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Updating *BPM6* Issues for Consideration—An Australian Perspective

1. INTRODUCTION

Australia strongly supports the underlying economic principles of BPM6 and appreciates the coherent guidance for compiling international accounts statistics. Australia considers BPM6 provides a robust overall framework for compilation of Balance of Payments and International Investment statistics.

In readiness for BPM7, plans should commence now to address outstanding issues in the framework given updating BPM6 commenced in 2001 and was not finalised until 2008. Australia's position is that emphasis should be placed on a coherent conceptual framework based on consistent application of underlying principles; pragmatic considerations should be addressed through compilation guidance.

This paper outlines a number of issues Australia would like BOPCOM to consider for resolution through the drafting of BPM7. The predominant reason for raising these issues (particularly the conceptual issues) is to better align the recommendations of BPM7 with the underlying macroeconomic principles of accrual accounting, market valuation and the use of the 'debtor / creditor' principle in preference to the 'transactor' principle.

2. ISSUES FOR BPM7 CONSIDERATION

2.1 Conceptual issues

Conceptual issues - Valuation

Valuation of Trade in Goods (Basic Prices)

According to BPM6:

“The principle for valuation of general merchandise is the market value of goods at the point of uniform valuation. The point of uniform valuation is at the customs frontier of the economy from which the goods are first exported, that is, free on board (FOB)...” (BPM6 paragraph 10.30).

By contrast the 2008 SNA values transactions at the "transaction price at change of ownership". For example, according to the 2008 SNA, cross-border trade in goods should be recorded at amounts specified between the buyers and sellers. The transport and insurance costs of exporting or importing will or will not be covered in accordance with the amounts specified by the two parties:

“...the question of whether the value of goods covers the cost of transportation or not depends on whether the exporter or importer is responsible for transport...” (2008 SNA paragraph 14.68).

Australia requests BPM7 introduce coherence between SNA and BPM on the valuation of international trade in goods.

Valuation of Trade under Long-Term Contract

The production of bulk commodities usually requires significant upfront capital investment. In order to guarantee a return on the investment, trade in these commodities frequently involves long-term contracts (with terms extending beyond 20 years) with either fixed prices or index-linked prices supported by a floor. Over time, the contract prices can deviate markedly from the spot price for the commodities.

Australia requests that the treatment of prices under long-term trade contracts be examined with consideration given to the position that the historic nature of pricing of these traded commodities is not a true reflection of the current market value. A more appropriate reflection of the economic reality may be to record the trade as taking place at the market (spot) price and to treat the long-term supply contract as a forward financial derivative.

Varying this treatment would have implications for SNA. Additional practical guidance would be required in the circumstances where spot markets are not sufficiently deep to provide reliable pricing observations.

Valuation of Loans (Fair Value)

BPM6 records loans at nominal value as a standard component requiring fair value as a memorandum item. Australia considers the concept of fair value to be a closer approximation of market value and that the concept of market value is a fundamental underpinning of the Balance of Payments and National Accounts. Australia requests that loans be valued at fair value in the core accounts of the BPM7 framework.

Varying this treatment would have implications for the SNA.

Valuation of Interest on Debt Securities (Creditor Approach)

SNA08 and BPM6 advocate the use of the debtor approach in the situation of changing interest rates and the measurement of income flows on tradeable securities. The debtor approach records the interest accruing at the contractual rate agreed at the time of issue of the security. The creditor approach records the interest accruing at the current market interest rate. Proponents of the debtor approach argue that it records the legal liability of the debtor to the creditor. Proponents of the creditor approach argue that it is more consistent with the market valuation principle and economic rather than legal realities.

Australia strongly endorses the creditor approach as a better reflection of the market reality in terms of valuing the underlying instrument and the interest that accrues over the life of the instrument. Australia currently departs from the international standards on this issue. Research undertaken by the IMF supports such a position¹.

Varying this treatment would have implications for SNA.

