Chapter 4. Economic Territory, Units, Institutional Sectors, and Residence

A. General Principles

4.1 This introductory section to this chapter will explain how an economic territory consists of institutional units and how the concept of residence is used to classify an institutional unit to an economic territory. As background, the section will note that increasing international economic openness means that some institutional units have connections to more than one economy. This chapter will introduce the concept of a predominant center of economic interest as the way to show the link between the economy and the institutional unit. This concept is designed to ensure that each unit is a resident of one and only one economy (or, in a few exceptional cases that will be set out in this chapter, a single real-world unit is split into separate institutional units that are residents of different economies).

B. Economic Territory

4.2 An economic territory will be defined by reference to an area under the effective economic control of a government, as in *BPM5* para. 59. This principle will be elaborated to cover embassies abroad, territories, and special zones such as free-trade zones and offshore financial centers. It will be noted that an implication of the definition is that embassies, foreign military bases, peacekeeping operations, and international organizations are not residents of the territory where they are physically located.

4.3 An economic territory consists of all the institutional units (defined below) that are resident (defined below) in that territory. It will be emphasized that a territory covers all entities subject to its laws, even where the government provides exemption from particular ones (such as taxation or banking regulations). The chapter will elaborate on which dimensions of the application of the laws of a territory should be specified as relevant to determining whether an entity is subject to the laws of the territory, for example, that the unit is subject to laws that apply only to some part of its operations (such as fund-raising or trade) and is not potentially subject to laws more generally.

[Question: Is this approach suitable?]

4.4 The possible inclusion of disputed zones or zones under rebel control will be discussed. In such cases, it is proposed that compilers decide on including or excluding the zone, basing its treatment on their own circumstances, and that they should state which treatment they adopted in metadata. It will be recognized that compilers will need to consider political and practical issues, as well as methodological aspects, in deciding about the scope of the economic territory.

[Question: Is this proposal suitable?]

4.5 A single government may wish to treat differently the areas under its control, usually because they are subject to different laws, such as a free-trade zone or an "offshore" financial center or have some degree of self-government. For economies with a particular interest in special territories or zones, the manual will propose that an economy show these territories or zones separately from the rest of the economy, but that they also prepare a consolidation, to produce a national total. It will emphasize that the requirement for international purposes is for national totals to cover all units under the government's effective control and that all units be a part of one and only one economic territory. A proposed presentation for consolidating different economic areas under a single government will be illustrated in the manual.

4.6 The treatment of changes in sovereignty over a particular area will be discussed. The chapter will explain that an exchange of a geographical/physical area by mutual agreement (defined as in *GFSM 2001* para. 3.5) from one government to another or an exchange under a decision of a court satisfies the definition of a transaction. Accordingly, the chapter will indicate that such a transfer will be treated as an acquisition of land in the capital account, along with associated buildings and equipment in the goods and services account. If the exchange is paid for, the offsetting entry will be a financial account entry for the agreed amount. If there is no payment, the offsetting entry is a capital transfer. If there is a mutual exchange of land or buildings, the manual will recommend that both entries in the exchange will be shown in the accounts on a gross basis (viz., capital account in the case of land; construction services in the goods and services account, in the case of buildings).

4.7 If the change in the status of a particular area is not by mutual agreement (defined as in *GFSM 2001* para. 3.5), then it would not qualify as a transaction: it would be treated as other changes in volumes.

4.8 Treatment of cases of joint sovereignty will be discussed:

(a) If economic administration of a zone is effectively with only one government, the zone could be considered as in the economic territory of that government.

(b) If the zone is jointly administered, then the applicable laws will differ from other territory of any of the individual governments, so the joint zone is potentially a territory in its own right. However, if the zone is relatively small or data are confidential, it may be better to split the institutional units in the zone among the primary territories:

- If there is a strong connection to just one of the primary territories, particular enterprises in the zone or the whole zone could be allocated to that territory.

- If there are connections to both territories, then particular enterprises in the zone or the whole zone may be split in a similar way to enterprises that operate in two or more territories, as discussed under residence later in this chapter.

The statistical compilers of each territory should consult to adopt consistent methods with no gaps or overlaps.

[Question: Are these proposals suitable?]

4.9 The chapter will indicate that instances of a single territory splitting, or two or more territories combining, are not transactions between two parties, because these instances involve the creation or elimination of parties (and are, therefore, distinguishable from two parties exchanging a particular area, which was discussed earlier). Accordingly, the chapter will note that there is a reclassification, which should be shown as other changes in assets account. (The proposals were explained in more detail in BOPCOM-02/59.) (In any case, like other large, lumpy items, it is desirable that they be shown separately in national presentations of the data, so that users can understand the event and exclude it if they wish.)

4.10 The words “territory,” “economy,” and “economic territory” are used interchangeably in international accounts literature to represent an area for which international accounts are compiled. It will be mentioned that “economic territory” is generally a country but may also be applied to other territories, such as dependencies or crown territories. The concept of economic territory can also generally be applied to a group of countries (e.g., for an economic or monetary union) or parts of countries (e.g., for states, provinces, local governments, or regions). In the case of groups of countries, there is a need to consolidate transactions and positions between different countries within the group. These issues are discussed in more detail in an appendix. For parts of an economy, such as provinces or states, it will be noted that the issue is specialized, that there may be difficulty in separating the operations of entities operating in more than one area, and that these issues are outside the scope of the manual.

