# CHAPTER 20

# The government accounts

## Introduction

20.01 The activities of government are presented separately from those of the rest of the economy because the powers, motivation, and functions of government are different from those of other sectors. This Chapter presents general government sector accounts and a government finance statistics (GFS) presentation that gives an integrated picture of government economic activities: revenue, expenditure, deficit/surplus, financing, other economic flows and balance sheet.

20.02 Governments have powers to raise taxes and other compulsory levies and to pass laws affecting the behaviour of economic units. The principal economic functions of government are as follows:

(a) to provide goods and services to the community, either for collective consumption such as public administration, defence, and law enforcement, or individual consumption such as education, health, recreation and cultural services, and to finance their provision out of taxation or other incomes;

(b) to redistribute income and wealth by means of transfer payments such as taxes and social benefits;

(c) to engage in other types of non-market production.

20.03 The GFS presentation of general government economic activities presents the usual sequence of accounts in a manner that is more suitable for government finance analysts and policymakers. The GFS presentation uses aggregates and balancing items defined in terms of the ESA concepts, definitions, classifications, and accounting rules so that they are measured consistently with other macroeconomic variables, and with the same measures in other countries. Items such as saving and net lending/net borrowing are already available in the sequence of accounts. Other items, such as total revenue, total expenditure, the tax burden and total debt, are not shown explicitly.

20.04 Additional rules on some more difficult issues of classification and measurement for the general government sector are given in the section 'Accounting issues relating to general government'.

## Defining the general government sector

20.05 The general government sector (S.13) consists of all government units and all non-market non-profit institutions (NPIs) that are controlled by government units. It also comprises other non-market producers as identified in paragraphs 20.18 to 20.39.

20.06 Government units are legal entities established by political process which have legislative, judicial or executive authority over other institutional units within a given area. Their principal function is to provide goods and services to the community and to households on a non-market basis and to redistribute income and wealth.

20.07 A government unit usually has the authority to raise funds through compulsory transfers from other institutional units. In order to satisfy the basic requirements of an institutional unit, a government unit must have funds of its own either raised by income from other units or received as transfers from other government units, and must have the authority to disburse such funds in the pursuit of its policy objectives. It must also be able to borrow funds on its own account.

## Identification of units in the government

### *Government units*

20.08 In all countries, there is a core entity, notably inside the central government that exercises national executive, legislative and judiciary powers. Its revenues and expenditures are directly regulated and controlled by a Ministry of Finance, or its equivalent, by means of a general budget approved by the legislature. Despite its size and diversity, this entity is usually a single institutional unit. Ministerial departments, agencies, boards, commissions, judicial authorities, and legislative bodies are part of this core central government unit. The separate ministries within it are not recognised as separate institutional units as they do not have the authority to own assets, incur liabilities, or engage in transactions in their own right.

20.09 General government subsectors such as state and local governments can include such primary core government units as described in paragraph 20.08, each related to a given level of government and geographic area.

20.10 In addition to this primary unit, there are government entities with separate legal identities and substantial autonomy, including discretion over the volume and composition of their expenditures and a direct source of revenue, such as earmarked taxes. Such entities are often established to carry out specific functions, such as road construction or the non-market production of health, education or research services. These entities are considered to be separate government units where they maintain full sets of accounts, own goods or assets in their own right, engage in non-market activities for which they are held accountable at law, and are able to incur liabilities and enter into contracts. Such entities (together with non-profit institutions controlled by government) are known as 'extra-budgetary units' because they have separate budgets, receive substantial transfers from the main budget, and their primary sources of finance are supplemented with own sources of revenue that fall outside the main budget. These extra-budgetary units are classified to the general government sector unless they are predominantly market producers controlled by another government unit.

20.11 The general budget of any government level can include unincorporated enterprises that are market producers and quasi-corporations. If they qualify as institutional units, such enterprises are not considered to be part of general government, but classified to the non-financial or financial corporations sector.