Valuation of FISIM

Australia would like to revisit the recommended cost of funds reference rate used for calculating Financial Intermediation Services Indirectly Measured (FISIM). Currently SNA08 and BPM6 recommend the interbank lending rate be used as the reference rate.

There are some issues with this:

- Interbank rates can be for terms relatively short compared to normal deposit and loan terms and hence there can be negative FISIM applied to deposits
- Interbank rates can tend to be volatile and responsive in the short term on monetary policy rather than any 'true' cost of intermediation
- Interbank rates are not necessarily 'risk-free'; and
- Some interbank rates have been open to undue influence.

Australia is asking that further investigation is conducted into determining a better risk free reference rate for the purposes of calculating FISIM, building on the previous international research conducted in this field.

Varying this treatment would have implications for SNA.

Conceptual issues - Transactions

Merchanting of services

Australia believes that BPM7 should provide clarification on the treatment of so-called 'merchanting of services' (i.e. where a service is delivered by one country directly to a recipient in another country without any bundling or transformation, with payment being made from a third country). Australia considers that the payment should be re-routed through the service recipient (with the transaction between the payer and recipient treated as an injection of equity where there is an existing equity relationship, or a transfer if no relationship exists). The proposed treatment assumes that the receipt of the services changes the productive capacity of the recipient, which would be reflected, in part, in the market value of the equity of the recipient.

Where the third party facilitates the provision of the service and receives a commission, this should be treated as the provision of an 'other business service' by the third party, provided to the payer of the commission.

Where the third party bundles the services with other services, or transforms them before provision to the final recipient, then these services would be treated as an import of services by the third party from the service provider, and an export of services to the final recipient.

Repurchase Agreements

A repurchase agreement (repo) involves the sale of securities or other assets with a commitment to repurchase equivalent assets at a specified price. The right to on-selling of these securities has become almost universal. The SNA93 and the BPM6 treat repos similarly to collateralised loans, or as other deposits if repos involve liabilities classified under national measures of broad money.

Consistent with the principles of economic ownership, Australia maintains that the best statistical representation of a repo is that of a sale of securities, with the obligation to sell/buy-back similar securities recorded as a forward contract (i.e. a financial derivative). This treatment has the advantage of unduplicated recording of securities assets, whereas the collateralised loan approach requires recording of negative security assets to maintain equality between total securities asset holdings and total securities liabilities on issue.

Australia currently departs from the international standards on this issue. Varying this treatment would have implications for the SNA.

Exchanges in International Positions

BPM6 paragraph 3.7 states that domestic transactions resulting in a change in the sectoral allocation of external asset positions should be recorded as a 'reclassification' in the international investment position. Similarly, transactions between two non-residents in a position issued by a resident would also be recorded as a reclassification.

Australia considers that this approach reflects a 'transactor' view of the exchange. Consistent with the 'creditor/debtor' principle Australia believes that by issuing a tradeable instrument, the issuer is implicitly a counterpart to any secondary trading in the instrument and that a transaction should be recorded between the vendor and the issuer extinguishing the position, and a second transaction between the purchaser and the issuer creating the position.

Australia currently departs from the international standards on this issue. Varying this treatment would have implications for the SNA.

Conceptual issues - Other

Other Economic Flows on Insurance and Pension Reserves

Australia requests clarification on the treatment of other economic flows on insurance and pension reserves (i.e. should they be treated as revaluations or other changes in volume). The compilation guide to BPM6 provides inconsistent advice, with paragraphs A2.113-114 referring to "holding gains" while table A2.1 and footnote 30 refer to "other changes in volume". In the accompanying paper, Australia presents an argument that, except for exchange rate movements, all other economic flows on insurance and pension reserves should be treated as other changes in volume².

2.2 Classification issues

Classification used for Trade in Services

Trade in services has grown, year after year, in importance in the world economy. Australia would like to see BPM7 adopt, as supplementary information as a minimum, the Extended Balance of Payments in Services classification (EBOPS 2010) to provide more detailed taxonomical breakdowns of these important flows.