C. Units

4.11 The chapter will introduce the principles relating to units for statistical purposes, using the general principles in the *1993 SNA* Chapter IV (at length), *MFSM* paras. 62–79, and *GFSM 2001* paras. 2.11–2.21 (both more briefly). While the principles for units are the same in all the macroeconomic datasets, it is useful to briefly outline them in this manual. Following *1993 SNA* para. 2.19, institutional units will be stated in terms of ability to own assets, incur liabilities, and undertake a full range of transactions. It will be noted specifically that institutional units relate to the point of financial decision-making, so they include some arrangements that may not be legal entities in their own right, such as unincorporated joint ventures, branches, and partnerships. Also, some entities that are separate legal entities are combined as not having a separate economic status, such as ancillary companies. While institutional units for statistical purposes use legal units as a starting point, as noted below, some combinations and splits are made to improve their usefulness for economic analysis.

4.12 The "enterprise" is defined in *1993 SNA* para. 5.1 as an institutional unit that undertakes production, and so is useful in international statistics. (Note that some institutional units that do not engage in production but hold financial assets—such as holding companies, mutual funds, and some SPEs—are referred to as enterprises in the *1993 SNA*, *BPM5*, and *MFSM*, despite *1993 SNA* para. 5.1.) Enterprises will be contrasted with enterprise groups and establishments (the latter also called local kind of activity units). Enterprises will be stated to include corporations and quasicorporations, that is, unincorporated structures such as branches. In addition, government entities, households, nonprofit institutions serving households, and international organizations are institutional units.

4.13 The principles for institutional units take into account the desirability of having institutional units that are only resident of a single territory. In a few cases where a single entity has strong links to two or more economies, the entity will be split into separate units. Those cases include branches, multiterritory enterprises, other legal structures, preparatory expenses, and ownership of land, as discussed below. Also, legal entities will not be combined across territories. Entities may normally be combined with owners because they have no separate decision-making, such as ancillary companies and some trusts. But in cases in which they are located in a different territory to that of their owners, they will be treated as separate institutional units.

1. Branches and other quasicorporations

4.14 When a single legal entity has sufficiently substantial operations in two or more territories, unincorporated branches will be recognized as separate institutional units in territories outside that of the legal entity. The rationale for this treatment will be given that the parts of the legal entity should be separate for statistical purposes, because each of the parts has its strong connection with a different economic territory. The requirements for a branch to be recognized as a separate unit will be that the operation:

(a) has undertaken or has an intention to undertake production on a significant scale for at least one year;

(b) has its own separate income statement and statement of assets and liabilities; and

(c) acts in its own right rather than as an agent.

(It will be noted that although "branch" is used more generally in common usage for incorporated subsidiaries, the international accounts term is limited to unincorporated branches recognized as a separate entity for statistical purposes.)

4.15 These requirements for identifying a branch as a separate entity are similar to *BPM5* para. 78, except that the requirement for significant physical presence given in *BPM5* will be limited to activities that require physical presence. (As an illustration, some financial services can be undertaken with little or no physical presence.) In addition, the unit's being subject to income tax laws will be mentioned as strong evidence of the existence of a branch, but will not be a requirement, as was the case in *BPM5*.

[Question: Are these principles for the identification of branches suitable?]

4.16 A branch is a type of direct investment enterprise (see Chapter 5 Classifications). A branch is one form of "quasicorporation," in the terminology of the *1993 SNA*, that is, it is an unincorporated enterprise that functions as if it were a corporation.

4.17 A quasicorporation can also be identified for an unincorporated partnership, such as a joint venture.

4.18 The application of the principles on branches to construction projects will be discussed and illustrated by specific situations, such as long-term projects and site offices. The same principles will be applied for both capital formation and repairs (in contrast to *ESA9*5 page 18 footnote 4, where a notional institutional unit is imputed in all cases where the output is gross fixed capital formation.)

4.19 Branches will be contrasted with agents, as in *BPM5* para. 83.

2. Multiterritory enterprises

4.20 In some cases, it is not possible to separately identify a branch because a single entity is officially authorized to be run as a seamless operation across several economic territories. The *BPM5*-preferred treatment (para. 82) of prorating the operations of the company to the individual territories will be adopted. *BPM5* proposed equity contributions as the basis for prorating. In addition, it will be proposed that other factors, such as fixed assets by location, may be considered if equity shares are unrepresentative of the operations. It will be noted that the situation applies beyond operators of mobile equipment, for example, to a range of cross-border activities including hydroelectricity schemes on border rivers, pipelines, bridges, tunnels, and undersea cables. The same issue arises for a *societas europaea*—a company created under one European Union member state and able to operate in any member state. The manual will note that the treatment will mean that each transaction by these enterprises needs to be split into resident and nonresident components. (The same solution is proposed as an option above in cases of zones of joint sovereignty.)

4.21 Compilers in each of the territories involved in such arrangements will be encouraged to cooperate to develop consistent data and avoid gaps. In view of the complexity of splitting of units, which results in each transaction of the enterprise also being split, an example could be included as an appendix to this chapter. Alternatively, although this suggestion raises some conceptual issues, the example could be included in the revised version of the *Balance* *of Payments Compilation Guide*. For other territories that have transactions or positions with the multiterritory enterprise, the implications of splitting will be noted.

3. Other legal structures

4.22 The following types of legal structures have varying degrees of legal status and only partially separate identities from their owners, so their status as units needs to be discussed:

(a) Unincorporated entities used to undertake production. Whether branches, trusts, partnerships, or unincorporated joint venture structures, these will be treated as separate institutional units from their owners if they are in a separate territory from at least one of their own owners and qualify as entities, using the guidelines for identifying branches discussed above.

[Question: Are the proposed treatments for unincorporated entities suitable?]

(b) Holding corporations. Defined in *MFSM* para. 70 as enterprises whose principal activities are holding and directing subsidiaries, these are separate institutional units. These entities are direct investors when the holding corporation is in one territory and the subsidiaries are in another.

[Question: Is the proposed treatment for holding corporations suitable?]