20.12 Social security funds are government units devoted to the operation of social security schemes. Social security schemes are social insurance schemes covering all or a large part of the community as a whole, which are imposed and controlled by government. A social security fund is an institutional unit if it is organised separately from the other activities of government units, holds its assets and liabilities separately, and engages in financial transactions on its own account.

### *NPIs classified to the general government sector*

20.13 Non-profit institutions (NPIs) that are non-market producers and are controlled by government units are units of the general government sector.

20.14 Governments may choose to use some NPIs rather than government agencies to carry out government policies because they are seen as more detached, objective, and less subject to political pressures. For example, research and development and the setting and maintenance of standards in fields such as health, safety, the environment, and education are areas in which NPIs may be more effective than government agencies.

20.15 Control of a NPI is defined as the ability to determine the general policy or programme of the NPI. Public intervention in the form of general regulations applicable to all units working in the same activity is irrelevant when deciding whether the government holds control over an individual unit. To determine whether a NPI is controlled by the government, the following five indicators of control should be considered:

(a) the appointment of officers;

(b) other provisions of the enabling instrument, such as the obligations in the statute of the NPI;

(c) contractual agreements;

(d) degree of financing;

(e) risk exposure.

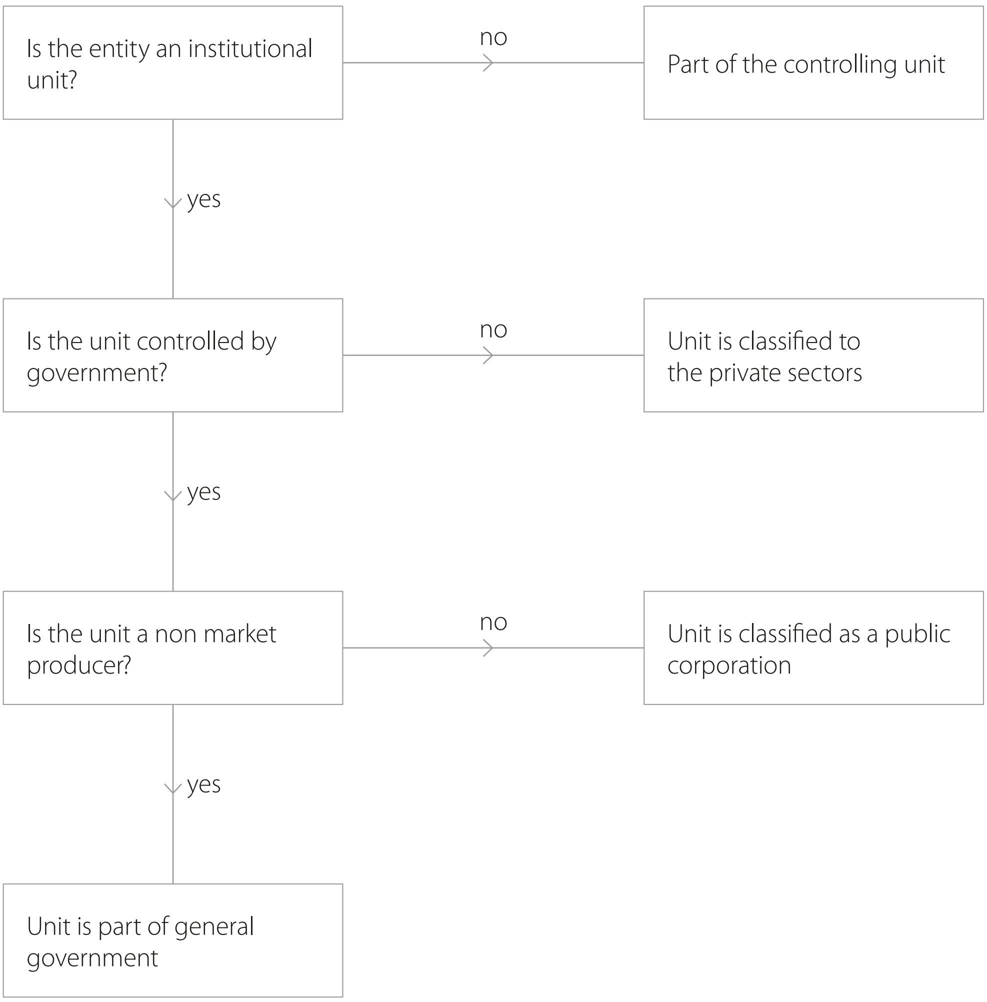
A single indicator can be sufficient to establish control. However, if a NPI that is mainly financed by government remains able to determine its policy or programme to a significant extent along the lines mentioned in the other indicators, then it would not be considered as being controlled by government. In most cases, a number of indicators will collectively indicate control. A decision based on these indicators will be judgmental in nature.

