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

A. Introduction

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

1. The rest of the world account in the SNA

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

Current accounts

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

26.4 As well as entries for imports, exports and the items appearing in the allocation of primary income account, there are potential transactions with the rest of the world to be recorded for all entries in the secondary distribution of income account and for the adjustment item for the net change in pension liabilities appearing in the use of income account.

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

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

Accumulation accounts

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

26.8 The financial account and balance sheets detailing transactions in, and stocks of, financial assets and liabilities where one party is non-resident are viewed as a particularly important part of the rest of the world accounts. Indeed, in *BPM6* more text is devoted to these items than to the items in the current accounts.

26.9 In addition, there are possible entries for other changes in the volume of assets and liabilities and revaluation items for both, relevant to the rest of the world account.

2. The international accounts in *BPM6*

26.10 In the description of the rest of the world accounts above, it was noted that exports, for example, are treated as a use by the rest of the world and imports as a resource from the rest of the world. As its name implies, the rest of the world account is drawn up from the perspective of the rest of the world. *BPM6* looks at the same stocks and flows from the point of view of the domestic economy. Thus the *BPM6* entries are the mirror image of the SNA entries relating to the rest of the world.

26.11 Further, in the context of *BPM6*, stock levels are usually referred to as positions and the balance sheet accounts for all financial assets and liabilities where one party to the arrangement is non-resident is called the international investment position.

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

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

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

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

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

3. The structure of the chapter

26.13 Section B of the chapter discusses the accounting rules of the international accounts. These are consistent with the SNA accounting rules and agreement has been reached on when the SNA and when *BPM6* takes the lead in defining the rules to be applied in both contexts. Residence is a case in point where the SNA follows *BPM6*.

26.14 The structure of the international accounts and their relation to similar SNA accounts is the subject of section C.

26.15 A feature of the financial accounts and IIP of the international accounts is the introduction of functional categories that describe the main purpose of financial investment abroad. This is the subject of section D.

26.16 Section E touches on some considerations of particular importance to the international accounts; global imbalances, exceptional financing, debt reorganization, currency unions and currency conversions.

B. Accounting principles

1. Comparison with SNA accounting principles

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

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

Valuation

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

Time of recording and change of ownership

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

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

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

Netting

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

2. Units

26.24 The international accounts and the SNA are built on the same definitions of institutional units and residence. Because the international accounts focus on economic relationships between residents and non-residents, more elaboration of borderline cases is provided in *BPM6*.

Economic territory

26.25 The most commonly used concept of economic territory is the area under the effective economic control of a single government. However, currency or economic unions, regions, or the world as a whole may be used, as they may also be a focus for macroeconomic policy or analysis.

26.26 An economic territory includes the land area including islands, airspace, territorial waters and territorial enclaves in the rest of the world (such as embassies, consulates, military bases, scientific stations, information or immigration offices, that have immunity from the laws of the host territory) physically located in other territories. Economic territory has the dimensions of physical location as well as legal jurisdiction, so that corporations created under the law of that jurisdiction are part of that economy. The economic territory also includes special zones, such as free trade zones and offshore financial centres. These are under the control of the government so are part of the economy, even though different regulatory and tax regimes may apply. (However, it may also be useful to show separate data for such zones.) The territory excludes international organizations and enclaves of other governments that are physically located in the territory.

Institutional units

26.27 The concept of an institutional unit is the same in the SNA and *BPM6*. Because of the focus on the national economy, there are some special treatments of units in cross-border situations. As discussed below, in some cases, legal entities are combined into a single institutional unit if they are resident in the same economy, but are not combined if they are resident in different economies. Similarly, a single legal entity may be split when it has substantial operations in two or more economies. As a result of these treatments, the residence of the resulting units concerned becomes more clear-cut and the concept of the economic territory is strengthened.

26.28 As discussed in chapter 4, resident artificial subsidiaries and special purpose entities (SPEs) are combined with their owners into single legal entities. However, a legal entity that is resident in one jurisdiction is never combined with a legal entity resident in another. As a result, SPEs and other similar corporate structures owned by non-residents are considered to be resident of their territory of incorporation, even though most or all of their owners and most or all of their assets are in another economy.

26.29 Similarly, members of a household must all be resident in the same economy. If a person resides in a different economy from the other members of a household, that person is not regarded as a member of that household, even though they may share income and expenses, or hold assets together.