(c) Ancillary companies. The *1993 SNA* (para. 4.40) defines ancillary companies as those whose activities are limited to providing services to its parent, such as sales, management, or financial services. While the *1993 SNA* paras. 4.43–44 state that ancillary companies are not treated as separate units, consistent with *MFSM* para. 71, it will be stated that an ancillary enterprise is treated as a separate institutional unit if it is located in a different territory from that of the parent corporation. If an ancillary company is identified, it is likely that it provides goods or services to affiliated enterprises, so compilers may need to pay attention to identifying any such flows (as in *MSITS* 3.135). In the case where an ancillary company serves a number of related companies—at least one of which is in the same territory—it would still be treated as a separate entity.

[Question: Is the proposed treatment for ancillary companies suitable?]

(d) Special purpose entities/vehicles. When used to issue debt securities on behalf of a parent company, they are separate entities if they are resident in a different territory to that of their owners.

[Question: Is the proposed treatment for special purpose vehicles used for fund-raising suitable?]

(e) Entities for holding and managing wealth. These may have varying titles and legal structures, for examples, international business companies (IBCs), shell companies, shelf companies, brass plate companies, special purpose entities/vehicles, estates, other trusts, and partnerships. (See BOPCOM-02/60.) These structures have a common economic function of holding wealth rather than undertaking production. While they always hold assets, some of these entities also have liabilities, such as for geared investment. They will be treated as separate entities from their owners if they are established in a different territory from the residence of at least one of their owners. The possibility of these being shown as a separate subsector is raised below.

[Question: Is the proposed treatment of wealth management entities suitable?]

(f) Nominees. These are a legal device for holding assets for confidentiality or convenience reasons. Assets held by a nominee are treated as being owned by the beneficial owner, rather than by the nominee or as an imputed unit (see *CPISG2* para. 3.20). (It can be recognized that there are practical problems in recording assets as belonging to the nominee as an institutional unit or to the beneficial owner.)

[Question: Is the proposed treatment for assets held by nominees suitable?]

4. Preparatory expenses prior to the creation of a legal entity

4.23 As decided by BOPCOM in 2001 (see paper 01/20B), a resident notional enterprise will be identified if it undertakes preparatory expenses associated with an institutional unit to be created in the future, even though it may precede the legal creation of the unit. Examples will be given, such as paying for mining rights licenses, and legal costs. (Notional institutional units are called quasicorporations in the *1993 SNA*.)

5. Ownership of land and associated buildings by nonresidents

4.24 As in *BPM5* para. 64, where immovable assets (such as land and associated buildings) are owned by nonresidents (see Section E ahead), a resident notional enterprise (quasicorporation) will be identified as the owner. The rationale for this treatment is that it avoids the immovable asset being owned by an institutional unit that is resident in a territory other than that in which the immovable asset is located. It will be stated that the same treatment will be applied to long-term leases of immovable assets on the basis that long-term leases approximate ownership.

[Question: Is the proposed treatment for long-term leases of land suitable? If so, what is the definition of "long-term"? Is it one year, as in other cases or something longer?]

4.25 The manual will elaborate further that unless the activities undertaken on the land are sufficient to qualify as a branch, then the income of the imputed unit will be confined to what is generated from the provision of rent or rentals to the owner. It will be noted that the notional unit is almost always a direct investment enterprise.

4.26 It will be stated that notional units will not automatically be imputed for other nonproduced nonfinancial assets (such as patents, mining rights, or broadcasting spectrum) owned by nonresidents. Nevertheless, it will be stated that it will normally be expected that the owner of these rights would have sufficient operations to constitute a resident unit or have the intention to establish a resident unit. (Also discussed in BOPCOM-02/59. Note that *BPM4* also required units to be imputed for ownership of leases, copyrights, patents, etc.)

[Question: Is the proposed treatment for other nonfinancial nonproduced assets suitable?]

D. Institutional Sectors

4.27 This section will introduce the principles relating to groupings of institutional units for statistical purposes, based on the principles in the *1993 SNA* Chapter IV (at length) and *MFSM* paras. 80–115 and *GFSM 2001* paras. 2.9–2.10 (both more briefly). While the principles are the same in different economic datasets, it is considered useful to briefly outline them in this manual.

4.28 The *1993 SNA*/*MFSM* institutional classification will be taken as the basis, following the ECB proposal (in BOPCOM-02/64) to bring the sectoral classification into line with the *1993 SNA*. Table 4.1 shows two alternative presentations for the institutional sector classification.

Table 4.1A. Institutional Sector Classification Option based on *1993 SNA*/*MFSM*

Financial corporations Central bank[*1] Other depository corporations Other financial corporations Insurance corporations and pension funds *Mutual funds, unit trusts, and other collective investment schemes* Other financial corporations, except insurance corporations and pension funds, *and mutual funds etc.* Financial auxiliaries *Holding companies* *Entities for holding and managing wealth*
Nonfinancial corporations
General government
Households
Nonprofit institutions serving households[*2]
Supplementary sectors for counterpart data: *International organizations* *International financial organizations* *Other international organizations*

Possible additional institutional sector classifications shown in italics; see discussion below.

(This classification is from *MFSM* Box 3.1, without the more detailed breakdowns of nonfinancial corporations and general government. For reconciliation with government finance statistics, there may be interest in providing additional detail for the general government sector. International organizations are not resident sectors but are relevant if data on the sector of the nonresident counterpart are prepared.)

Table 4.1B. Institutional Sector Classification Option based on the *1993 SNA/MFSM* classification, rearranged to be compatible with the *BPM5* classification

General government
Central bank[*1]
Other depository corporations
Other sectors Other financial corporations Insurance corporations and pension funds Other financial corporations, except insurance corporations and pension funds Financial auxiliaries Nonfinancial corporations Households Nonprofit institutions serving households[*2]
Additional sectors for counterpart data: *International organizations* *International financial organizations* *Other international organizations*

(This classification uses the same items as Table 4.1A, rearranged to be more compatible with the *BPM5* headings, and would allow the less detailed breakdown to be continued where the full classification was not being adopted.)

