

## 6. Expense

*This chapter defines the concept of expense and describes the manner in which expense is classified.*

### A. Classifications of expense

**6.1** *Expense* is a decrease in net worth resulting from a transaction. Governments have two broad economic responsibilities: to assume responsibility for the provision of selected goods and services to the community on a nonmarket basis and to redistribute income and wealth by means of transfer payments. These responsibilities are largely fulfilled through expense transactions, which are classified in two ways in the GFS system: an economic classification and a functional classification.

**6.2** When supplying nonmarket goods and services to the community, a government unit may produce the goods and services itself and distribute them, purchase them from a third party and distribute them, or transfer cash to households so they can purchase the goods and services directly. The economic classification identifies the types of expense incurred for these activities. Compensation of employees, use of goods and services, and consumption of fixed capital all relate to the costs of production undertaken by government itself. Subsidies, grants, social benefits, and miscellaneous other expense relate to transfers in cash or in kind and purchases from third parties of goods and services for delivery to other units. The functional classification provides information on the purpose for which an expense was incurred. Examples of functions are education and environmental protection.

**6.3** The functional classification described in this chapter is not limited to expense transactions. Acquisitions of nonfinancial assets can also be classified using the functional classification. The term “outlays” is used in connection with the functional classification to include these acquisitions of assets

as well as expense. In addition, the economic and functional classifications can be cross-classified to show the types of transactions engaged in to carry out a given function.

**6.4** Two types of transactions are treated as expense despite a surface impression that they may increase net worth. First, refunds, recoveries of overpayments and erroneous payments, and similar transactions appear to increase net worth. More accurately, they are adjustments that correct the excessive decrease in net worth previously recorded. As such, these transactions are treated as negative expense. Second, the costs incurred in the production of goods and services are recorded as expense despite the fact that the goods and services may have been sold for a price that exceeded the cost of production, thereby increasing net worth.

**6.5** The acquisition of a nonfinancial asset by purchase or barter does not affect net worth, and the transaction is not an expense. It is a transaction in nonfinancial assets as described in Chapter 8. When ownership of an asset is given up without receiving anything of value in return, the net worth of the unit has decreased and the expense is recorded as a type of capital transfer, such as a capital grant.

**6.6** The time at which expense transactions should be recorded is determined according to the accrual basis, which is when the activities, transactions, or other events occur that create the unconditional obligation of general government units to make payments or otherwise give up resources. Complications arise, however, in regard to the acquisition and subsequent use of goods. In concept, the purchase of goods that are not immediately used in some manner is an addition to inventories rather than an expense. When the goods are consumed in production or otherwise utilized, a transaction must be recorded to reduce inventories and increase an expense or other category depending on the use made of the goods.

Other applications of the accrual basis to expense transactions are indicated in each section of the economic classification as necessary.

## B. The economic classification of expense

6.7 Table 6.1 shows the economic classification of expense, and the following paragraphs describe each category in detail.

### I. Compensation of employees [GFS]<sup>1</sup> (21)<sup>2</sup>

6.8 Compensation of employees is the total remuneration, in cash or in kind, payable to a government employee in return for work done during the accounting period, except for work connected with own-account capital formation. (The same exception applies to each subcategory of compensation of employees.) It includes both *wages and salaries* (211) and *social contributions* (212) made on behalf of employees to social insurance schemes. Excluded are amounts payable to contractors, self-employed outworkers, and other workers who are not employees of general government units. Any such amounts are recorded under *use of goods and services* (22). Compensation of employees engaged in own-account capital formation, which is the production of nonfinancial assets for own use, is recorded as the acquisition of nonfinancial assets (see Chapter 8).

6.9 Compensation of employees is measured by the value of the remuneration in cash or in kind an employee becomes entitled to receive from an employer for work done during the relevant period, whether paid in advance, simultaneously, or in arrears of the work itself. To the extent that payment has not been made for work performed, the general government unit must record an entry in accounts payable (see Chapter 7).

#### a. Wages and salaries [GFS] (211)

6.10 Wages and salaries consist of all compensation of government employees except for *social contributions* (212) by employers. It includes pay in cash or in kind.

<sup>1</sup>[GFS] indicates that this item has the same name but different coverage in the 1993 SNA.

<sup>2</sup>The numbers in parentheses after each classification category are the GFS classification codes. Appendix 4 provides all classification codes used in the GFS system.

Table 6.1: Economic Classification of Expense

<b>2</b>	<b>Expense</b>
<b>21</b>	<b>Compensation of employees [GFS]</b>
211	Wages and salaries [GFS]
2111	Wages and salaries in cash [GFS]
2112	Wages and salaries in kind [GFS]
212	Social contributions [GFS]
2121	Actual social contributions [GFS]
2122	Imputed social contributions [GFS]
<b>22</b>	<b>Use of goods and services</b>
<b>23</b>	<b>Consumption of fixed capital [GFS]</b>
<b>24</b>	<b>Interest [GFS]</b>
241	To nonresidents
242	To residents other than general government
243	To other general government units
<b>25</b>	<b>Subsidies</b>
251	To public corporations
2511	To nonfinancial public corporations
2512	To financial public corporations
252	To private enterprises
2521	To nonfinancial private enterprises
2522	To financial private enterprises
<b>26</b>	<b>Grants</b>
261	To foreign governments
2611	Current
2612	Capital
262	To international organizations
2621	Current
2622	Capital
263	To other general government units
2631	Current
2632	Capital
<b>27</b>	<b>Social benefits [GFS]</b>
271	Social security benefits
2711	Social security benefits in cash
2712	Social security benefits in kind
272	Social assistance benefits
2721	Social assistance benefits in cash
2722	Social assistance benefits in kind [GFS]
273	Employer social benefits
2731	Employer social benefits in cash
2732	Employer social benefits in kind
<b>28</b>	<b>Other expense</b>
281	Property expense other than interest
2811	Dividends (public corporations only)
2812	Withdrawals from income of quasi-corporations (public corporations only)
2813	Property expense attributed to insurance policyholders [GFS]
2814	Rent
282	Miscellaneous other expense
2821	Current
2822	Capital

Social contributions paid by deduction from employees' wages and salaries are included in this category.

**6.11** Wages and salaries exclude the reimbursement of expenditures made by employees in order to enable them to take up their jobs or to carry out their work. For example, the reimbursement of travel, removal, or related expenses incurred by employees when they take up new jobs or are required by their employers to move their homes are classified as *use of goods and services* (22) rather than wages and salaries. Also excluded are reimbursements of expenditures by employees on tools, equipment, special clothing, or other items that are needed exclusively or primarily to enable them to carry out their work. The amounts reimbursed are treated as *use of goods and services* (22).

**6.12** Wages and salaries also exclude social benefits paid by employers in the form of children's, spouse's, family, education, or other allowances in respect of dependents; payments made at full or reduced wage or salary rates to workers absent from work because of illness, accidental injury, or maternity leave; and severance payments to workers, or their survivors, who lose their jobs because of redundancy, incapacity, or accidental death. These social benefits are included in *employer social benefits* (273).

**6.13** *Wages and salaries in cash [GFS] (2111)*. This category consists of payments in cash to employees in return for services rendered, before deduction of withholding taxes and employees' contributions to social insurance schemes. Included are basic wages and salaries; extra pay for overtime, night work, and weekend work; cost of living allowances, local allowances, and expatriation allowances; bonuses; annual supplementary pay, such as "13th month" pay; allowances for transportation to and from work; holiday pay for official holidays or annual holidays; and housing allowances.