Branches

26.30 A branch is an unincorporated enterprise that belongs to a non-resident unit, known as the parent. It is resident and treated as a quasi-corporation. The identification of branches as separate institutional units requires indications of substantial operations that can be separated from the rest of the entity. A branch is recognized in the following cases:

a. Either a complete set of accounts, including a balance sheet, exists for the branch, or it is possible and meaningful, from both an economic and legal viewpoint, to compile these accounts if required. The availability of separate records indicates that an actual unit exists and makes it practical to prepare statistics.

In addition, one or both of the following factors tend to be present:

b. The branch undertakes or intends to undertake production on a significant scale which is based in a territory other than that of its head office for one year or more:

- if the production process involves physical presence, then the operations should be physically located in that territory;

- if the production does not involve physical presence, such as some cases of banking, insurance, other financial services, ownership of patents, merchanting and "virtual manufacturing", the operations should be recognized as being in the territory by virtue of the registration or legal domicile of those operations in that territory.

c. The branch is recognized as being subject to the income tax system, if any, of the economy in which it is located even if it may have a tax-exempt status.

26.31 The identification of branches has implications for the statistical reporting of both the parent and branch. The operations of the branch should be excluded from the institutional unit of its head office and the delineation of parent and branch should be made consistently in both of the affected economies. A branch may be identified for construction projects or mobile operations such as transport, fishing or consulting. However, if the operations are not substantial enough to identify a branch, they are treated as an export of goods or services from the head office.

26.32 In some cases, preliminary operations related to a future direct investment project prior to incorporation are sufficient evidence of establishing residence that a quasi-corporation is established. For example, licences and legal expenses for a project are shown as being incurred by a quasi-corporation, and are part of direct investment flows into that unit rather than sales of licences to non-residents, or exports of services, respectively, to the head office.

Notional resident units

26.33 When land located in a territory is owned by a non-resident entity, a notional unit that can be treated as resident is identified for statistical purposes as being the owner of the land. This notional resident unit is a kind of quasi-corporation. The notional resident unit treatment is also applied to associated buildings, structures and other improvements on that land, leases of land for long periods, and ownership of natural resources other than land. As a result of this treatment, the non-resident is owner of the notional resident unit, rather than owning the land directly, so there is an equity liability to the non-resident, but the land and other natural resources are always assets of the economy in which they are located. The notional resident unit usually supplies services to its owner, for example accommodation in the case of vacation homes.

26.34 In general, if a non-resident unit has a long-term lease on an immovable asset such as a building, this is associated with it undertaking production in the economy where it is located. If for any reason there is no associated production activity, a notional resident unit is also created to cover such a lease.

Multiterritory enterprises

26.35 A few enterprises operate as a seamless operation over more than one economic territory, typically for cross-border activities such as airlines, shipping lines, hydroelectric schemes on border rivers, pipelines, bridges, tunnels and undersea cables. If possible, separate branches should be identified, but if the entity is run as a single operation with no separate accounts or decision-making for each territory that it operates in, it is not possible to delineate branches. In such cases, because of the central focus on data for each national economy, it is necessary to split the operations between economies. The operations should be prorated according to an appropriate enterprise-specific indicator of the proportions of operations in each territory. The prorating treatment may also be adopted for

Table 26.1:Selected effects of a household's residence status on the statistics of the host economy

Economic flow or position	Resident (for example, long-term guest worker)	Non-resident (for example, short-term guest worker)
Compensation of employees received from enterprises in the reporting economy	Resident-to-resident compensation of employees	Resident-to-non-resident compensation of employees
Personal expenditure in the reporting economy	Resident-to-resident transaction	Exports of services, mainly travel
Transfers to relatives in home economy	Resident-to-non-resident current or capital transfers	Non-resident-to-non-resident transfer (There is often some international financial transaction of the short-term worker returning funds from his host to his home economy, for example via a bank in the host economy)
A resident institutional unit's financial claims on or liabilities to the household	Resident-to-resident financial claim	International financial claim
Land and buildings owned in host economy	Non-financial asset	Non-financial asset and direct investment liability of a notional resident unit
Land and buildings owned in home economy	Direct investment asset in notional resident unit	Not in balance sheet of host economy

enterprises in zones subject to joint administration by two or more governments.