[*1] In cases where certain central banking functions are performed wholly or partly outside the central bank, consistent with *MFSM* para. 403, it will be suggested that, if parts of general government undertake central bank functions, consideration be given to compiling accounts for “monetary authorities” that combine the central bank functions or that the monetary authorities’ activities outside the central bank be shown as a memorandum item accompanying central bank data.

[*2] May be combined with households.

[Questions: (i) Is the enhancement of compatibility with the SNA/MFSM suitable? Which option is preferred? (ii) Is the MFSM approach to the selective use of a monetary authorities sector suitable?]

4.29 A possibility is to use the *1993 SNA* classification for compilation but to use a lesser degree of detail in the standard components. Such a proposal would allow generally insignificant components to be omitted from the standard presentation, while allowing other presentations to be prepared as needed and reconciliation with other datasets to be achieved.

For example, it will be recognized that, in practice, households and nonprofit institutions serving households are often combined.

4.30 In the discussion of institutional sector classifications, cases of particular importance to international transactions will be noted. These cases will include:

(a) branches and other cases where institutional units for statistical purposes are identified but are not legal entities (called "quasicorporations" in the *1993 SNA*). These entities are included in either the financial or nonfinancial corporations sector, according to their own function (usually, but not necessarily the same as the parent entity);

(b) clearing houses (such as stock exchanges, option exchanges, and repurchase agreement settlement institutions). It is proposed to classify these as "other financial institutions" if they take positions in the instruments they handle; otherwise, as "financial auxiliaries";

(c) international financial organizations (such as the IMF, World Bank, Bank for International Settlements, and regional development banks). It will be stated that within the international organizations category, it is useful to classify entities as either financial or nonfinancial entities;

(d) occupying authorities and international organizations that act as the administrators of a territory. When another government acts as occupying authority of another territory, it will be treated as part of parent government and nonresident in the territory that it administers. Administrations by international organizations will be classified as international organizations and nonresident of the territory they administer;

(e) holding companies, which belong to the preponderant sector of the group of companies of which the holding company is part (including nonresident members of the group, determined by relative size; otherwise, if that is not practical, by number of subsidiaries). The *1993 SNA* para. 4.100 suggests both the subsidiaries of the holding company and the group as a whole as criteria. However, it will be noted that holding companies can themselves be subsidiaries or associates and that a company group structure can include more than one holding company. In such a case, the preponderant sector of the group as a whole may differ from that of the subsidiaries of the particular holding company, making the *1993 SNA* self-contradictory, so it has been proposed to adopt the sector of the group as a whole as the criterion. Alternatively, a convention could be adopted to classify holding companies as other financial intermediaries or financial auxiliaries either in all cases or in those located in a different territory to other members of the group;

[Questions: Would it be preferable to treat all holding companies as financial intermediaries? Or only those in different territories from the other members of the group? Or should the sector be determined from other members of the group?]

(f) entities that solely hold assets and/or liabilities without undertaking production (such as some special purpose entities and trusts). In the absence of a more specific heading, these entities could be classified as "other financial intermediaries or financial auxiliaries" (in the next paragraph, the possibility of having a specific category for these entities is raised);

(g) entities that raise funds on behalf of their owners on financial markets. These will be classified as "other financial intermediaries" (see *MFSM* para. 72); and

(h) ancillary companies, which will be classified according to the predominant sector of the company or companies served.

The manual will give other difficult cases, if solutions are available, for example, "bad banks."

[Questions: (i) Are there other special cases that should be discussed? (ii) Are the proposed solutions appropriate?]

4.31 Possible additions to the institutional sector classification are:

(a) mutual funds, unit trusts, and other collective investment schemes (other than life insurance and pension schemes, already shown separately). In light of their (growing) importance, there is interest in showing separately mutual funds from other financial corporations. Mutual funds, etc. would be defined as including unit trusts and other legal structures that carried out the function of being a collective investment vehicle. Whether hedge funds and vehicles limited to a small number of investors are included in this category would need to be determined. One possibility would be to define mutual funds, etc. in terms of the regulatory boundary. Note that in Chapter 5, Classifications, it is also proposed to show equity in mutual funds, etc. as a separate financial instrument;

[Question: Should mutual funds and related entities be shown as a separate subsector?]

(b) Entities for holding and managing wealth. These entities hold financial assets or valuables, sometimes partly financed by debt, but do not produce goods or services or act as financial intermediaries. Their objective is usually to hold private wealth, often using the legal structures of trusts, international business companies, or other private companies. As noted in the previous paragraph, the function carried out by the entity does not fit well with the function of any of the possible institutional sectors (namely, financial intermediation, being an auxiliary supporting financial intermediation, or production of nonfinancial goods or services for the market). Besides the adoption of a convention, such as to treat them as financial auxiliaries, another possibility would be to add an institutional sector category; and

[Question: Should asset-holding entities be recognized as a separate sector or subsector?]

(c) Holding companies. An alternative to allocating these based on the sector of related entities would be to treat them all as a subsector of financial intermediaries.

[Question: Should holding companies be recognized as a separate sector or subsector?]

4.32 While the institutional sector classification is mainly applied to resident units, as in *BPM5*, another possibility is compiling supplementary data on the sector of the nonresident counterpart. For example, in an economy that received international aid, there may be interest in separating data on general government from private sources.

E. Residence

1. General principles

4.33 The concept underlying residence will be stated, that is, for each institutional unit, the territory will be identified with which the unit has the strongest link, in other words, its "predominant center of economic interest." Each unit should be a resident of one and only one territory. Because some units have connections with two or more territories, there is a need to choose between alternative criteria for economic interest, and there may be different perceptions about which criterion is applicable. Physical presence for a year or more is the main criterion, but other criteria apply, for example, in the cases of governments, international organizations, and units without physical presence. (It will be noted that some corporate entities with substantial connections to more than one economy may have been split, as described in Section C above.)