20.16 The non-market characteristic of an NPI is determined in the same way as for other units of general government.

### *Other units of general government*

20.17 It can be difficult to decide on the classification of producers of goods and services that operate under the influence of government units. The alternatives are to classify them as general government or, if they qualify as institutional units, as public corporations. For such cases, the following decision tree is used.

**Diagram 20.1** — Decision tree




## Public control

20.18 Control over an entity is the ability to determine the general policy or programme of that entity. In order to determine the existence of control by government, the criteria used are those used for corporations liable to be public corporations, as set out in paragraph 2.32.

## Market/non-market delineation

### *Notion of economically significant prices*

20.19 Non-market producers provide all or most of their output to others free of charge or at prices that are not economically significant. Economically significant prices are prices which have a substantial influence on the amounts of products producers are willing to supply and on the amounts of products that purchasers wish to acquire. It is the criterion that is used to classify output and producers as market or non-market, thus deciding whether an institutional unit in which government has a controlling interest is to be designated as a non-market producer and so classified in the general government sector, or as a market producer and so classified as a public corporation.

20.20 Whereas the assessment of whether a price is economically significant is carried out at the level of each individual output, the criterion determining the market/non-market character of a unit is applied at the level of the unit.

20.21 When the producers are private corporations, it can be presumed that prices are economically significant. By contrast, when there is public control, a unit's prices may be established or modified for public policy purposes, which may cause difficulties in determining whether the prices are economically significant. Public corporations are often established by government to provide goods and services that the market would not produce in the quantities or at the prices to meet government policy. For such public units enjoying government support, the sales may cover a large part of their costs, but they will respond to market forces differently from private corporations.

20.22 To analyse the difference between a market and a non-market producer, in relation to changes in market conditions, it is useful to specify which units are the consumers of the goods and services in question and whether the producer actually competes on the market or is the only supplier.

### *Criteria of the purchaser of the output of a public producer*

#### The output is sold primarily to corporations and households.

20.23 Economically significant prices normally result when two major conditions are fulfilled:

(1) the producer has an incentive to adjust supply either with the goal of making a profit in the long run or, at a minimum, covering capital and other production costs, including consumption of fixed capital, by sales; and

(2) consumers are free to choose on the basis of the prices charged.

#### The output is sold only to government.

20.24 Some services are typically required as ancillary services. They include activities such as transportation, financing and investment, purchasing, sales, marketing, computer services, communications, cleaning, and maintenance. A unit that provides this type of services exclusively to its parent unit or to other units in the same group of units is an ancillary unit. It is not a separate institutional unit and is classified with its parent unit. Ancillary units provide all of their output to their owners for use as intermediate consumption or gross fixed capital formation.

20.25 If a public producer sells only to government and is the only supplier of its services, it is presumed to be a non-market producer unless it competes with a private producer. A typical case is tendering for a contract with government on commercial terms and therefore government payments are only for services delivered.

20.26 If a public producer is one of several suppliers to government, it is considered a market producer if it competes with other producers on the market and its prices satisfy the general criteria to be economically significant, as defined in paragraphs 20.19 to 20.22.