Financial Derivatives by Type

Australia has seen significant interest from users in the area of hedging and currency risk and there exists significant demand from these users for more detail on derivative assets and liabilities. Australia would like the current presentation of financial derivatives to be examined with a view to including type of derivative breakdowns (e.g. split by forwards and options).

Credit Default Swaps

Credit default swaps (CDS) are explicitly included as options in BPM6. Australia's view is that CDSs should be classified as a forward rather than an option for the following reasons:

- CDSs are essentially used to hedge against default risk similar to how forwards (including swaps) are used to hedge against currency exchange and interest rate risk
- An integral property of options is the one-sided obligation on the seller of the option. CDSs provide mutual obligations on the seller and buyer
- CDSs, like other forwards have zero value at inception being an exchange of equal risk
- CDSs may be an asset or liability for both parties over the life of the contract

This discussion is only relevant if a presentation of financial derivatives by type is adopted.

International Reserves

Currently central bank institutions in their reserve management capacity are represented under the functional category Reserve Assets. Australia believes there is analytic value in understanding the liabilities incurred by these institutions in performing their reserve related roles. As a consequence 'International Reserves' should be introduced as a functional category for both assets and liabilities including, inter alia, IMF Credit, loans from the fund, Special Drawing Rights(SDRs) liabilities, and derivatives in a liability position.

Ancillary Units (Holding companies)

Under SNA08 and BPM6, holding companies (units which hold the assets of subsidiary corporations but do not undertake any management activities) receive the sectoral classification of ‘Captive financial institutions and money lenders’.

Australia deems this treatment to mis-represent the sectoral exposure risks, as risk would predominately reside in the finance sector as opposed to a true reflection of the sector holding those assets or liabilities. Australia believes that holding companies should be classified according to the predominant activities of the assets that they hold.

Australia currently departs from the international standards on this issue. Varying this treatment would have implications for the SNA.

2.3 Presentation issues

Revisit reasoning for negative exports in merchanting

The purchase of goods for merchanting is recorded as a negative export as per BPM6 paragraph 10.44 (a) and 10.45. The reason for treating as a negative export rather than an import is not readily explained.

Australia would like to see BPM7 provide clarification on the reasoning for treating purchases as negative export, or record the purchase of goods for merchanting as imports.

Notional Units holding real estate

BPM6 paragraph 6.13 states:

“Direct investment may include real estate investment, including investment properties and vacation homes. As discussed in paragraphs 4.26–4.40, branches or notional units are identified when non-residents own real estate and other natural resources”

It is of interest to policy makers to understand the changes within an economy of non-residents owning real estate. Australia proposes BPM7 include a supplementary item separately identifying notional units holding real estate.

2.4 Other issues

Trade in Value Added (TiVA)

Australia would like BPM7 to include TiVA in the appendix on relationships to other statistical frameworks.

3. CONCLUSION

Australia recommends these issues be included in the annotated draft of BPM7 and be resolved through the research program leading to the finalisation of the next edition of the manual.

REFERENCES

1. IMF Working Paper WP/01/132 - *Statistical Treatment of Accrual of Interest on Debt Securities*; John Joice and Chris Wright; IMF 2001
2. BPM7 Issues for Consideration – *An Australian Perspective: The Treatment of Pension and Insurance Reserves*; Ben Loughton; Australian Bureau of Statistics 2015
3. Balance of Payments and International Investment Position Manual 6; IMF 2009
4. BPM6 Compilation Guide; IMF 2014
5. System of National Accounts 2008; European Communities, IMF, OECD, UN and World Bank 2009
6. Manual on Statistics of International Trade in Services 2010; UN, IMF, OECD, Statistical Office of the European Union, United Nations Conference on Trade and Development, World Tourism Organization, World Trade Organization; 2011