**6.14** *Wages and salaries in kind [GFS] (2112)*. This category consists of payments in kind to employees in return for services rendered. Examples are meals and drinks, including those consumed when traveling on business; housing services or accommodation of a type that can be used by all members of the household to which the employee belongs; uniforms or other forms of special clothing that employees choose to wear frequently outside of the workplace as well as at work; the services of vehicles or other durables provided for the personal use of employees;

goods and services produced by the employer, such as free travel on government airplanes; sports, recreation, or holiday facilities for employees and their families; transportation to and from work; car parking; and day care for the children of employees. Also included is the value of interest foregone when loans are provided to employees at reduced or zero rates of interest. If goods and services are provided to employees at reduced cost, then only the net cost to the employer is recorded in this category.

#### **b. Social contributions [GFS] (212)**

**6.15** Social contributions are payments, actual or imputed, made by general government units to social insurance schemes to obtain entitlement to social benefits for their employees, including pensions and other retirement benefits. Social benefits are described in the annex to Chapter 2.

**6.16** Some social contributions are paid directly by the general government unit that is the employer to a second general government unit, usually a social security fund. These transactions are not eliminated in consolidation because they are rerouted, as described in paragraph 3.20 of Chapter 3, first to the employees and then from the employees to the social insurance schemes.

**6.17** *Actual social contributions [GFS] (2121)*. This category consists of contributions payable to insurance enterprises, social security funds, or other institutional units responsible for the administration and management of social insurance schemes, including general government units operating nonautonomous pension funds.

**6.18** *Imputed social contributions [GFS] (2122)*. Some governments provide social benefits directly to their employees, former employees, or dependents out of their own resources without involving an insurance enterprise or an autonomous or nonautonomous pension fund. In this situation, social contributions equal in value to the amount of social contributions that would be needed to secure the de facto entitlements should be imputed.

#### **2. Use of goods and services (22)**

**6.19** This category consists of goods and services used for the production of market and nonmarket goods and services—except for own-account capital formation—plus goods purchased for resale less the

net change in inventories of work in progress, finished goods, and goods held for resale.<sup>3</sup> General government units may engage in a number of transactions in goods and services that are not classified as use of goods and services. In particular:

- Goods acquired for use as fixed assets or valuables or for use in own-account capital formation are classified as acquisitions of fixed assets or valuables. Expenditures on inexpensive durable goods, such as hand tools, are treated as use of goods and services when such expenditures are made regularly and are small compared with expenditures on machinery and equipment.
- Goods and services acquired to increase inventories of strategic stocks or of materials and supplies are classified as *changes in inventories*, a type of acquisition of nonfinancial assets (see Chapter 8).
- Goods and services used as compensation of employees in kind are classified as *compensation of employees* (21).
- Goods and services acquired and transferred in kind without being used by the general government unit in a production process are classified as transfer payments, such as *subsidies* (25), *grants* (26), *social benefits* (27), or *other expense* (28), depending on the reason for the transfer.
- Reimbursements by a general government unit for purchases of goods and services by households in connection with social assistance or social insurance schemes are classified as *social benefits* (27).

**6.20** Fees and charges collected for goods and services provided by general government units, such as for certain types of social benefits or grants, should be shown as revenue rather than deducted from expense.

**6.21** The value of goods and services used in production is recorded when the goods or services are actually used rather than when they were acquired. In practice, the two times coincide for inputs of services but not for goods, which may be acquired some time in advance of their use. The value of goods purchased and held for resale is recorded as use of goods and services when they are sold. Sales of goods acquired and held as strategic stocks are recorded as disposals of nonfinan-

<sup>3</sup>Use of goods and services is closely related to intermediate consumption in the 1993 SNA. The relationship between the two concepts is explained in Appendix 3.

cial assets rather than as sales revenue. Therefore, the transaction has no effect on use of goods and services.

**6.22** In practice, units do not usually record the actual use of goods in production directly. Instead, they keep records of purchases of materials and supplies intended to be used as inputs and also of any changes in the amounts of such goods held in inventory. An estimate of use of goods and services during a given accounting period can then be derived by subtracting the value of changes in inventories of materials and supplies from the value of purchases made.

**6.23** Goods and services consumed for the maintenance and repair of fixed assets constitute use of goods and services. Major renovations, reconstructions, or enlargements of existing fixed assets are treated as acquisitions of fixed assets. Maintenance and repairs are distinguished by two features: (a) they are activities that owners or users of fixed assets are obliged to undertake periodically in order to be able to utilize such assets over their expected service lives and (b) they do not change the fixed asset or its performance, but simply maintain it in good working order or restore it to its previous condition in the event of a breakdown. In contrast, major improvements to fixed assets are distinguished by the following features: (a) the decision to renovate, reconstruct, or enlarge a fixed asset is a deliberate investment decision that may be undertaken at any time and is not dictated by the condition of the asset and (b) renovations or enlargements increase the performance or capacity of existing fixed assets or significantly extend their previously expected service lives.

**6.24** Goods and services used for research and development, staff training, market research, and similar activities are treated as use of goods and services rather than acquisitions of intangible fixed assets even though some of them may bring benefits for more than one year.

**6.25** Materials to produce coins or notes of the national currency or amounts payable to contractors to produce the currency are included as use of goods and services. The issuance of the coins or notes is a financial transaction that does not involve revenue or expense.

**6.26** Use of goods and services includes purchases of weapons (for example, rockets, missiles, and the associated warheads) and equipment used to deliver those weapons (for example, rocket launchers, warships, submarines, and tanks). Purchases of items that

can be used for civilian purposes in the same way as they are used for military purposes, such as military airfields, docks, colleges, hospitals, and office machinery, are treated as acquisitions of fixed assets. Weapons or armored vehicles acquired by police and internal security services, however, are treated as acquisitions of fixed assets even though expenditures on the same kind of equipment by the military would be treated as use of goods and services.

**6.27** Depending on the purpose made of them, goods and services purchased by government units and consumed by their employees could be use of goods and services or compensation of employees in kind. In general, when employees are obliged to use the goods or services in order to enable them to carry out their work, that constitutes use of goods and services. On the other hand, when the goods or services are used by employees in their own time and at their own discretion for the direct satisfaction of their needs or wants, that constitutes compensation of employees. The following types of goods and services provided to employees are treated as use of goods and services: (a) tools or equipment used exclusively or mainly at work; (b) clothing or footwear worn exclusively or mainly at work, such as protective clothing, overalls, or uniforms; (c) accommodation services at the place of work that cannot be used by the households to which the employees belong, such as barracks, cabins, dormitories, and huts; (d) special meals or drinks necessitated by exceptional working conditions, and meals or drinks provided to servicemen or others while on active duty; (e) transportation and hotel services provided while the employee is traveling on business; (f) changing facilities, washrooms, showers, and baths necessitated by the nature of the work; and (g) first aid facilities, medical examinations, or other health checks required because of the nature of the work. Employees may sometimes be responsible for purchasing the kinds of goods or services listed above and are subsequently reimbursed by the employer. Such reimbursements are treated as use of goods and services rather than as wages and salaries.