3. Residence

26.36 ***The residence of each institutional unit is the economic territory with which it has the strongest connection, expressed as its centre of predominant economic interest.*** An institutional unit is resident in an economic territory when there exists, within the economic territory, some location, dwelling, place of production, or other premises on which or from which the unit engages and intends to continue engaging, either indefinitely or over a finite but long period of time, in economic activities and transactions on a significant scale. The location need not be fixed so long as it remains within the economic territory. Actual or intended location for one year or more is used as an operational definition. While the choice of one year as a specific period is somewhat arbitrary, it is adopted to avoid uncertainty and facilitate international consistency. Most units have strong connections to only one economy but with globalization, a growing number have strong links to two or more economies.

Residence of households

26.37 A household is resident in the economic territory in which household members maintain or intend to maintain a dwelling or succession of dwellings treated and used by members of the household as their principal dwelling. If there is uncertainty about which dwelling is the principal dwelling, it is identified from the length of time spent there, rather than other factors such as cost, size, or length of tenure. Being present for one year or more in a territory or intending to do so is sufficient to qualify as having a principal dwelling there. The implications of the residence of a household for the recording of its flows and stocks are summarized in table 26.1.

26.38 In addition to the general principles, additional guidance in determining the residence of households is given in the following specific cases:

a. *Students*. People who go abroad for full-time study generally continue to be resident in the territory in which they were resident prior to studying abroad. This treatment is adopted even though their course of study may exceed a year. However, students become residents of the territory in which they are studying when they develop an intention to continue their presence in the territory of study after the completion of the studies. Members of the same household who are accompanying dependents of students are also considered to be residents of the same economy as the student.

b. *Patients*. People who go abroad for the purpose of medical treatment maintain their predominant centre of interest in the territory in which they were resident prior to the treatment, even in the rare cases where complex treatments take a year or more. As with students, accompanying dependents are treated in the same way.

c. *Crew of ships etc.* Crew of ships, aircraft, oil rigs, space stations or other similar equipment that operate outside a territory or across several territories are treated as being resident in the territory of their home base. The home base is determined by where they spend most of their time when not undertaking their duties. This location may not be the same as that of the operator of the mobile equipment.

d. *Diplomats, military personnel, etc.* National diplomats, military personnel and other civil servants employed abroad in government enclaves and their households are considered to be residents of the economic territory of the employing government. However, other employees, such as locally recruited staff and international organization staff are resident in the location of their principal dwelling.

e. *Cross-border workers*. There is no special treatment for these workers. The residence of the persons concerned is based on the principal dwelling, rather than the territory of employment, so employees who cross borders to undertake a job still have their residence determined from their principal dwelling.

f. *Refugees*. No special treatment is adopted for refugees, so their residence will change from their home territory if they stay or intend to stay in another economy for a year or more, regardless of their legal status or intention to return.

Table 26.2:Selected effects of the residence status of an enterprise on the statistics of the host economy

Economic flow or position	Resident enterprise (for example, major long-term construction project)	Non-resident enterprise (for example, minor short-term construction project)
Sales by enterprise to residents	Resident-to-resident transaction	Imports of goods and services
Purchases by enterprise from residents	Resident-to-resident transaction	Exports of goods and services
Compensation of employees payable to residents of host economy	Resident-to-resident compensation of employees	Non-resident-to-resident compensation of employees
Compensation of employees payable to residents of home economy	Resident-to-non-resident compensation of employees	Not a transaction of host economy
Net operating surplus	Dividends payable or reinvested earnings	Not a transaction of host economy
Injections of funds by owners	Direct investment liabilities of the reporting economy	Not a transaction of host economy
A resident institutional unit's financial claims on or liabilities to the enterprise	Resident-to-resident financial claims	International financial claims

g. *Highly mobile individuals*. Some individuals have close connections with two or more economies. In cases of no principal dwelling, or two or more principal dwellings in different economies, the residence is determined on the basis of the territory in which the predominant amount of time is spent in the year. While these individuals need to be classified as residents of a single economy for statistical purposes, additional information may be needed in recognition of strong ties to another economy.

26.39 When households change their economy of residence, there are changes to the status of the assets they own and liabilities they owe. These changes are recorded as reclassifications through the other changes in volume account. Because of the treatment of having a notional resident unit for ownership of land by non-residents, new notional units may be identified or old ones converted to ownership of the assets as a result of changes in residence of the owners.