[Comment: The addition of the word "predominant" to the term "center of economic interest" is not intended to be a substantial change. Rather, it is a presentational change to recognize and emphasize that some units have economic interest in more than one territory, so that there may be more than one potential "center of economic interest." In such cases, the principle is to identify the territory to which the unit has the stronger or strongest connection.]

2. Residence of households

4.34 It will be noted that the household sector includes unincorporated entities that are resident in the same territory as the households that own them and that do not satisfy the criteria to be a quasicorporation, as in *1993 SNA* para. 4.49. This chapter will state that the principle of predominant center of economic interest is also applied to determine the residence of households. The chapter will make clear the relationship between individuals and households. A household is defined so that all members have the same economy of residence. Thus the residence of individuals needs to be established before a household can be identified. It will be noted that, as a result of that definition, there is a reconciliation of the apparent incompatibility between the use of households as a unit for international accounts statistics and the use of data on international movements that are undertaken by individuals.

4.35 It is proposed that the definition of the residence of households and individuals for international accounts should be consistent or reconcilable with international standards in migration, tourism, and services statistics, to the extent practical. Accordingly, proposals in this chapter may need to be amended in the light of ongoing discussions with experts and agencies in those fields. Any remaining differences in the residence concept with these other statistics will be explained in this chapter.

4.36 The starting point of discussion will be identification of the predominant center of economic interest, which will be contrasted with other links to a territory, such as citizenship, migration status, and income tax status. Subject to developments in international standards noted in the previous paragraph, to assist compilers on applying the concept of predominant center of interest, this chapter will propose a guideline of actual or intended residence for a year or more.

4.37 The chapter will explain that the guideline of one-year or more will have the advantage of straightforward practical implementation and ensuring international consistency. It will also explain that a convention is needed because some households have strong connections to more than one economy. The chapter will recognize that, in practice, data about individuals may be inadequate. Therefore, the residence of households will often need to be determined from general trends identified in aggregate data. Similarly, while data on intention may not be available, it could be inferred from past behavior of similar groups of people, or a convention may be needed. The classification of being a resident or not determines how the income and expenditure of the people concerned are treated in international accounts statistics.

4.38 The manual will give guidance on specific cases. The following cases are proposed as exceptions to the guideline of one year or more:

(a) diplomats and their families; and

(b) expatriate staff of foreign military bases and their families.

These exceptions are made because, although physically present in the host territory, the households are subject to the jurisdiction of their home territories.

4.39 It will be stated that the guideline of one year or more will be applied in the following cases:

(a) students;

(b) patients;

(c) ship's crew (i.e., if present on a ship for a year or more, they will have the residence of the operator of the ship as their own territory of residence);

(d) employees of international organizations and their accompanying dependents. These differ from embassy staff in their being subject, to a greater degree, to the laws of the host economy;

(e) local employees of embassies and military bases;

(f) nonpermanent workers and their accompanying family members; and

(g) refugees.

The one year or more guideline was not applied to students and patients in *BPM5*; the change is proposed for greater simplicity, for consistency with tourism, demographic, and immigration statistics, and for avoidance of anomalies for those who undertake other activities in addition to studies or heath care.

In practice, intergovernmental agreements and taxation issues may be relevant to assessing the connections of the individuals concerned. In these cases, host and source territories should be able to identify a consistent treatment (see South African Reserve Bank, 2003).

Another possible issue that could be considered, within the constraint of consistency with those other fields of statistics, is the inconsistency between the use of "a year or more" in the definition of residence but "more than a year" in the definition of long-term.

[Comment: It would look more systematic and be easier to remember if the definition were the same. However, since the criteria evolved independently in financial and demographic statistics, it might not be practical to change them.]

[Questions: (i) Is the extension of the one year or more guideline to students supported? (ii) Is the extension of the one year or more guideline to patients and ship's crew supported? (iii) Is any change needed for nonpermanent workers? (iv) Do any other cases need to be mentioned?]

4.40 In the following cases, the one year or more guideline is not conclusive, so additional guidance is needed:

(a) people who leave their original home for a year or more but reside in two or more other economies each for less than a year. In these cases, residence will be determined from the predominant location during the period;

(b) border workers. The residence will be determined from the location of the dwelling of the individual, rather than the place of work; and

(c) individuals who move back and forth between territories, so they do not stay in any one territory for a year or more, such as those who have dwellings in two or more economies and commute between them. The residence status will be determined from their predominant location during the period, that is, where the most time is spent.

4.41 In each case, in view of the conceptual and practical difficulties, this chapter will emphasize the importance of metadata that would state the treatment of the above categories of individuals. In the case of significant population movements between two territories, it will be urged that the compilers of each territory cooperate to ensure consistent definitions and measurement.

4.42 As noted above, the chapter will recognize that some individuals have close connections with two or more economies. Some common examples of such individuals are nonpermanent workers, students, patients, and their accompanying dependents. While such individuals need to be classified as residents of a single economy for international accounts purposes, it may be desirable for compilers to provide supplementary data on those who are classified as nonresidents of their economy but maintain significant links with it. Similarly, it may be desirable to have supplementary data on those who are classified as residents of the economy but maintain significant links to other economies. Possible data and presentations will be discussed in an appendix to this chapter.

4.43 A brief summary will encapsulate the implications for the international accounts of whether a household is classified as resident or nonresident of the reporting economy for different types of flows. In particular it will be noted that any changes in the criteria for residence will affect service flows (e.g., expenditure by foreign students or guest workers either being included as services exports or as out of scope of the balance of payments, depending on their residence status).