**6.28** All transfers of goods and services to other governments or international organizations other than goods and services produced by the donor government unit are treated as *grants* (26). Such grants may entail the transfer of government-owned fixed assets, the transfer of goods held in inventory, the construction of fixed assets, or the purchase and simultaneous transfer of either fixed assets or goods and services for current consumption. Examples are

transfers of food, clothing, blankets, and medicines as emergency aid after natural disasters; transfers of machinery and other equipment; the direct provision of the construction of buildings or other structures; and transfers of military equipment of all types. Goods and services used to produce nonmarket goods and services consumed by other governments and international organizations are included in use of goods and services. An example would be the goods and services acquired so that government employees can conduct relief operations in a foreign country after a natural disaster.

**6.29** Use of goods and services includes all goods and services consumed by a general government unit to produce nonmarket goods and services that are distributed either as social benefits in kind or distributed to households in particular circumstances, such as following a natural disaster. Such social benefits can be distributed through social security schemes; social insurance schemes operated for the benefit of government employees, their dependents, or survivors; or social assistance schemes. A common type of social benefit likely to be produced by general government units and distributed in kind is related to health care, such as medical or dental treatments, surgery, hospital accommodation, home care, and similar services. Benefits for government employees and dependents typically include general medical services not related to the employee's work, convalescent and retirement homes, education services, and access to recreation or holiday facilities. Any nominal payments made by the households should be deducted from use of goods and services expense.

**6.30** Goods and services that were not produced by the donor government unit, but are distributed as social benefits in kind or distributed to households in particular circumstances, are classified as *social benefits* (27) rather than use of goods and services. Such distributions include transfers of goods held in inventory, the purchase and simultaneous transfer of goods and services from market producers, and the reimbursement of expenditures by households on specified goods or services, such as expenditures on medicines, medical or dental treatments, hospital bills, and optometrists' bills.

**6.31** Use of goods and services includes payments for the rental of produced assets, especially buildings, transport equipment, and machinery. Payment for the rent of nonproduced naturally occurring assets, such as land, is classified as *rent* (2814). The

difference in treatment arises because lessors of produced assets are engaged in a production process whereby they provide services to the lessees, such as maintaining inventories of fixed assets available for lease at short notice and repairing and maintaining the leased assets. Owners of land and other nonproduced assets, however, merely place these assets at the disposal of other units. Hence, they are not considered to be engaged in productive activity.

**6.32** On occasion, government units engage in transfer payments by purchasing goods and services for prices that greatly exceed their market value. As described in paragraph 3.9 of Chapter 3, when such transactions can be detected, they should be partitioned into a purchase of goods and services at their true market value and a transfer payment of the appropriate category.

### 3. Consumption of fixed capital [GFS] (23)

**6.33** Consumption of fixed capital is the decline during the course of an accounting period in the value of fixed assets owned and used by a general government unit as a result of physical deterioration, normal obsolescence, or normal accidental damage.<sup>4</sup> It is valued in the average prices of the period. Consumption of fixed capital may deviate considerably from depreciation as recorded in government financial records, which is normally calculated using the original costs of fixed assets.

**6.34** Consumption of fixed capital is a forward-looking measure because its value is based on future events rather than past events. The value of a fixed asset is the present discounted value of the stream of rentals that the owner of a fixed asset could expect if it were rented out over the remainder of its service life. The rentals, in turn, depend upon the benefits that units expect to derive from using the asset. Thus, consumption of fixed capital is the decrease in the present value of the remaining sequence of rentals, with the rentals valued at the average prices of the period. The extent of the decrease will be influenced not only by the decrease in the benefits derived from the asset, or its efficiency, during the

current period, but also by the shortening of its service life and the rate at which its efficiency is expected to decline over its remaining service life. Furthermore, changes in the price of the asset must be excluded from consumption of fixed capital. Price changes are recorded as holding gains, as described in Chapter 10.

**6.35** Consumption of fixed capital is estimated with respect to all tangible and intangible fixed assets, including infrastructure assets, major improvements to land, and the costs of ownership transfer incurred on the acquisition of valuables and nonproduced assets. Although some fixed assets, such as roads or railway tracks, may appear to have infinite service lives if properly maintained, their value may nevertheless decline because of a decrease in the demand for their services as a result of technical progress and the appearance of substitutes. Many fixed assets are scrapped or demolished only because they have become obsolete. Consequently, consumption of fixed capital must include an allowance for anticipated obsolescence.

**6.36** If a general government unit engages in own-account capital formation, then this category of expense does not include the consumption of fixed capital related to the fixed assets used in that production process. As described in the previous sections on compensation of employees and use of goods and services, the costs incurred in own-account capital formation, including consumption of fixed capital, are classified as acquisitions of fixed assets.

**6.37** Consumption of fixed capital also excludes the loss of value when fixed assets are destroyed by acts of war, natural disasters, and other exceptional events. Similarly, it excludes losses due to unexpected technological developments that may significantly shorten the service life of an existing fixed asset and the depletion or degradation of nonproduced assets such as land and subsoil assets. These events are treated as other economic flows, as described in Chapter 10.

**6.38** To compute consumption of fixed capital, the fixed assets purchased in the past and still in use have to be revalued at the average prices of the current period and assumptions have to be made regarding the remaining service lives of each asset and the rate at which their efficiency is expected to diminish. Linear or geometric patterns of decline, or some combination of them, are the patterns most

<sup>4</sup>The concept of consumption of fixed capital is identical to the concept used in the 1993 SNA. The coverage of consumption of fixed capital expense may differ from the amount recorded in the production account of the 1993 SNA because of the GFS treatment of own-account capital formation. When nonfinancial assets are produced on own account, some consumption of fixed capital is recorded in the GFS system as acquisitions of fixed assets rather than expense (see paragraph 6.36). Consumption of fixed capital is described in the 1993 SNA in paragraphs 6.179 through 6.203.

commonly assumed.<sup>5</sup> In limited cases, it may be possible to estimate consumption of fixed capital from observations of used asset prices in markets.

#### 4. Interest [GFS] (24)

**6.39** Interest is payable by units that incur certain kinds of liabilities, namely deposits, securities other than shares, loans, and accounts payable.<sup>6</sup> These liabilities are created when a general government unit borrows funds from another unit. Interest is the expense that the general government unit (the debtor) incurs for the use of the principal outstanding, which is the economic value that has been provided by the creditor.

**6.40** Interest expense accrues continuously over the period that the liability exists. The rate at which interest accrues may be stated as a percentage of the outstanding principal per time period, a predetermined sum of money, a variable sum of money dependent on a defined indicator, or some combination of these methods. Interest normally is not paid until the expense has accrued. That is, if interest on a loan is paid monthly, the amount paid is usually the expense that has accrued during the previous month. Until a payment takes place, the debtor's total liability to the creditor has increased by the amount of interest expense incurred but not paid. What are commonly referred to as interest payments, therefore, are reductions of the debtor's existing liability, part of which was created by the already incurred interest expense.

**6.41** This manual recommends that accrued but unpaid interest be added to the principal of the underlying instrument. That is, as interest accrues on a government bond, the principal of the bond would increase. It is recognized, however, that interest accruing on deposits and loans may have to follow national practices and be classified under accounts payable.