Residence of enterprises

26.40 An enterprise is resident in an economic territory when the enterprise is engaged in a significant amount of production of goods or services from a location in the territory. Taxation and other legal requirements tend to result in the use of a separate legal entity for operations in each legal jurisdiction. In addition, a separate institutional unit is identified for statistical purposes where a single legal entity has substantial operations in two or more territories (for example, for branches, land ownership and multiterritory enterprises, as noted above). As a result of splitting such legal entities, the residence of each of the subsequently identified enterprises is usually clear. The implications of the residence of an enterprise for the recording of its flows and stocks are summarized in table 26.2.

26.41 In some cases, the physical location of an enterprise is not sufficient to identify its residence because the enterprise has little or no physical presence, for example its administration is entirely contracted out to other entities. Banking, insurance, investment funds, securitization vehicles and some special purpose entities may operate in this way. Many trusts, corporations, or foundations that hold private wealth also have little or no physical presence. Similarly, with virtual manufacturing, all the physical processes are outsourced to other units. In the absence of any significant physical dimension to an enterprise, its residence is determined according to the economic territory under whose laws the enterprise is incorporated or registered. The incorporation and registration represent a substantial degree of connection to the economy, associated with jurisdiction over the enterprise's existence and operations. In contrast, other connections such as ownership, location of assets, or location of its managers or administrators may be less clear-cut.

26.42 In some rare cases, laws allow enterprises to change their economy of residence, such as within an economic union. In such cases, as for households, a change of residence means that their assets and liabilities change their status through other changes in volumes. More commonly, what is called "corporate migration" involves the conveyance of assets and liabilities from a corporation in one economy to a related entity in another economy recorded as a transaction rather than a change of residence of the entity.

Residence of other entities

26.43 General government includes territorial enclaves, such as embassies, consulates, military bases and other enclaves of foreign governments. However, an entity created by a government under the laws of another jurisdiction is an enterprise resident in the host jurisdiction and not part of the general government sector in either economy.

26.44 International organizations are resident in an economic territory of their own and not of the economy in which they are physically located. An international organization that operates military forces or acts as the interim administration in a territory remains an international organization and is non-resident in that territory, even if it undertakes general government functions there. In cases where these organizations are significant, it may be desirable to identify them separately. Some international organizations cover a group of economies in a particular region, such as with economic or currency unions. If statistics are prepared for that region as a whole, these regional organizations are residents of the region as a whole, even though they are not residents of any member economy.

26.45 A non-profit institution serving households (NPISH) has a centre of economic interest in the economy where the institution is legally created or otherwise officially recognized. When an NPISH is engaged in charity or relief work on an international scale, the foreign operations may be sufficiently substantial to be recognized as branches.

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

26.46 Like the SNA, the international accounts cover accounts for current transactions, accumulation accounts and balance sheets. The transaction accounts are collectively called the balance of payments. An overview of the international accounts presentation (using the SNA numerical example) is given in tables 26.3. The three current accounts are the goods and services account, the primary income account and the secondary income account. The primary income account corresponds to the allocation of primary income accounts in the SNA, the secondary income account to the secondary distribution of income account in the SNA. The income accounts in *BPM6* do not use distribution and redistribution in their titles, since they do not show distribution and redistribution from one party to another, but just show the income from the point of view of one party. Because there is no account corresponding to use of income in the international accounts, the adjustment for the change in pension entitlements term appears as a single item after the secondary income account. (Cross-border pensions are currently minor for most economies.)

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

26.48 Table 26.3 also shows the restricted form of the capital account in the international accounts and the financial account using the functional classification of financial transactions rather than the instrument classification used in the SNA. Because the functional classification is a grouping of instruments, the two forms of presentation are strictly consistent. The functional classification is described below in section D. (The explanation of the shaded cell for reserves liabilities is explained in section D also.)