3. Residence of enterprises

4.44 The enterprise sector will be noted as including quasicorporations, that is, unincorporated entities that are separate from the owners. This relates to *1993 SNA* paras. 4.49–51, which includes unincorporated joint ventures, limited liability partnerships, and other unincorporated entities owned by nonresidents.

4.45 The residence of enterprises is based on the same general principles of identifying the predominant center of economic interest used for households and other entities. As applied to enterprises, the specific criteria as follows:

(a) First, the territory where or from which the enterprise engages in a significant amount of production over a significant period, as in *BPM5* paras. 73 and 79–83. This criterion involves physical presence. The case of enterprises that undertake production in other economies from a base in one economy will be covered, as in *BPT* paras. 104–106. Types of mobile delivery of services include transport, advice, and repairs. In these cases, this chapter will state that the residence is determined from the base of operations rather than the point of delivery (unless the activities elsewhere are sufficiently substantial and significant to amount to a branch, as defined above). For example, the operations of a ship that was on the high seas are part of the enterprise that operates the ship, and the residence of the enterprise is determined from its base or bases of operations; or

(b) Second, if the enterprise does not have a physical presence, the territory of incorporation or registration. For entities that have little or no physical presence and/or do not undertake production, location and production may not be useful criteria. As a result, the jurisdiction that allows the creation of and regulates the entity will be considered as the entity's predominant center of economic interest. (If there is no incorporation or regulation, legal domicile will be used, that is, the jurisdiction whose laws the entity is subject to.) The *Debt Guide* and *CPISG2* already adopt a residence concept based on incorporation where there is little physical presence. However, the *Benchmark Definition of FDI* (para. 69) classifies the residence of some entities according to the territory of the management office, which may sometimes differ. No exception would be made for entities owned by a general government entity of another jurisdiction. The application of these principles will be stated for unincorporated entities that have some legal recognition, including limited liability partnerships, trusts, and joint ventures. The identification of the jurisdiction of *societas europaea* will be discussed.

[Questions: (i) Is this approach to enterprises with little or no physical presence suitable? (ii) Is any further specification necessary for societas europaea*?]*

4.46 The chapter will note that many of the apparently difficult cases for determining residence are actually problems of whether there is a separate unit, as discussed above, under the section on units in this chapter.

4.47 The chapter will illustrate applying of the general principles to some of the difficult cases. It will note that enterprises that are run as a single institutional unit in two or more economies should be split up by prorating (as discussed already under Section C (2) above).

4.48 There will be a brief summary of the implications for the international accounts of whether an enterprise is treated as a resident enterprise or as a nonresident for different types of flows.

4. Residence of other institutional units

4.49 The residence of embassies, military bases, and intergovernmental organizations will be covered, using the same concepts as stated in *BPM5*. This section will note that these are simply applications of the concept of economic territory because these institutions are outside the control of the government of the territory in which they are located. It will be noted that corporations created on behalf of a government in territories other than its own follow the residence principles for corporations (i.e., the corporation is a resident of the territory in which it was created; it may also have a branch if it has operations in other territories).

> *[Note: This issue is currently under discussion. Question: Is the treatment of government offshore corporations suitable?]*

4.50 International organizations will be defined as organizations created by agreements between national states and/or other international organizations whose members are national states. They will be specifically excluded as residents in the economy in which they are physically located.

4.51 Consistent with that principle, it is proposed that the central bank of a currency union be treated as an international organization. In contrast, *BPM5* para. 90 required that the financial assets and liabilities of a “regional central bank” be prorated to the members. This chapter will discuss the treatment of central banks of a currency union, including whether it is appropriate to have monetary activities become transactions with nonresidents. It will also discuss how the activities undertaken by national central banks within a currency union should be treated.

> *[Question: What treatment should be adopted for the central banking functions in a currency union?]*

4.52 The treatment of international organizations that operate military forces and act as the interim administration of a territory will be discussed, for example, based on treatments adopted for Kosovo. Two units provide supports in the post-war Kosovo. The Kosovo Force (KFOR) is under the control of NATO and its member countries. The United Nations Mission in Kosovo (UNMIK) also provides collective nonmarket services. The UNMIK’s operations are predominantly controlled and financed by the United Nations and its members. (The treatment of the associated costs as being a transfer to the administered economy will be cross-referenced.)

4.53 It will be noted that the IMF collects selected data on international organizations to include in global totals. Regional intergovernmental organizations should not be included in national totals, that is, regional international organizations should be included in world totals as well as any regional totals that cover all the economies of the organization.

4.54 It will be noted that a separately constituted pension fund of an international organization is regarded as a resident of the territory in which it is located (i.e., in the same territory where the fund is administered, which would often be where the organization's headquarters is located).

4.55 Nonprofit institutions serving households will be mentioned briefly, as in *BPM5*, including the guidelines for recognizing a branch. It will be noted that nonprofit institutions serving households are not international organizations, which are defined as being created by governments.

F. Other Issues Associated with Residence

1. Assets and liabilities held by groups that include both residents and nonresidents

4.56 Some economic entities such as partnerships, bank accounts, and trusts may have owners who are residents of different territories. The manual will use a convention introduced in *MFSM* para. 318—that accounts held by emigrant workers in their economy of origin that are freely usable by family members in that economy are treated as accounts held by residents of the economy of origin. The manual will extend that convention to treat all assets and liabilities of groups that include both residents or nonresidents as being held by residents of the economy in which the account is held. However, compilers would be able to adopt other treatments, such as actual shares or prorating between residents and nonresidents if appropriate information were available and the amounts were significant. It is also important that compilers share information with their counterparts in affected economies with a view to developing consistent measures.

[Question: Is the proposed treatment suitable?]