#### The output is sold to government and others.

20.27 If a public producer is the only supplier of its services, it is presumed to be a market producer if its sales to non-government units are more than half of its total output or its sales to government fulfils the tendering condition of paragraph 20.25.

20.28 If there are several suppliers, a public producer is a market producer if it competes with the other producers through tendering for a contract with government.

## The market/non-market test

20.29 The sector classification of core government units, engaged in the provision of goods and services on a non-market basis and/or in the redistribution of income and wealth, is straightforward.

For other producers that operate under the control of government, an assessment of their activity and resources is necessary. In order to decide if they are market units, and charge economically significant prices, the criteria as set out in paragraphs 20.19 to 20.28 are to be checked. In summary the conditions are as follows:

(a) the producer is an institutional unit (a necessary condition; see also the decision tree in paragraph 20.17);

(b) the producer is not a dedicated provider of ancillary services;

(c) the producer is not the only supplier of goods and services to government, or, where that producer is, it has competitors; and

(d) the producer has an incentive to adjust supply to undertake a viable profit-making activity, to be able to operate in market conditions and to meet its financial obligations.

The ability to undertake a market activity will be checked notably through the usual quantitative criterion (the 50 % criterion), using the ratio of sales to production costs (as defined in paragraphs 20.30 and 20.31). To be a market producer, the public unit shall cover at least 50 % of its costs by its sales over a sustained multi-year period.

20.30 For the market/non-market test, sales of goods and services correspond to sales receipts, in other words to the market output (P.11) increased by payments for non-market output (P.131), if any. Own-account production is not considered as part of sales in this context. Sales exclude also all payments received from government unless they are granted to other producers undertaking the same activity.

20.31 Production costs are the sum of intermediate consumption, compensation of employees, consumption of fixed capital and other taxes on production. For the purpose of the market/non-market test, production costs are increased by the net interest charge and decreased by the value of any imputed production, notably own-account production. Subsidies on production are not deducted.

### *Financial intermediation and the government boundary*

20.32 The case of units engaged in financial activities needs special consideration. Financial intermediation is the activity in which units acquire financial assets and at the same time incur liabilities on their own account by engaging in financial transactions.

20.33 A financial intermediary places itself at risk by incurring liabilities on its own account. For instance, if a public financial unit manages assets but does not place itself at risk by incurring liabilities on its own account, it is not a financial intermediary and the unit is classified in the general government sector rather than in the financial corporations sector.

20.34 Applying the quantitative criterion of the market/non-market test to public corporations involved in financial intermediation or in managing assets is generally not relevant, because their earnings arise from both property income and holding gains.

## Borderline cases

### *Public head offices*

20.35 Public head offices are entities whose main function is to control and direct a group of subsidiaries under the control of a government unit. Two cases are distinguished.

(a) To the extent that the public head office is an institutional unit and is engaged in the management of market producers, it is classified according to the main activity of the group, in sector S.11 if the main activity is to produce goods and non-financial services, or in sector S.12 if it produces mainly financial services (see also paragraphs 2.23 and 2.59).

(b) If the public head office is not an institutional unit, and so sometimes known as a 'shell', or acts as a government agent for public policy purposes, such as channelling funds amongst subsidiaries, and organising privatisation or defeasance, it is classified to the general government sector.

20.36 The term 'public head office' used here covers units which are also known under the label of 'public holding companies'.

20.37 Subsidiaries forming part of the group, engaged in production and keeping a full set of accounts, are deemed to be institutional units even if they have partially surrendered some of their autonomy of decision to the central body (see paragraph 2.13). The market/non-market test is applied to individual units. It may thus happen that one subsidiary, but not others, is recognised as non-market and classified to the general government sector.

### *Pension funds*

20.38 Employers' pension schemes are arrangements set up to provide retirement benefits to participants, based on a contractual employer-employee relationship. They include funded, unfunded, and partly funded schemes.