1. Goods and services account

26.49 The goods and services account consists only of imports and exports of goods and services because these are the only transactions in goods and services with a cross-border dimension. Goods and services are recorded when there is a change of economic ownership from a unit in one economy to a unit in another country. Although there is usually a

Table 26.3:Overview of the balance of payments

	Credits	Debits	Balance
Current accounts			
Goods and services account			
Goods	462	392	
Services	78	107	
Goods and services	*540*	*499*	*41*
Primary income account			
Compensation of employees	6	2	
Interest	13	21	
Distributed income of corporations	17	17	
Reinvested earnings	14	0	
Primary income account	*50*	*40*	*10*
Goods, services and primary income	*590*	*539*	*51*
Secondary income account			
Current taxes on income, wealth, etc.	1	0	
Net non-life insurance premiums	2	11	
Non-life insurance claims	12	3	
Current international transfers	1	31	
Miscellaneous current transfers	1	10	
Secondary income	*17*	*55*	*-38*
Current account balance			*13*
Capital account			
Acquisition or disposals of non-produced assets	0	0	
Capital transfers	1	4	
Capital account balance			*-3*
Net lending (+) or net borrowing (-)			10
Financial account (by functional category)			
Direct investment	8	11	
Portfolio investment	18	14	
Financial derivatives (other than reserves) and ESOs	3	0	
Other investment	20	22	
Reserve assets	8		
Total changes in assets or liabilities	*57*	*47*	
Net lending (+) or net borrowing (-)			*10*
Net errors and omissions			*0*

physical movement of goods when there is a change of ownership, this is not necessarily the case. In the case of merchanting, goods may change ownership and not change location until they are resold to a third party.

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

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

26.52 The main source of data for goods is international merchandise trade statistics. International standards are given in *International Merchandise Trade Statistics: Concepts and Definitions (IMTS)* (United Nations, 1998). *BPM6* identifies some sources of difference that may occur in some or all countries. It also recommends a standard reconciliation table to assist users in understanding these differences. One major source of difference is that the standards for IMTS use a CIF-type (cost, insurance and freight) valuation for imports, while the balance of payments use a uniform FOB valuation for both exports and imports. It is therefore necessary to exclude freight and insurance costs incurred between the customs frontier of the exporter and the customs frontier of the importer. Because of variations between the FOB-type valuation and actual contractual arrangements, some freight and insurance costs need to be rerouted.

26.53 The change of ownership basis used for the balance of payments means that goods entries will have a time of reporting consistent with the corresponding financial flows. In *BPM6*, there are no longer exceptions to the change of ownership principle. In contrast, IMTS follow the timing of customs processing. While this timing is often an acceptable approximation, adjustments may be needed in some cases, such as goods sent on consignment. In the case of goods sent abroad for processing with no change of ownership, the values of goods movements are included in IMTS, but changes in ownership are the primary presentation in the balance of payments. (However, the values of goods movements are recommended as supplementary items to understand the nature of these arrangements.) Further details of the recording of these processing arrangements are given in chapter 21. Other adjustments to IMTS may be needed to bring estimates into line with the change of economic ownership of goods, either generally or because of the particular coverage of each country. Possible examples include merchanting, non-monetary gold, goods entering or leaving the territory illegally, goods procured in ports by carriers, and goods moving physically but where there has been no change of ownership.

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

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

26.56 Detail is produced for the following 12 standard components of services:

a. Manufacturing services on physical inputs owned by others;

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

c. Transport;

d. Travel;

e. Construction;

f. Insurance and pension services;

g. Financial services;

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

i. Telecommunications, computer and information services;

j. Other business services;

k. Personal, cultural and recreational services; and

l. Government goods and services n.i.e.

26.57 Three of the standard components are transactor-based items, that is, they relate to the acquirer or provider, rather than the product itself. These categories are travel, construction and government goods and services n.i.e.

a. Travel covers all goods or services acquired by non-residents during visits whether for own use or to give away. Travel includes goods, local transport, accommodation, meals and other services.

b. Construction covers both the total value of the product delivered by the contractor and any goods and services sourced locally by the contractor that are not recorded in imports and exports of goods.

c. Government goods and services n.i.e. cover a range of items that cannot be allocated to more specific headings.

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

2. The primary income account

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

26.59 Rent may arise in cross-border situations, but rarely, because all land is deemed to be owned by residents, if necessary by creating a notional resident unit. An example where rent may be recorded in the international accounts may be short-term fishing rights in territorial waters provided to foreign fishing fleets. It is common in the international accounts to use the term investment income meaning property income excluding rent. Investment income therefore reflects income arising from the ownership of financial assets and the disaggregation of investment income matches that of financial assets and liabilities so that rates of return can be calculated.

26.60 In *BPM6*, interest flows are measured on exactly the same basis as in the SNA with FISIM separated and treated as an import or export of financial services.