**6.42** With the exception of index-linked securities, including floating-rate notes, the rate at which interest expense accrues is determined when the contract is established and the funds have been borrowed.<sup>7</sup> In the simplest case, a sum of money is borrowed, periodic

payments are made equal to the interest expense incurred during the previous period, and at the end of the contract a final interest payment is made together with the original amount borrowed. The amount of interest expense incurred each period is equal to the interest rate stated in the contract multiplied by the amount borrowed. As each period passes, the amount of principal outstanding increases as interest expense is incurred. At the end of the period, the payment reduces the principal to the amount originally borrowed. Unless the end of the accounting period coincides with a periodic payment, the total liability at the end of the period will include some amount of interest incurred but not yet paid.

**6.43** Certain financial instruments, such as bills and zero-coupon bonds, are such that the debtor is under no obligation to make any payments to the creditor until the liability matures. In effect, no interest is due for payment until the liability matures, at which point the debtor's liability is discharged by a single payment covering both the amount of the funds originally borrowed and the interest accrued and accumulated over the entire life of the liability. Instruments of this type are said to be discounted because the amount initially borrowed is less than the amount to be repaid. The difference between the amount repaid at the end of the contract and the amount originally borrowed is interest that must be allocated over the accounting periods between the beginning and end of the contract. The interest accruing each period is treated as being paid by the debtor and then borrowed as an additional amount of the same liability. Thus, interest expense and an increase in the liability are recorded each period. When more than one accounting period is involved, there is a number of ways to allocate the total amount of interest among the periods involved. The most common and among the simplest is to assume that the interest rate is constant throughout the contract period.

**6.44** A slightly more complicated case consists of a discounted instrument that also requires periodic payments. In such cases, the interest expense is the amount of the money income payable periodically plus the amount of interest accruing each period attributable to the difference between the redemption price and the issue price. Again, the most common assumption is that the interest rate is constant over the entire period of the contract. This interest rate is the one that makes the sum of all future payments equal to the amount initially borrowed when the future payments are discounted by the interest rate.

<sup>5</sup>Organisation for Economic Co-operation and Development, *Measuring Capital—OECD Manual: Measurement of Capital Stocks, Consumption of Fixed Capital and Capital Services* (Paris, 2001) contains an extensive discussion of the methods for estimating consumption of fixed capital.

<sup>6</sup>Financial assets and their classification are defined in Chapter 7.

<sup>7</sup>An alternative view of the computation of interest is explained in paragraphs 6.48 to 6.50.

**6.45** In some cases, securities other than shares are issued at a premium rather than a discount. The method of determining the interest expense is identical to the case of a discounted instrument except that the premium (the difference between the redemption price and the issue price) is treated as negative interest expense.

**6.46** Loans are often structured with periodic payments that incorporate both interest and principal payments. The excess of the periodic payment over the interest accrued reduces the original principal. Over time, the share of the payment allocated to the payment of accrued interest decreases and the share allocated to reducing the original principal increases.

**6.47** Index-linked securities are financial instruments for which the amounts of the periodic payments and/or the principal outstanding are linked to a price index or an exchange rate index. When the periodic payments are index linked, as with floating-rate notes, the full amounts of such payments are treated as interest. When the value of the principal is index linked, the difference between the eventual redemption price and the issue price is treated as interest accruing over the life of the asset in the same way as for a discounted security whose redemption price is fixed in advance. In practice, the change in the value of the principal outstanding between the beginning and end of a particular accounting period due to the movement in the relevant index may be treated as interest accruing in that period in addition to any interest due for payment in that period. As with discounted instruments, the interest accruing as a result of the indexation is treated as being paid by the debtor and then borrowed as an additional amount of the same liability.

**6.48** In some cases the value of a liability and the current market interest rate are interrelated. When the future cash flows associated with a financial instrument are fixed, then the market value of the instrument is the sum of the future flows discounted by the current market interest rate. An example is a bond that calls for fixed periodic monetary payments and a final repayment of principal when the bond matures. If the market interest rate increases, then the market value of the bond decreases because the future cash flows are discounted by a larger amount. When the current market interest changes, therefore, a holding gain or loss occurs with respect to many financial assets and liabilities. The change in interest rates also raises the question of how to determine interest expense from that point forward.

**6.49** There are three general possibilities, which are referred to as the debtor, creditor, and acquisition approaches. The debtor approach assumes that interest expense is determined for the entire life of a financial instrument when it is created, except for changes in index-linked securities. If interest rates change, for example increase, then the market value of the instrument will change, in this case decrease. The decrease in the debtor's liability is treated as a holding gain. If there are no further changes in the interest rate, then over the remaining period of the contract, the market value of the instrument will increase gradually until at maturity it equals the amount the debtor is obligated to pay. These increases in the market value are treated as holding losses. The debtor approach is the one that is generally understood to be embedded in the *1993 SNA* and is the approach followed in this manual.

**6.50** With the creditor approach, it is assumed that future interest expense is recalculated each time there is a change in the interest rate. To use the same example, an increase in the interest rate leads to a decrease in the market value of the instrument and there has been a holding gain for the debtor. At this point, the instrument is treated as a new instrument that was issued at a discount. If there are no further changes in the interest rate, then the gradual increases in the market value of the instrument over the remaining period will be treated as interest expense. The acquisition approach is the same as the debtor approach except that changes in the interest rate are acknowledged when there is a change in the ownership of the instrument, usually from trading in a secondary market.

**6.51** The interest expense payable to financial intermediaries recorded in this manual differs from the amount recorded in *1993 SNA*. A financial intermediary sets its interest rates for depositors and borrowers at levels that will provide a margin large enough to defray the costs of providing its services to its depositors and borrowers without explicit fees. In concept, the value of the services provided by financial intermediaries to a borrowing general government unit should be treated as a use of goods and services expense. To accomplish this treatment, the actual interest expense payable to financial intermediaries would need to be decreased by the value of the services. The value of the financial services, however, can be estimated only indirectly by compilers of the national accounts because data for all depositors and borrowers of financial intermediaries are required. Thus, in this manual, no adjustment is made for financial services indirectly measured.

**6.52** Government units may make interest payments on loans and other interest-bearing liabilities of other units for which they act as guarantors. These payments should not be classified as interest until the government unit has assumed the debt. If the government unit has not assumed the debt, then two transactions are possible. First, if the government unit does not receive a financial claim on the other unit or receives a financial claim that is not likely to be paid, then the transaction should be recorded as a *subsidy* (25) if the other unit is a corporation, as a *grant* (26) if the other unit is another general government unit, or as *other expense* (28) if the other unit is a household or a nonprofit institution serving households. If the government unit receives a financial claim on the other unit for the amount paid and the claim is likely to be paid, then the transaction should be recorded by the government unit as an acquisition of a financial asset.<sup>8</sup>

**6.53** In the 1993 SNA as originally published, payments related to certain derivatives were treated as interest expense. Subsequently, the 1993 SNA was amended so that no payments related to derivatives are considered to be interest. This manual follows that amendment.<sup>9</sup>

**6.54** As noted in Chapter 5, interest assessed on the late payment of taxes or that is otherwise related to an infringement of tax regulations is treated as tax revenue by the receiving government unit. If this interest is paid by a general government unit, then it is classified as a tax payment, a component of *miscellaneous other expense* (282).

