fact that investors find the rate of return on these assets more attractive, at the margin, than investment opportunities in the domestic economy. The provision of resources to the rest of the world in the form of a buildup of net claims on nonresidents will, by and large, result in an efficient allocation of the domestic economy's saving as long as the buildup of net claims reflects the operation of market forces rather than government policies designed directly or indirectly to increase such claims.

584. Thus, for analyzing the balance of payments of a country in persistent surplus, one key consideration is whether government policies distort saving/investment decisions and thereby bias the payments position of an economy toward a surplus. Such distortions can take many forms. First, there are measures aimed directly at influencing the **current account**. Examples are tariffs and quotas that limit imports, restrictions on payments abroad, and export subsidies and government procurement policies that give preference to domestic producers. Moreover, an exchange market intervention policy may be directed at deliberately undervaluing the country's currency to achieve a current account surplus. Finally, there may be measures that limit foreign acquisition of domestic assets—a limitation that would tend to bias the ***financial account*** toward a net outflow and thereby shift the **current account** in the direction of a surplus.

585. These measures may, in fact, not be successful in achieving a larger current account surplus. Policy

[21]Of course, for the world as a whole, the balance of payments positions of all countries are equal to zero. Nonetheless, the recorded balance of payments position for the world, which is equal to the sum of the positions of all countries, is not equal to zero because of measurement problems. For a discussion of this issue, see the International Monetary Fund's *Report on the World Current Account Discrepancy*, September 1987, and *Report on the Measurement of International Capital Flows*, September 1992.

actions aimed at particular components of the balance of payments will, over time, lead to offsetting movements in other components in the absence of changes in the underlying determinants of saving and investment. In any event, if a large and persistent current account surplus appears to arise from such distortionary measures, the appropriate policy action is the reduction and eventual removal of these distortions. If a persistent surplus remains after such measures are eliminated, then the accumulation of net claims on the rest of the world would appear to manifest the saving and investment propensities of the economy. If, in this case, one were to identify the surplus as a problem, it would generally be necessary to establish that private saving or government saving was excessively high or that domestic investment was too low. It is considerably more difficult to arrive at such a conclusion than to identify the previously enumerated distortions that relate directly to international transactions.

586. A current account surplus, while reflecting entirely a response to market forces, may cause economic difficulties for a country. For example, a country with "Dutch disease" experiences either a natural resource discovery or a substantial improvement in the terms of trade for the natural resources sector. The expanding sector or terms of trade gains lead to an improvement in the **current account** and an appreciation of the exchange rate. This development tends to make other sectors of the economy contract and be less competitive internationally. If the newly discovered resources are expected to be depleted fairly rapidly and the gains in terms of trade to be transitory, it may be appropriate to protect the sectors adversely affected. One way to achieve this objective is through exchange market intervention to prevent or moderate the exchange rate appreciation. The accumulation of *reserve assets* tends to insulate the real economy from having to adjust to the short-run disturbance.

587. The general conclusion of such an analysis is that, when no government policy actions are aimed at achieving a surplus balance of payments position, it may be difficult to establish that an economy is investing too much of its saving abroad. However, it may be somewhat easier to reach a conclusion with respect to *reserve assets*. Rather than leading to a rise in net foreign assets held by the private sector, a current account surplus can be reflected in a buildup of foreign *reserve assets*. A buildup represents specific government policy action in the form of foreign exchange market intervention. Intervention, which involves the sale of domestic currency in exchange for foreign currency, has the tendency to keep the foreign exchange value of the domestic currency lower than it otherwise would be. The accumulation of *reserve assets* may therefore limit the extent to which the currency appreciates and thereby prevent the operation of the self-correcting mechanism that would tend to reduce the current account surplus.

588. Thus, one aspect of balance of payments analysis for a country with a persistent current account surplus involves an appraisal of the level of external *reserve assets* held by monetary authorities. The accumulation of such assets is excessive if the assets exceed, by a wide margin, the amount required to finance short-run balance of payments deficits. In such a situation, the country's resources may well be better invested in domestic capital formation. If the private and government sectors are unlikely to increase domestic capital formation, cessation of reserve asset accumulation would lead to an increase in domestic absorption and/or to a rise in net foreign investment by domestic residents.[22] In either case, allocation of the economy's resources would tend to be more efficient as the allocation would be responding to market forces.

[22]Countries that are large exporters of nonrenewable resources, such as oil, may have limited domestic investment opportunities. In such cases, the buildup of foreign assets can be viewed not so much as an accumulation of *reserve assets* for balance-of-payments financing purposes but rather as a diversification of the country's stock of wealth. Also, there may be a case for the accumulation of *reserve assets* in the instance of a country subject to Dutch disease if the effects are expected to be transitory.

Balance of Payments

Index

Index

Numbers refer to paragraphs; ranges (e.g., 175–185) are inclusive. References followed by* n *indicate footnotes.