Income of direct investment enterprises

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

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

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

26.64 Reinvested earnings may be negative, for example where the enterprise makes a loss or where dividends are distributed from holding gains, or in a quarter when an annual dividend is paid. However, if the dividends are disproportionately large relative to recent levels of dividends and earnings, the excess should be recorded as a withdrawal of owner's equity from the corporation as explained in paragraph 7.131.

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

3. Secondary income account

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

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

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

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

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

26.70 The structure of the balancing items in the balance of payments is somewhat different from that in the SNA, in that each account has its own balancing item and another that carries down to the next account. To illustrate, the primary income account has its own balancing item (balance on primary income) and a cumulative balance (balance on goods, services and primary income). The external balance on primary income corresponds to balance of primary incomes and is the item feeding into GNI. The current external balance corresponds to saving by the rest of the world relative to the domestic economy. The balancing items in the *BPM6* structure of accounts are shown in table 16.3, reproduced here for convenience as table 26.4.

5. The capital account

26.71 The elements of the capital account subject to international transactions are more restricted than those covered in the SNA. The entries in the capital account cover acquisitions and disposals of non-produced non-financial assets and capital transfers. There are no transactions recorded as capital formation of produced assets because, as explained earlier, the ultimate use of exports is not a concern for the national economy.

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

6. The financial account and IIP

26.73 The financial account of the balance of payments and the IIP are of particular importance because they provide an understanding of international financing as well as of international liquidity and vulnerability. The integrated IIP statement, including the IIP and associated financial and other changes accounts, is shown in Table 26.5. The primary classification is based on functional categories, with additional data on instruments and institutional sectors.

26.74 The functional categories, described in section D, convey more information about the motivation and relationship between the parties, which are of particular interest to international economic analysis. Data by functional category are further subdivided by instrument and institutional sector, which makes it possible to link them to the corresponding SNA and monetary and financial statistics items. The institutional sector classification is the same as in the SNA, although it is usually abbreviated (to five sectors in the standard components). In addition, a supplementary subsector is used for monetary authorities, which is a functional subsector linked to reserve assets. It covers the central bank and any parts of general government or financial corporations other than the central bank that hold reserve assets, so is relevant for countries

Table 26.4: Balancing items in the international accounts in relation to the SNA sequence of accounts

Uses		Resources
Rest of the world	Transactions and balancing items	Rest of the world
	Goods and services account	
	Imports of goods and services	499
540	Exports of goods and services	
- 41	*External balance of goods and services*	
	Primary income account	
6	Compensation of employees	2
	Taxes on production and imports	
	Subsidies	
44	Property income	38
- 10	*External balance of primary income*	
- 51	*External balance of goods, services and primary income*	
	Secondary income account	
17	Current transfers	55
38	*External balance of secondary income*	
	Adjustment for the changes in pension entitlements	
- 13	*Current external balance*	
	Capital account	
	Acquisitions less disposals of non-produced assets	
	Capital transfers, receivable	4
	Capital transfers, payable	- 1
3	*External capital account balance*	
- 10	***Net lending (+) / net borrowing (–)***	

where some or all reserves are held outside the central bank.

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

26.76 The balancing item on the IIP is the net IIP. The net IIP plus non-financial assets in the national balance sheet equal national net worth, because resident-to-resident financial claims net to zero in the national balance sheet.

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

7. The other changes in assets accounts

26.78 International assets and liabilities may be subject to all the possible types of other changes in the volume of assets and liabilities and to revaluation changes.

26.79 Because instruments are often denominated in foreign currencies and analysis of the effect of exchange rate movements is particularly important, there is a breakdown of revaluations into exchange rate changes and other factors.

D. International accounts functional categories

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

a. direct investment;

b. portfolio investment;

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

d. other investment; and

e. reserve assets.