2. Data by partner economy

4.57 This section will state that the primary presentation of international accounts is to show all nonresidents as a single group. However, data broken down into individual partner economies or groups of economies may be of analytical interest. Data may be for the balance of payments or international investment position as a whole, or for particular components such as goods, services, direct investment, or portfolio investment. In addition, such data make possible bilateral comparisons and, hence, assist in identifying data problems. Some direct investment data and the CPIS will be cited as examples. (The *BPM5* terminology "Regional Statements" will be replaced because it applies not only to "regions," but also to individual economic territories.)

[Question: (i) Should there be a standard requirement for partner data? (ii) If so, should it be in general or for any particular components?]

4.58 The guidelines will be as in *BPM5* paras. 478–498 and spelled out in more detail as in *CPISG2* in the case of portfolio investment. In general, the attribution of partner is based on the residence of counterparty to the transaction or financial position. As a result, all the residence issues discussed above are applicable (and are often more difficult to obtain information on). Among the issues that arise for compiling partner data to be discussed in the manual are:

(a) Goods. The residence of the seller/purchaser of the good is the conceptually correct partner. It will be recognized that, in practice, data are based on the territory of origin, consignment, destination, etc. which may not always be the same.

(b) Freight. The residence of the freight service provider is the correct partner. It will be recognized that, in practice, data may be based on other bases, such as the territory of source or destination of the goods carried, or the flag of the ship.

(c) Financial transactions. The debtor/creditor principle will be explained (as per *BPM5* paras. 334, 482–483, and 493–494) and recommended. (The transactor principle will be noted as a conceptually less suitable basis adopted in some cases as the result of limited data availability. It will be noted that the transactor principle is not suitable for position data.)

(d) Monetary gold and SDRs. As these have no counterparty, the manual will note the need for an "unallocated" category.

(e) Direct investment. There can be "chains" of direct investment, for example, when a direct investor X in Territory A has a fully owned subsidiary Y in Territory B, which in turn has a fully owned subsidiary Z in Territory C. The territory of ownership of the investment in Territory C will be Territory B. However, the possibility of supplementary data based on *ultimate beneficial owner* (in the example, Territory A) or *ultimate destination* (in the example, Territory C) will be discussed.

These bases, showing the underlying reality in a potentially useful way, will be of interest to some data users. Definitions of ultimate beneficial owner or destination will be given, but significant and unresolved practical difficulties will be noted and such data would not be the standard basis for reporting international accounts.

It will be noted that in the case of "round tripping" (discussed in Chapter 5, Classifications) the ultimate beneficial owner and ultimate destination are in the same territory. In such cases, each territory would include itself as a source and destination of foreign investment.

[Question: Is this recognition of the ultimate beneficial owner and/or ultimate destination suitable?]

(f) Depository receipts. Depository receipts will be explained briefly. It will be stated that they will be attributed on the basis of the issuer of the underlying security, not the issuer of the depository receipts, as in *CPISG2* Appendix 1 Note 8.

[Question: Should the CPISG2 treatment be reviewed, to be more consistent with data availability and to be consistent with other cases where legal form is adopted in preference to underlying economic reality?]

(g) Nominee accounts and custodians. Nominee accounts and custodians will be explained briefly. It will be stated that the assets should be classified on the basis of the beneficial owner.

(h) Securities. It will be noted that securities are to be classified on the basis of the residence of the issuer, not the place of issue, the residence of a guarantor, or the currency of issue.

(i) Multiterritory enterprises. The implications of splitting an enterprise (as noted in this chapter above) for other territories that have transactions or positions with the enterprise will be noted.

3. Changes in residence of institutional units

4.59 An individual or enterprise can change its economy of residence. The manual will cross-reference the discussions on the treatment of changes in residence in Chapter 3, Accounting Principles. It is proposed to treat a change of residence of households as a reclassification and, hence, such changes would be recorded as other changes in financial assets and liabilities accounts rather than as capital transfers, as occurs in *BPM5*.

APPENDIX: INDIVIDUALS AND HOUSEHOLDS WITH CONNECTIONS TO TWO OR MORE TERRITORIES

Nonpermanent workers, students, and their accompanying dependents may have strong connections with two or more economies. Thus, they are difficult to cover adequately in a balance of payments framework.

The balance of payments structure limits the treatment of households to a resident-nonresident split, but it will be recognized that, in reality, a range of degrees exists of connections to both home and host territories. Accordingly, a possible way of responding to these concerns is as follows: the manual would propose that, for territories where these issues are significant, compilers consider supplementary presentations that provide other information separately (e.g., data on the numbers, demographic characteristics, earnings, expenditure, and saving of these groups, or where nonpermanent residents are combined with nonresidents in short-term employment). Such supplementary monetary and nonmonetary data could allow users to assess the effect of different definitions on the international accounts and understand the phenomenon of international labor movement as a whole.

A possible satellite or supplementary presentation would be to bring together relevant components of services, compensation of employees, workers' remittances, migrants' transfers, financial flows, and positions. It could also include data on certain resident-to-resident transactions undertaken by groups with connections to other territories, such as expenditure by long-term guest workers.

Such a presentation would not be a standard requirement and would only be suggested for economies where the impact of people with connections to other economies was regarded as an economically significant issue.

> *[Question: Is this proposal suitable for a supplementary presentation for nonpermanent workers and their accompanying dependents?]*

A possible definition of nonpermanent residents is as follows: workers, students, patients, and their accompanying dependents who have lived or intend to live in one or more territories other than their home territory for a period from one year up to five years, with an intention to return to the home territory at the end of that time. Depending on the circumstances, intention could be identified from surveys, the type of visa issued, or past patterns of behavior by that class of people.

There may be different presentations for different classes of nonpermanent residents, for example, a territory that provides major education services may wish to show the various flows associated with types of students. (Particularly if the proposal to apply the one-year or more criterion for residence to students is accepted, it could be useful to bring together data on students above and below the one-year criterion.)