**6.55** Total interest payable is subdivided into *interest payable to nonresidents* (241), *interest payable to residents other than general government* (242), and *interest payable to other general government units* (243). Interest payable to other general government units is required only when statistics are compiled for a subsector of the general government sector. Otherwise all such transactions are eliminated in consolidation.

## 5. Subsidies (25)

**6.56** Subsidies are current unrequited payments that government units make to enterprises on the basis of the levels of their production activities or the quantities or values of the goods or services they produce, sell,

export, or import. Subsidies may be designed to influence levels of production, the prices at which outputs are sold, or the remuneration of the enterprises.

**6.57** Subsidies are payable to producers only, not to final consumers, and are current transfers only, not capital transfers. Transfers that government units make directly to households as consumers and most transfers to nonprofit institutions serving households are treated as either *social benefits* (27) or *miscellaneous other expense* (282) depending on the reason for the payment. Most transfers made to general government units are included in *grants* (26).<sup>10</sup> Payments to enterprises to finance their capital formation, to compensate them for damage to nonfinancial assets, or to cover large operating deficits accumulated over two or more years are *miscellaneous other capital expense* (2822).

**6.58** Subsidies can be payable on specific products or on production in general. A subsidy on a product is a subsidy payable per unit of a good or service. The subsidy may be a specific amount of money per unit of quantity of a good or service, or it may be calculated ad valorem as a specified percentage of the price per unit. A subsidy may also be calculated as the difference between a specified target price and the market price actually paid by a buyer. A subsidy on a product usually becomes payable when the good or service is produced, sold, exported, or imported, but it may also be payable in other circumstances, such as when a good is transferred, leased, delivered, or used for own consumption or own capital formation.

**6.59** Subsidies on production consist of subsidies that enterprises receive as a consequence of engaging in production but that are not related to specific products. Included are subsidies on payroll or workforce, which are payable on the total wage or salary bill, the size of the total workforce, or the employment of particular types of persons; subsidies to reduce pollution; and payments of interest on behalf of corporations.

**6.60** Subsidies also include transfers to public corporations and quasi-corporations to compensate for losses they incur on their productive activities as a result of charging prices that are lower than their

<sup>8</sup>Additional information on debt operations is provided in Appendix 2.

<sup>9</sup>International Monetary Fund, *The New International Standards for the Statistical Measurement of Financial Derivatives: Changes to the Text of the 1993 SNA* (Washington, 2000).

<sup>10</sup>In rare cases payments to general government units and nonprofit institutions serving households can be classified as subsidies. The payments must depend on general regulations applicable to all producers, nonmarket as well as market. For example, a government may pay a subsidy to all employers that employ members of a specified profession or people with a specified disability.

average costs of production as a matter of deliberate government economic and social policy. If such losses have been accumulated over two or more years, the payments are classified as *miscellaneous other capital expense* (2822).

**6.61** Subsidies are classified first by whether the recipient is a public or private producer and then by whether the producer is a nonfinancial or financial enterprise. The four possibilities are *public nonfinancial corporations* (2511), *public financial corporations* (2512), *private nonfinancial enterprises* (2521), and *private financial enterprises* (2522).

## 6. Grants (26)

**6.62** Grants are noncompulsory current or capital transfers from one government unit to another government unit or an international organization.<sup>11</sup> Grants are classified first by the type of unit receiving the grant and then by whether the grant is current or capital.

**6.63** Three types of recipients of grants are recognized in the GFS system: *grants to foreign governments* (261), *grants to international organizations* (262), and *grants to other general government units* (263). The category of grants to other general government units is required only when statistics are compiled for a subsector of the general government sector. Otherwise these transactions are eliminated in consolidation.

**6.64** Current grants are those made for purposes of current expense and are not linked to or conditional on the acquisition of an asset by the recipient. Capital grants involve the acquisition of assets by the recipient and may consist of a transfer of cash that the recipient is expected or required to use to acquire an asset or assets (other than inventories), the transfer of an asset (other than inventories and cash), the cancellation of a liability by mutual agreement between the creditor and debtor, or the assumption of another unit's debt.<sup>12</sup> If doubt exists regarding the character of a grant, it should be classified as current.<sup>13</sup>

**6.65** Grants in kind should be valued at current market prices. If market prices are not available, then the

<sup>11</sup>See footnote 10 for an exception.

<sup>12</sup>Appendix 2 provides details on debt cancellation, debt assumption, and other government debt operations.

<sup>13</sup>The identification of capital grants is necessary to calculate gross and net saving.

value should be the explicit costs incurred in providing the resources or the amounts that would be received if the resources were sold.

**6.66** Grants are recorded when all requirements and conditions for receiving them are satisfied and the donor unit has an unconditional obligation. Determining this time can be complex because there is a wide variety of eligibility conditions that have varying legal powers. In some cases, a potential grant recipient has a legal claim when it has satisfied certain conditions, such as the prior incurrence of expenses for a specific purpose or the passage of legislation. In many cases, the grant recipient never has a claim on the donor and the grant should be attributed to the time at which the payment is made.

## 7. Social benefits [GFS] (27)

**6.67** Social benefits are defined in the annex to Chapter 2 as transfers in cash or in kind to protect the entire population or specific segments of it against certain social risks. A social risk is an event or circumstance that may adversely affect the welfare of the households concerned either by imposing additional demands on their resources or by reducing their incomes. Examples of social benefits are the provision of medical services, unemployment compensation, and social security pensions. They are classified according to the type of scheme governing their payment, which are social security, social assistance, and employer social insurance schemes.

**6.68** Not all social benefits as defined in the annex to Chapter 2 are treated as expense. The payment of pensions and other retirement benefits through employer social insurance schemes are treated as reductions in liabilities.<sup>14</sup> Social benefits produced by a general government unit and transferred to households are expense transactions but are not classified as social benefits. Instead, the expenses of producing them are part of compensation of employees, use of goods and services, and consumption of fixed capital.<sup>15</sup> All social benefits are current transfers; none are capital transfers.

<sup>14</sup>In the 1993 SNA, payments of retirement benefits by autonomous and nonautonomous pension funds are treated as transfer payments as well as reductions in liabilities. An adjustment entry is made to remove the double counting of the payment. Payments by unfunded retirement schemes are only transfer payments.

<sup>15</sup>In the 1993 SNA, when a general government unit produces goods and services that are distributed as social benefits, the costs of producing them, such as compensation of employees, are classified in the same way as in this manual. In addition, the value of the goods and services produced is included as social benefits.

**6.69 Social security benefits (271)** are social benefits payable in cash or in kind to households by social security schemes. Typical social security benefits in cash include sickness and invalidity benefits, maternity allowances, children's or family allowances, unemployment benefits, retirement and survivors' pensions, and death benefits.

**6.70** Social security benefits in kind consist of goods and services purchased from a market producer on behalf of households and reimbursements of benefits purchased by households in accordance with the rules of the scheme. These benefits are likely to consist of medical or dental treatments, surgery, hospital accommodation, spectacles or contact lenses, pharmaceutical products, home care, and similar goods or services.

**6.71 Social assistance benefits (272)** are transfers payable to households to meet the same needs as social insurance benefits but which are not made under a social insurance scheme. Social assistance benefits may be payable when no social insurance scheme exists to cover the circumstances in question, certain households do not participate in existing social insurance schemes, or social insurance benefits are deemed inadequate to meet particular needs. Social assistance benefits do not include transfers made in response to events or circumstances that are not normally covered by social insurance schemes, such as natural disasters. Such transfers are recorded under *miscellaneous other expense (282)*. Social assistance benefits in kind consist of transfers to households similar in nature to social security benefits in kind and provided under the same circumstances as social assistance benefits.