26.81 Detailed definitions are given later in this section. The functional categories are built on the classification of

Table 26.5:Overview of Integrated International Investment Position Statement

	Opening position	Transactions (Financial account)	Other changes in the volume of assets	Revaluation	Closing position
Assets (by functional category)					
Direct investment	78	8	0	1	87
Portfolio investment	190	18	0	2	210
Financial derivatives (other than reserves) and ESOs	7	3	0	0	10
Other investment	166	20	0	0	186
Reserve assets	833	8	0	12	853
Total	*1 274*	*57*	*0*	*15*	*1 346*
Liabilities (by functional category)					
Direct investment	210	11	0	2	223
Portfolio investment	300	14	0	5	319
Financial derivatives (other than reserves) and ESOs	0	0	0	0	0
Other investment	295	22	0	0	317
Total	*805*	*47*	*0*	*7*	*859*
Net IIP	*469*	*10*	*0*	*8*	*487*

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

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

26.83 The instrument classification alone does not fully reflect these behavioural differences. For example, a loan can appear under direct investment or other investment, but the different nature of the relationship between the parties

Table 26.6: Link between Financial Assets Classification and Functional Categories

SNA /*MFSM* Financial Assets and Liabilities Classification	Functional categories				
	Direct investment	Portfolio investment	Financial derivatives (other than reserves) and ESOs	Other investment	Reserve assets
Monetary gold					X
Special drawing rights				X*1	X*1
Currency and deposits:					
Currency				X	X
Interbank positions				X	X
Other transferable deposits	X			X	X
Other deposits	X			X	X
Debt securities	X	X			X
Loans	X			X	X
Equity and investment fund shares:					
Equity:					
Listed shares	X	X			X
Unlisted shares	X	X			x
Other equity	X			X	
Investment fund shares/units:					
Money market fund shares/units	x	X			X
Other investment fund shares/units	x	X		x	X
Insurance, pension and standardized guarantee schemes:					
Non-life insurance technical reserves	x			X	
Life insurance and annuity entitlements	x			X	
Pension entitlements				X	
Claims of pension funds on pension managers	X			X	
Entitlements to non-pension benefits				X	
Provisions for calls under standardized guarantees	X			X	
Financial derivatives and employee stock options:					
Financial derivatives			X		X
Employee stock options			X		
Other accounts receivable/payable:					
Trade credit and advances	X			X	
Other accounts receivable/payable	X			X	

Footnote 1: SDR assets are reserve assets; SDR liabilities are other investment;
X shows applicable functional categories; x shows cases that are considered to be relatively uncommon.

means that the risks and motivations behind the transaction tend to differ. A direct investment loan is more likely to be provided and generally involves less vulnerability on the part of the borrowing economy because of the relationship between the parties. Table 26.6 shows the relationship between instruments and functional categories.

1. Direct investment

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

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

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

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

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

26.89 Those direct investment enterprises that are controlled by non-residents correspond to the SNA subsectors of foreign-controlled enterprises. However direct investment enterprises include those not subject to control from abroad but still subject to a significant degree of influence. The SNA’s foreign-controlled enterprises are limited to inward direct investment, while the international accounts are also concerned with outward direct investment. Reinvested earnings on foreign direct investment in the SNA have the same scope as in the balance of payments (although “foreign” is not used because it is redundant in the context of the international accounts).

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

2. Portfolio investment

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

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

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

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

4. Other investment

26.94 ***Other investment is a residual category that includes positions and transactions other than those included in direct investment, portfolio investment, financial***

derivatives and employee stock options and reserve assets. It includes the remainder of the following financial instruments:

a. other equity;

b. currency and deposits;

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

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

e. trade credit and advances;

f. other accounts receivable/payable; and

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

5. Reserve assets

26.95 ***Reserve assets are those external assets that are readily available to and controlled by monetary authorities for meeting balance of payments financing needs, for intervention in exchange markets to affect the currency exchange rate and for other related purposes (such as maintaining confidence in the currency and the economy, and serving as a basis for foreign borrowing). Reserve assets must be denominated and settled in foreign currency.*** Underlying the concept of reserve assets are the notions of "control" and "availability for use" by the monetary authorities.

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

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

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

E. Special international accounts considerations

1. Global imbalances

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

2. Exceptional financing

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

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

26.102 There is more discussion on exceptional financing in appendix 1 of *BPM6*.

3. Debt instruments

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

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

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

4. Debt reorganization

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

26.107 The four main types of debt reorganization are:

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

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

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

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

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

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

5. Regional arrangements, including currency unions

26.109 Regional arrangements include:

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

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

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

BPM6 gives detailed guidance on the treatments of these arrangements. Among the issues that are dealt with are the production of consolidated data for a union as a whole, the treatment of regional organizations, including the central bank, treatment of bank notes in a currency union, and revenue-sharing arrangements in a customs union.

6. Currency conversion, including multiple exchange rates

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

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

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

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