> *[Question: Is the proposed definition for nonpermanent residents suitable?]*

ECONOMIC TERRITORY, UNITS, INSTITUTIONAL SECTORS, AND RESIDENCE

References

BPM5
Residence Chapter IV
"Regional statements" Chapter XXIV
Institutional sectors Appendix II

BPT Chapter II (note: guidelines for branches appear to be less restrictive than *BPM5*)

External Debt Statistics: Guide for Compilers and Users paras. 29–37

CPISG2 paras. 3.6–3.32

Benchmark Definition of FDI, 1996

1993 SNA Chapter IV, paras.14.9–14.34 (effectively repeats *BPM5* Chapter IV)

MFSM paras. 26–35, 46–14

M. Debabrata Patra and M. Kapur, *India's Worker Remittances: A User's Lament About Balance of Payments Compilation*, BOPCOM-03/20

ECB, *Updating BPM5: Possible Expansion of the Sector Breakdown*, BOPCOM-02/64

IMF, *The Legal Structure, Economic Function, and Statistical Treatment of Trusts*, BOPCOM-01/12

IMF, *Clarification of the Recommended Treatment of Selected Foreign Direct Investment Transactions*, BOPCOM-01/20B

IMF, *Recommended Treatment of Selected Direct Investment Transactions (2002)* http://www.imf.org/external/np/sta/di/fditran.htm, based on previous BOPCOM decisions

IMF, *Residence*, BOPCOM-02/59

Hong Kong Special Administrative Region, Census and Statistics Department, *Nonpermanent Workers*, BOPCOM-03/19

R. Kozlow, *Exploring the Borderline Between Direct Investment and Other Types of Investment: The U.S. Treatment*, BOPCOM-02/35

R. Kozlow, *Investment Companies: What are they, and Where Should they be Classified in the International Economic Accounts?* BOPCOM-03/22

A. Ridgeway, *A Note on Trusts and Partnerships*, BOPCOM-02/60

South African Reserve Bank, *The Concept of Residence with Special Reference to the Treatment of Migrant Workers in the Balance of Payments of South Africa*, BOPCOM-03/18

Changes from *BPM5*

(a) *Changes proposed:*

The definition of economic territory will be refined (para. 4.3).

A discussion of the treatment of changes in sovereignty and joint sovereignty will be introduced (although not covered in *BPM5*, the proposed treatment is in accord with general principles) (paras. 4.6–4.8).

Modification of the definition of branches so that payment of income taxes will instead be taken as an indication of a branch, rather than a requirement (para. 4.15).

The *1993 SNA*/*MFSM* institutional sector classification will be adopted. The use of a "monetary authorities" sector will remain as an option, where appropriate (para. 4.28).

Change in definition of residence by qualifying "center of economic interest" with "predominant" (para. 4.33).

Stricter application of the guideline for residence of households based on presence for one year or more than in *BPM5* including application to students, patients, and ship's crew; decision to take into account harmonization with demographic, immigration, and tourism statistics (para. 4.39).

Residence of entities with little or no physical dimension to be attributed to the territory of registration or legal domicile (para. 4.45(b)). (This issue was not discussed in *BPM5*, but proposal is the same as in the *Debt Guide* and *CPISG2*.)

Treatment of central banks of currency unions not to involve prorating of assets and liabilities to members (para 4.51).

Clarification of the residence of treatment of joint accounts and discretionary trusts is covered (para. 4.56).

Adoption of preference of debtor/creditor principle over the transactor principle (para. 4.58(c)).

Clarification of the classification of the residence of issuer of depository receipts and like instruments (para. 4.58(f)).

(b) *Changes raised as an option:*

A discussion of treatment of rebel-held areas (which are not mentioned in *BPM5*) with a recommendation for transparency but no standard treatment (para. 4.4).

Treatments for unincorporated entities, holding companies, ancillary companies, special purpose entities, entities for holding wealth, and nominees are proposed (paras. 4.22, 4.30(e), 4.31(b) and (c)).

Treatment of leases of land and other nonproduced is proposed (paras. 4.24–4.26).

The possibility of showing mutual funds as a separate sector is raised (para. 4.31(a)).

The possibility of a convention or separate sector classification for asset-holding entities is raised (para. 4.31(b)).

Treatment of government offshore corporations, central banks of currency unions, and administering authorities is proposed (paras. 4.49–4.52).

Possible recognition of selected data by partner as a standard component (para. 4.57).

Supplementary information on direct investment, using ultimate beneficial owner and/or ultimate destination as the basis (para. 4.58(e)).

Provide supplementary data on nonpermanent workers, students, patients, and their accompanying dependents who have connections to both a host and home territory (Appendix).

Glossary

Ancillary company
"Bad banks"
Branch (note that common usage may also be used for incorporated subsidiaries, while international accounts usage is limited to unincorporated structures)
Brass plate company
Central bank
Custodians
Debtor/creditor principle
Depository corporations
Depository receipts
Enterprise
Estate

Financial auxiliaries
Financial corporations
General government
Holding company (should not be assumed to be at top of organizational chart; may also be a subsidiary)
Household
Institutional unit
Insurance corporations
International business company
International organization
Joint venture
Limited liability partnership
Monetary authorities
Mutual funds (It will be noted that statistical treatments will be the same for unit trusts and any other structures that undertake the same economic function)
Nominee
Nonfinancial corporations
Nonpermanent worker
Nonprofit institutions serving households
Notional unit
Offshore financial center
Partnerships
Pension funds
Predominant center of economic interest
Quasicorporation
Regional central bank (used in *BPM5*, but may need to be replaced by "central bank of a currency/monetary union")
Regional international organization (i.e., established by two or more governments)
Rent (cf. rental)
Residence
Securities
Shell company, shelf company
Special purpose entity/vehicle (SPE, SPV)
Transactor principle
Trust
Ultimate beneficial owner