**6.72 Employer social benefits (273)** are social benefits payable in cash or in kind by government units to their employees or employees of other government units participating in the scheme (or to survivors and dependents of the employees who are eligible for such payments). The kinds of benefits provided are similar to those listed for social security schemes, such as the continued payment of wages during periods of absence from work as a result of ill health, accidents, maternity, etc.; family, education, or other allowances; severance allowances in the event of redundancy, incapacity, or accidental death; general medical expenses not related to the employees' work; and charges for convalescent and retirement homes. Outlays on pensions and other retirement benefits are reductions in liabilities, not social benefits expense.

## 8. Other expense (28)

### a. Property expense other than interest (281)

**6.73** Property expense is the expense payable by a general government unit to the owner of a financial asset or a tangible nonproduced asset when the general government unit makes use of such an asset. One type of property expense is interest, which is classified in category 24. Property expense other than interest may take the form of dividends, withdrawals from income of quasi-corporations, property expense attributed to insurance policyholders, or rent.<sup>16</sup> Dividends and withdrawals from income of quasi-corporations apply only to public corporations.

**6.74 Dividends (2811).** Because public corporations receive equity funds from general government units and possibly other units, they may pay dividends to those units. Such payments are not required; the board of directors or other managers of the corporation must declare a dividend payable on their own volition. Distributions of profits by public corporations may take place irregularly and may not be explicitly labeled as dividends. Nevertheless, except for distributions by fiscal, export, or import monopolies, dividends include all distributions of profits by public corporations to their shareholders or owners.<sup>17</sup> Dividends are recorded either on the date they are declared payable or, if no prior declaration occurs, on the date the payment is made. Large and exceptional one-off payments based on accumulated reserves, privatization receipts and other sales of assets, or holding gains are withdrawals of equity rather than dividends. See paragraphs 5.85 to 5.87 of Chapter 5.

**6.75 Withdrawals from income of quasi-corporations (2812).** By definition, quasi-corporations cannot

<sup>16</sup>In the 1993 SNA, reinvested earnings on direct foreign investment is a type of property expense that conceivably could apply to a public corporation. Briefly, a direct foreign investment enterprise is a public corporation in which at least one foreign investor owns sufficient shares to have an effective voice in its management. An increase in retained earnings of a direct foreign investment enterprise is treated as if it were remitted as a form of property expense to the foreign direct investors in proportion to their ownership of the equity of the enterprise and then reinvested in additional equity. The imputed remittance of these retained earnings is treated as property expense in the 1993 SNA but not in the GFS system. Such an increase in the value of the equity held by a direct foreign investor is accounted for as a holding gain in the same way as it is for other equities (see Chapter 10). This different treatment causes net lending/borrowing in the two systems to differ. Reinvested earnings on direct foreign investment are described in paragraphs 7.119 to 7.122 of the 1993 SNA.

<sup>17</sup>Distributions of profits by fiscal, export, and import monopolies are treated as taxes, classified as *miscellaneous other expense (282)*.

distribute income in the form of dividends, but the owner may choose to withdraw some or all of the income. Conceptually, the withdrawal of such income is equivalent to the distribution of corporate income through dividends and is treated in the same way. The amount of income that the owner of a quasi-corporation chooses to withdraw will depend largely on the size of its net income. All such withdrawals are recorded on the date the payment actually occurs. As with dividends, withdrawals from income of quasi-corporations do not include withdrawals of funds realized by the sale or other disposal of assets. See paragraphs 5.88 and 5.89 of Chapter 5.

**6.76 Property expense attributed to insurance policyholders [GFS] (2813).** Public corporations can be insurance enterprises, in which case they will hold technical reserves in the form of reserves against outstanding risks in respect of life insurance policies, including reserves for with-profit policies that add to the value on maturity of with-profit endowments or similar policies; prepayments of premiums; and reserves against outstanding claims. The reserves are considered to be assets of the policyholders or beneficiaries and liabilities of the insurance enterprises. In general, any income received from the investment of insurance technical reserves is also considered to belong to the policyholders or beneficiaries and therefore a property expense is recorded to reflect the increase in liabilities.

**6.77** General government units are less likely to operate an insurance scheme, but if they do and if they maintain separate reserves, the property expense attributed to insurance policyholders would be recorded in the same manner as for a public corporation. If the general government unit does not maintain separate reserves, then no property expense is recorded. A change in the amount of the liability would be recorded as a revaluation.

**6.78** Retirement schemes for government employees and their dependents and other beneficiaries are treated differently.<sup>18</sup> There are three types of employer retirement schemes: autonomous pension funds, nonautonomous pension funds, and unfunded retirement schemes. Autonomous and nonautonomous pension funds hold reserves dedicated to the payment of pensions and other retirement benefits to the employees of general government units and their dependents

or other beneficiaries. Both types of funds have liabilities equal to the present value of the promised benefits. An unfunded retirement scheme does not hold reserves dedicated to the payment of benefits, but the general government unit operating the scheme does have a liability equal to the present value of the promised benefits, just as with autonomous and nonautonomous pension funds. The property expense attributed to insurance policyholders for all three types of schemes is a component of the change in the scheme's liability.

**6.79** There are two basic types of retirement schemes: defined benefit and defined contribution.<sup>19</sup> With a defined-benefit scheme, the future retirement benefits are defined by some formula normally related to participants' length of service and salary. The nominal values of the retirement benefits to be paid in the future are determined actuarially based on estimates of variables such as expected retirement ages, mortality rates, expected inflation, and expected salary increases. The nominal values can then be converted to present values using an appropriate discount rate. Over time, the total liability of the pension scheme will change because of the receipt of additional contributions, the payment of benefits, changes in the actuarial assumptions, and the passage of time. The property expense attributed to insurance policyholders is equal to the increase in the liability resulting from the passage of time, which occurs because the future benefits are discounted over fewer accounting periods.

**6.80** With defined-contribution schemes, the level of contributions to the fund, rather than the level of benefits, is guaranteed by the employer. All defined-contribution schemes are funded, and the liability of a defined-contribution scheme is equal to the current market value of the fund's assets. Therefore, the property expense attributed to insurance policyholders is just the property income received from the investment of the fund's assets. Any holding gains received on the fund's assets are recorded as equal-valued holding losses for the unit's liability to the beneficiaries.

**6.81 Rent (2814).** Rent is the expense incurred in connection with certain leases of land, subsoil assets, and other naturally occurring assets. Other leases of these types of assets, notably leases of the

<sup>18</sup>Because no liabilities are recorded for pensions paid by social security schemes, no property expense is attributed to insurance policyholders.

<sup>19</sup>Defined-contribution schemes are also known as money-purchase schemes.

electromagnetic spectrum, may be considered to be intangible nonproduced assets. The terms and conditions governing the classification of leases of naturally occurring assets were still under discussion at the time of publication of this manual. The remainder of this section concerns only those leases classified as rent.

**6.82** Rent accrues continuously to the asset's owner throughout the period of the contract. The rent recorded for a particular accounting period is, therefore, equal to the value of the accumulated rent that becomes payable over the accounting period and may differ from the amount of rent that becomes due for payment or is actually paid during the period.