20.39 A defined-contribution funded scheme, established by a government unit, is not treated as a social security scheme, where there is no government guarantee on the level of pensions due, and the level of pensions is uncertain because it depends on asset performance. As a consequence, the unit identified as managing the scheme — as well as the fund itself, if it is a separate institutional unit — is considered a financial corporation, classified in the insurance corporations and pension funds subsector.

### *Quasi-corporations*

20.40 Quasi-corporations are unincorporated enterprises that function as if they were corporations. Quasi-corporations are treated as corporations: that is, as separate institutional units from the units to which they belong in recognition of their distinct economic and financial behaviour. Thus, market establishments controlled by government units and recognised as public quasi-corporations are grouped with corporations in the non-financial or financial corporations sectors.

20.41 A government establishment or a group of establishments engaged in the same kind of production under common management is treated as a public quasi-corporation if:

(a) it charges prices for its outputs that are economically significant;

(b) it is deemed to have autonomy of decision; and

(c) a complete set of accounts exists that enables its operating balances, savings, assets and liabilities to be separately identified and measured, or it is possible to construct such a complete set of accounts.

20.42 The amount of income withdrawn from a quasi-corporation during a given accounting period is decided by the owner. Such a withdrawal is equivalent to the payment of a dividend by a corporation to its shareholders. Given the amount of the income withdrawn, the amount of earnings retained within the quasi-corporation is determined. The owner may invest more capital in the enterprise or withdraw capital from it by disposing of some of its assets, and such flows of capital shall also be identifiable in the accounts whenever they occur. Investment and property income flows in the quasi-corporation are recorded in the same way as similar flows in corporations. In particular, investment grants are recorded as capital transfers.

20.43 The producer entities that are not treated as quasi-corporations remain integrated with the government units that own them. While units of government consist largely of non-market producers, market establishments can exist within a government unit. The sales of these market establishments are in addition to incidental sales, which are secondary output sold by non-market establishments at economically significant prices. As a result, a non-zero net operating surplus is possible for a government unit: the net operating surplus generated by market establishments.

### Restructuring agencies

20.44 Some public units are involved in the restructuring of corporations. Such corporations may or may not be controlled by government. The restructuring agencies may be long-standing public units or agencies created for this special purpose. Government funds the restructuring in various ways, either directly through capital injections such as capital transfers, loans or acquisition of equity, or indirectly, through granting guarantees. The major criteria determining sector classification of restructuring agencies are whether such entities are financial intermediaries, the market character of the main activity and the degree of risk assumed by the public agency. In many cases, the degree of risk taken by the restructuring agency is low due to the fact that it acts with public financial support and on behalf of the government. Restructuring agencies can handle privatisation or defeasance.

### Privatisation agencies

20.45 The first type of restructuring agency manages privatisation of public sector units. There are two cases.

(a) The restructuring unit, whatever its legal status, acts as a direct agent of the government or has a limited lifespan. Its main function is to redistribute national income and wealth, channelling funds from one unit to the other. The restructuring unit is classified in the general government sector.

(b) The restructuring unit is a holding company controlling and managing a group of subsidiaries, and only a minor part of its activity is dedicated to conducting privatisation and channelling funds from one subsidiary to the other on behalf of the government and for public policy purposes. The unit is classified as a corporation, and any transactions made on behalf of the government should be rerouted through the general government.

### Defeasances structures

20.46 The second type of restructuring agency deals with impaired assets, and may be set up in a banking or other financial crisis. Such agencies are referred to as defeasance structures or 'bad banks'.

A restructuring agency shall be classified according to the degree of risk it assumes, considering the degree of financial support of the government.

In the most common case, the restructuring agency purchases assets above market prices with the direct or indirect financial support of government. Its activities result in redistribution of national income and wealth. If the defeasance structure does not place itself at risk, it is classified to the general government sector.

### Special purpose entities

20.47 Special purpose entities (SPEs), also called special purpose vehicles (SPVs), may be set up for financial convenience by governments or by private entities. The SPE may be involved in fiscal operations, including securitisation of assets, borrowing on behalf of government, etc. Such SPEs are not separate institutional units when resident. These entities are classified according to the principal activity of the owner, and SPEs performing fiscal operations are classified to the general government sector.