**6.83** Payments for the extraction of minerals or fossil fuels are often described as royalties but are actually rents that accrue to owners of assets in return for putting the assets at the disposal of general government units for specified periods of time. The rents may take the form of periodic payments of fixed amounts, irrespective of the rate of extraction, or, more usually, will be derived according to the quantity, volume, or value of the asset extracted. Payments in exchange for the right to undertake test drilling or otherwise investigate the existence and location of subsoil assets are also treated as rents even though no extraction may take place. The actual outlays on drilling and other exploration are treated as the acquisition of a nonfinancial asset, as described in Chapter 8.

**6.84** Other types of rent include payments for the right to cut timber on noncultivated land, to exploit bodies of unmanaged water for recreational or commercial purposes, including fishing, to use water for irrigation, and to graze animals on land owned by other units.

**6.85** Rent should not be confused with the rental of produced assets, which is treated as *use of goods and services* (22). The difference in treatment arises because lessors of produced assets are engaged in a production process whereby they provide services to the lessees, such as maintaining inventories of fixed assets available for lease at short notice and repairing and maintaining the leased assets. In particular, the rentals paid by general government units as tenants are treated as payments for the provision of building or housing services. Units that own land or subsoil assets and merely place these assets at the disposal of general government units are not considered to be engaged in productive activity.

**6.86** A single transaction may comprise both rent and use of goods and services. Such an event can occur, for instance, when a general government unit, in a single contract, leases land and buildings situated on the land, and the contract does not separately identify the rent of the land from rental of the buildings. If there is no objective basis on which to apportion the payment between rent on land and rental on the buildings, the whole amount is recorded as a rental if the value of the building is greater than the value of the land and vice versa.

#### **b. Miscellaneous other expense (282)**

**6.87** Miscellaneous other expense includes a number of transfers serving quite different purposes and any other expense transaction not elsewhere classified. The most important types of transfers in this category follow:

- Current transfers to nonprofit institutions serving households. These transfers usually consist of cash in the form of membership dues, subscriptions, and voluntary donations, whether made on a regular or occasional basis. Such transfers are intended to cover the costs of the production of nonprofit institutions serving households or to provide the funds out of which current transfers may be made to households in the form of social assistance benefits. This category also covers transfers in kind in the form of food, clothing, blankets, and medicines to charities for distribution to households.
- Current and capital taxes, compulsory fees, and fines imposed by one level of government on another level. These transfers are subject to elimination by consolidation.
- Net tax credits. When the amount of a tax credit exceeds the amount of tax otherwise receivable from a taxpayer and the excess is paid to the taxpayer, the net payment is treated as expense rather than negative tax.
- Fines and penalties imposed by courts of law or quasi-judicial bodies. These transfers can be payable to any sector.
- Payments of compensation for injuries or damages caused by natural disasters.
- Payments of compensation for injury to persons or damage to property caused by general government units, excluding payments of non-life insurance claims. These payments can be either compulsory

payments awarded by courts of law or ex gratia payments agreed out of court.

- Scholarships and other educational benefits.
- Capital transfers to market enterprises and non-profit institutions serving households in cash or in kind to finance all or part of the costs of acquiring nonfinancial assets, to cover large operating deficits accumulated over two or more years, to cancel a debt by mutual agreement with the debtor, or to assume a debt.
- Non-life insurance premiums payable to insurance corporations to obtain cover against various events or accidents. Such payments are always treated as current transfers.<sup>20</sup>
- Non-life insurance claims payable by insurance schemes operated by a general government unit in settlement of claims that become due during the current accounting period. Claims become due when the eventuality occurs that gives rise to a valid claim. Such payments are always treated as current transfers, even when large sums are involved.
- Purchases of goods and services from market producers that are distributed directly to households for final consumption other than social benefits.

**6.88** Other expense is subdivided into *miscellaneous other current expense (2821)* and *miscellaneous other capital expense (2822)*. It may be of analytic interest to classify this group of transactions according to their recipients, such as residents and nonresidents. Among residents, it may also be of interest to classify them according to whether they are households, nonprofit institutions serving households, public nonfinancial corporations, public financial corporations, or private corporations.

### C. The functional classification of expense

**6.89** The Classification of Functions of Government (COFOG) is a detailed classification of the functions, or socioeconomic objectives, that general government units aim to achieve through various kinds of

<sup>20</sup>In the 1993 SNA, payments of non-life insurance premiums are partitioned into a purchase of a service and a transfer payment. In the GFS system, the entire premium is considered a transfer payment.

outlays. It is one of a family of four classifications referred to as classifications of expenditure according to purpose.<sup>21</sup>

**6.90** COFOG provides a classification pertaining to outlays by governments on functions that experience has shown to be of general interest and amenable to a wide variety of analytic applications. Statistics on health, education, social protection, and environmental protection, for example, can be used to study the effectiveness of government programs in those areas.

**6.91** The classification codes of COFOG are somewhat different from the structure of other GFS classification codes. The functions are classified using a three-level scheme. There are 10 first-level, or two-digit, categories, referred to as divisions. Examples are health (Division 07) and social protection (Division 10). Within each division, there are several groups, or three-digit categories, such as hospital services (073) and sickness and disability (101). Within each group, there are one or more classes, or four-digit categories, such as nursing and convalescent home services (0734) and disability (1012). All three classification levels and detailed descriptions of the contents of each class are reproduced in the annex to this chapter. Table 6.2 lists the divisions and groups. In this manual, the prefix “7” has been added to align the COFOG codes with other GFS classification codes.

**6.92** All outlays for a particular function are collected in one category of COFOG regardless of how the outlays are implemented. That is, cash transfer payments designed to be used for a particular function, the purchase of goods and services from a market producer that are transferred to households for the same function, the production of goods and services by a general government unit, or the acquisition of an asset for that same function are all in the same category.

**6.93** COFOG permits trends in government outlays on particular functions or purposes to be examined over time. Conventional government accounts are not usually suitable for this purpose because they reflect the organizational structures of governments. Not only might time series be distorted by organizational changes, but at a specific time some organizations may be responsible for more than one function,

<sup>21</sup>COFOG was produced by the Organisation for Economic Co-operation and Development and was published together with the other three classifications in United Nations, *Classifications of Expenditure According to Purpose* (New York, 2000). Material in this section is adapted from that publication.

Table 6.2: Classification of Expense by Function of Government

<b>7</b>	<b>Total outlays</b>	<b>706</b>	<b>Housing and community amenities</b>
<b>701</b>	<b>General public services</b>	7061	Housing development
7011	Executive and legislative organs, financial and fiscal affairs, external affairs	7062	Community development
7012	Foreign economic aid	7063	Water supply
7013	General services	7064	Street lighting
7014	Basic research	7065	R&D Housing and community amenities
7015	R&D <sup>1</sup> General public services	7066	Housing and community amenities n.e.c.
7016	General public services n.e.c. <sup>2</sup>	<b>707</b>	<b>Health</b>
7017	Public debt transactions	7071	Medical products, appliances, and equipment
7018	Transfers of a general character between different levels of government	7072	Outpatient services
<b>702</b>	<b>Defense</b>	7073	Hospital services
7021	Military defense	7074	Public health services
7022	Civil defense	7075	R&D Health
7023	Foreign military aid	7076	Health n.e.c.
7024	R&D Defense	<b>708</b>	<b>Recreation, culture, and religion</b>
7025	Defense n.e.c.	7081	Recreational and sporting services
<b>703</b>	<b>Public order and safety</b>	7082	Cultural services
7031	Police services	7083	Broadcasting and publishing services
7032	Fire protection services	7084	Religious and other community services
7033	Law courts	7085	R&D Recreation, culture, and religion
7034	Prisons	7086	Recreation, culture, and religion n.e.c.
7035	R&D Public order and safety	<b>709</b>	<b>Education</b>
7036	Public order and safety n.e.c.	7091	Pre-primary and primary education
<b>704</b>	<b>Economic affairs</b>	7092	Secondary education
7041	General economic, commercial, and labor affairs	7093	Postsecondary nontertiary education
7042	Agriculture, forestry, fishing, and hunting	7094	Tertiary education
7043	Fuel and energy	7095	Education not definable by level
7044	Mining, manufacturing, and construction	7096	Subsidiary services to education
7045	Transport	7097	R&D Education
7046	Communication	7098	Education n.e.c.
7047	Other industries	<b>710</b>	<b>Social protection</b>
7048	R&D Economic affairs	7101	Sickness and disability
7049	Economic affairs n.e.c.	7102	Old age
<b>705</b>	<b>Environmental protection</b>	7103	Survivors
7051	Waste management	7104	Family and children
7052	Waste water management	7105	Unemployment
7053	Pollution abatement	7106	Housing
7054	Protection of biodiversity and landscape	7107	Social exclusion n.e.c.
7055	R&D Environmental protection	7108	R&D Social protection
7056	Environmental protection n.e.c.	7109	Social protection n.e.c.

<sup>1</sup>R&D = Research and development.

<sup>2</sup>n.e.c. = not elsewhere classified.

and responsibility for one function might be divided among several organizations. For example, if a government establishes a new department that brings together some of the functions previously administered by several departments or at several levels of government, it will not usually be possible to use conventional government accounts to compare outlays on these purposes over time.

**6.94** COFOG is also used for making international comparisons of the extent to which governments are involved in economic and social functions. Just

as COFOG avoids the problems of organizational changes in a single government, so too does it avoid the problems of organizational differences among countries. In one country, for example, all functions connected with water supply may be undertaken by a single government agency, while in another country they may be distributed among departments dealing with the environment, housing, and industrial development.

**6.95** Government services can benefit the community either individually or collectively. COFOG is

used to distinguish between the individual and collective services provided by general government. The COFOG functions are defined so that they represent individual or collective consumption, but not both. In the annex, each class is marked “CS” or “IS” to designate it as collective services or individual services, respectively. Purchases of goods and services that are transferred to individual households or persons are treated as social transfers in kind in the *1993 SNA* so that the actual final consumption of government and households, in addition to their final consumption expenditure, can be computed. Thus statistics compiled by function will be useful for compiling national accounts according to the *1993 SNA*.

**6.96** The items classified should be, in principle, individual transactions. Each purchase of goods and services, wage payment, transfer, or other outlay should be assigned a COFOG code according to the function that the transaction serves. For most outlays, however, it will generally not be possible to use transactions as the classification items. Instead, COFOG codes may have to be assigned to all transactions of agencies, offices, program units, bureaus, and similar units within government departments or ministries.

**6.97** When government bodies rather than transactions are used for classification, it may happen that the smallest bodies that can be identified in the government accounts may perform more than one COFOG function. If possible, the outlays of multifunction bodies should be allocated among COFOG functions using a relevant physical indicator, such as hours worked by employees. It may be possible only to assign all outlays by multifunction units to whichever purpose appears to account for the largest part of total outlays.

**6.98** A single classification cannot serve all analytic purposes. The selection of functions in COFOG is not unique. The scope of each function could be broader or narrower, and completely different functions could have been included. For example, outlays for medical schools are classified in COFOG as education rather than health. Also, research and development could be a function of its own, but in COFOG research and development outlays are classified according to the function the goal of the research and development most closely serves. Thus, COFOG statistics must be used with care to be sure that the desired coverage is obtained for a specific analytic purpose.

**6.99** Government ministries generally are responsible for the formulation, administration, coordination, and monitoring of overall policies, plans, programs, and budgets; for the preparation and enforcement of legislation; and for the production and dissemination of general information, technical documentation, and statistics. Consequently, the outlays of these ministries have to be shared across the classes for which they are responsible. For example, the outlays of a ministry of transport should be divided between *road transport* (70451), *water transport* (70452), *railway transport* (70453), *air transport* (70454), and *pipeline and other transport* (70455).

**6.100** Administrative outlays on general services, such as personnel services, supply and purchasing services, accounting and auditing services, and computer and data processing services, undertaken by ministries or units within ministries should be classified at the most detailed level possible. If administrative outlays overlap two or more classes, an attempt should be made to apportion outlays between the classes concerned. If this approach is not feasible, the total should be allocated to that class that accounts for the largest part of the total outlay.

**6.101** Particular difficulties may arise with regard to subsidies. The main objective behind such government support may be, for example, to assure capacity to build naval vessels considered vital to national defense, to maintain living standards of important groups such as farmers or miners, or to provide employment for workers in underutilized hospitals. These political objectives are not to be confused with functions as the term is used in COFOG. Hence a government subsidy to shipyards is classified under *manufacturing* (70442); and grants to hospitals are classified under *hospital services* (7073) regardless of the ultimate purposes. Subsidies and grants designed chiefly to increase employment opportunities in general are an exception to this rule. As such programs do not focus on any single industry, they are classified under *general labor affairs* (70412).

**6.102** It is likely that consumption of fixed capital will be difficult to allocate by function, especially if only aggregated figures for total government capital stock and consumption of fixed capital are compiled. In these circumstances, approximations will have to be used. One possibility may be to distribute consumption of fixed capital according to

book value depreciation, if it is available for detailed organizational units within government. Another approach would be to distribute consumption of fixed capital among functions in proportion to gross fixed capital formation over a number of earlier years.

**6.103** A final caution regarding the use of COFOG statistics relates to outlays for nonfinancial assets. Because expense transactions classified by COFOG include consumption of fixed capital, which represents part of the resource cost of using previously acquired fixed assets, there is an overlap between the COFOG statistics for the current period and COFOG statistics for the periods in

which the assets were acquired. Thus, COFOG statistics should be cross-classified at least with total expense and acquisitions of nonfinancial assets. A cross-classification of COFOG with all categories of the economic classification of expense would be even more beneficial (see Table 6.3).

**D. Cross-classification of expense**

**6.104** The economic and functional classifications of expense can be cross-classified as illustrated in Table 6.3. The table includes a column for acquisitions of nonfinancial assets in addition to columns for each type of expense.

**Table 6.3: Cross-Classification of Functional and Economic Classifications of Expense**

	Compensation of employees [GFS]	Use of goods and services	Consumption of fixed capital [GFS]	Interest [GFS]	Subsidies	Grants	Social benefits [GFS]	Other expense	Acquisition of nonfinancial assets
General public services									
Defense									
Public order and safety									
Economic affairs									
Environmental protection									
Housing and community amenities									
Health									
Recreation, culture, and religion									
Education									
Social protection									