20.48 Non-resident SPEs are recognised as separate institutional units. All flows and stock positions between the general government and the non-resident SPE are recorded in the general government and SPE accounts. In addition, when such non-resident SPEs undertake government borrowing or incur government outlays abroad, even when there are no flows recorded between the government and the SPE related to those fiscal activities, transactions are imputed in the accounts of both the government and the non-resident entity to reflect the fiscal activities of the government. If a non-resident SPE engages in a securitisation operation without a sale of asset, the operation is considered to be a borrowing transaction of the government. The economic substance of this transaction is accounted for by imputing general government borrowing from the non-resident SPE for the same value and at the same time the SPE incurs a liability to the foreign creditor.

### Joint ventures

20.49 Many public units enter into arrangements with private entities or other public units to undertake a variety of activities jointly. The activities can result in market or non-market output. Joint operations can be structured broadly as one of three types: jointly controlled units, referred to here as joint ventures; jointly controlled operations; and jointly controlled assets.

20.50 A joint venture requires the establishment of a corporation, partnership or other institutional unit in which each party has joint control over the activities of the unit. As an institutional unit, the joint venture may enter into contracts in its own name and raise finance for its own purposes. A joint venture maintains its own accounting records.

20.51 Normally, the percentage of ownership will be sufficient to determine control. If each owner owns an equal percentage of the joint venture, the other indicators of control must be considered.

20.52 Public units can also enter into joint operating arrangements that are not run by separate institutional units. In this case, there are no units requiring classification, but care must be taken to ensure that the ownership of assets is recorded correctly and sharing arrangements of revenues and expense are made in accordance with the provisions of the governing contract. For example, two units may agree to be responsible for different stages of a joint production process or one unit may own an asset or a complex of related assets but both units agree to share revenues and expenses.

### *Market regulatory agencies*

20.53 Public agencies acting in the field of agriculture engage in two types of activity:

(a) either to buy, hold and sell agricultural and other food products on the market; or

(b) to be exclusively or principally a distributor of subsidies or other transfers to producers.

In the first case, given that it acts as a market producer, the institutional unit is classified in the non-financial corporations sector (S.11). In the second case, the institutional unit is classified in the general government sector (S.13).

20.54 Where the market regulatory agency performs both activities described in paragraph 20.53, it is split into two institutional units, according to the principal activity, one being classified in the non-financial corporations sector (S.11), the other in the general government sector (S.13). In the case where it would be difficult to split the agency in this way, a convention is to adapt the usual sector classification test applying a ‘principal activity’ criterion on the basis of costs. If the costs of the unit are very significantly linked to the market managing activity, the unit is classified in the non-financial corporations sector. An 80 % threshold of costs to sales ratio is recommended. If the costs to sales ratio linked to the regulatory activity are less than this threshold, the unit is classified in the general government sector (S.13).

### *Supranational authorities*

20.55 Some countries are part of an institutional agreement whereby the countries form part of a supranational authority. Normally such an arrangement implies monetary transfers from the member countries to the supranational authority and the reverse. The supranational authority will also engage in non-market production. In the national accounts of the member countries, the supranational authorities are non-resident institutional units that are classified to a specific subsector of the rest of the world.

## The subsectors of general government

20.56 Depending on the administrative and legal arrangements, there is generally more than one level of government within a country. In Chapter 2, three levels of government are specified: central, state (or regional) and local, with a subsector for each level. In addition to these levels of government, the existence and size of social security and its role in fiscal policy require that statistics for all social security units be compiled as a fourth separate subsector of general government. Not all countries have all levels; some may have only a central government or a central government and one lower level. In countries that have more than three levels, the various units should all be classified to one of the levels above.

### *Central government*

20.57 The central government (excluding social security) subsector (S.1311) consists of all government