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DEFINING ASSETS

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This document has been prepared by Anne Harrison, editor-in-chief SNA review

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For further information, please contact:
Anne Harrison
E-mail: anne.harrison@oecd.org

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Defining assets

Introduction

The Canberra Group has discussed refining the definition of an asset and John Pitzer provided a paper raising some of the points to be clarified. This document attempts to move this subject forward by suggesting elements which need to be added or changed to the SNA. Not all will fall in chapter 10 or only in chapter 10. Wording is important and comments on wording would be appreciated but more important at this stage is whether the approach taken is appropriate.

The present definition of an asset uses the concepts of ownership and benefits though neither of these terms is defined. This is an omission which needs correcting. However, I would prefer not to use the word "benefit" in this context since in the System it has a special meaning in the context of social benefits. In its place I suggest using "reward". This fits with the notion of "risks and rewards" which it is useful to use elsewhere and, with explanation, I think should not prove to be a problem though comments on this terminology would be welcome also.

The definition of rewards and ownership need to appear first in chapter 3. Here is some suggested text.

Rewards

The heart of the System describes how labour, capital and natural resources including land are used to produce goods and services. These goods and services are used for the three economic activities recognised in the System, production, consumption and accumulation. Rewards are defined as follows.

> ***Rewards are the means of acquiring goods and services for production, consumption or accumulation in the current period or in future periods.***

Sometimes the immediate reward is in terms of goods and services directly, for example own account production or wages and salaries in kind. More often a reward is in the form of the medium of exchange (money) for example as wages and salaries. Consumption is an activity which takes place in the current period only but may be financed from past rewards. Production and accumulation involve rewards postponed to future periods. Thus means of allowing rewards to be moved from one accounting period to another have to be recognised. These take the form of financial assets where a reward in one period is converted to a reward in one or more future periods. Similarly goods and services, or current rewards, may be acquired by committing future rewards in the form of financial liabilities.(The concept of reward in the System is analogous to that of benefit in commercial accounting but the term benefit is reserved in the System for use in the context of social benefits.)

Ownership

Two types of ownership can be distinguished, legal ownership and economic ownership.

> ***The legal owner of entities such as goods and services, natural resources, financial assets and liabilities is the institutional unit entitled in law and sustainable under the law to claim the rewards associated with the entities.***

Sometimes government may claim legal ownership of an entity on behalf of the community at large. No entity which does not have a legal owner, either on an individual or collective basis is recognised in the System.

The acts of production, consumption and accumulation, involve varying degrees of risk. Two main forms of risk can be identified. The first sort refers to production. These arise because of such uncertainties as the demand for goods and services once produced, developments in the economy in general and technical innovation which affects the rewards to be earned from capital and natural resources. The consequence is that rewards to capital, natural resources and labour in the form of operating surplus and income from employment, are not wholly predictable in advance, but embody a degree of risk.

The second type of risk refers to the process of transferring rewards between time periods. It arises because of uncertainty over interest rates in future periods, which in turn affects the comparative performance of different types of rewards.

When economic agents make decision about consumption or accumulation, they have to make a judgement about the relative advantages of rewards being converted to goods and services in the current period as against conversion in a later period. Thus all economic activity involves both rewards and risks. Transferring rewards between time periods inevitably involves transferring risks also. An agent may opt for a lower but more certain reward in future rather than a reward which might be higher but is less certain. Of particular interest is the case when an agent swaps rewards and risks associated with production with those associated with financial assets and liabilities.

> ***The economic owner of an entity such as goods and services, natural resources, financial assets and liabilities is the institutional unit which is entitled to claim the rewards associated with the use of entity in the course of an economic activity by virtue of accepting the associated risks.***

Every entity has both a legal owner and an economic owner, though in many cases, the economic owner and the legal owner of an entity are the same. Where they are not, the legal owner has handed responsibility for the risk involved in using the entity in an economic activity to the economic owner along with associated rewards. In return the legal owner accepts another package of risks and rewards from the economic owner.

When government claims legal ownership of an entity on behalf of the community at large, the rewards also accrue to the government on behalf of the community at large. Thus government is both the legal and economic owner of these entities.

The rewards inherent in financial assets and liabilities are seldom transferred from a legal owner to an economic owner in exactly the same state. They are usually transformed to new forms of financial assets and liabilities by the intermediation of a financial institution which assumes some of the risk and rewards while passing the balance on to other units.

Defining assets and the asset boundary

Leading on from the above it is possible to rephrase the definition of an asset, but not the substance of the definition.

The definition of an asset

> ***An asset is an entity from which the economic owner can derive a reward or series of rewards in future accounting periods by holding or using the entity over a period of time.***

All assets in the System are economic assets. Attributes such as reputation or skill which are sometimes described in common parlance as an asset, are not recognised as such in the System because they are not economic in nature in the sense described under ownership.

The asset boundary

Assets in the System are partitioned into financial and non-financial assets. Non-financial assets are further subdivided into those which are produced and those which are non-produced. The only assets included in the asset boundary of an economy are those whose economic owners are resident in the economy. Entities which are physically situated in an economy but are owned by non-residents are excluded; those which are physically situated in the rest of the world but owned by residents are included in the asset boundary.

All assets appear on the balance sheet of the economy. This, together with the requirement that they entail future rewards, implies that all assets can be represented by a monetary value. This value represents the market's view of the total of the rewards embodied by the asset. Where a direct market view of this value s not available, it must be approximated by other means. (discussed elsewhere)

Produced non-financial assets come into being via the production process or as imports. Two exceptions exist. Historical monuments are included as produced assets even though they may have been constructed long before economic accounts existed. Occasionally a monument may be newly recognised as having value and thus enter the asset boundary as a produced asset other than through a current production process. Similar arguments apply to artefacts treated as valuables. Produced non-financial assets leave the asset boundary by being exhausted or by being sold to resident units which will not continue to use the asset in production as a source of future rewards or by being sold to non-resident units.

Non-produced non-financial assets are of two types, natural resources and legal constructs. (Terminology to be reconsidered especially legal constructs). *The borderline for which natural resources are considered assets and which are not depends on a number of factors* . (More text to follow along the line of para 10.10 to 10.12). *Legal constructs come into being because a unit responsible for the development of an asset can legally control access to the asset, and those acquiring access rights acquire a set of rewards which qualify in turn as an asset*. (This to be amended/enlarged upon depending on discussions on this point. The question of whether and why to exclude government's right to levy taxes as an asset to be covered.) *Legal constructs leave the asset boundary when the conditions restricting access are lifted or when there is no longer a reward to be earned from having restricted access to the asset.*

Financial assets and liabilities come into being, sometimes for an indefinite period but often for a fixed term, by agreements which are not necessarily legal in themselves but which are legally enforceable between two units whereby one unit provides funds to another. (More along the lines of 10.4 and 10.5) *Financial assets and liabilities cease to exist when there is no longer a commitment for one unit to provide funds to the other. All extant financial claims and liabilities including a resident unit are included in the asset boundary and appear on the economy's balance sheet.*

Consumer durables are not regarded as assets in the system because the services they provide are not within the production boundary. Because the information on the stock of durables is of analytical interest, though, it is suggested that this information appear as a memorandum item in the balance sheet but not be integrated into the totals of the table.

Human capital is not treated by the System as an asset. Although such attributes as skills command rewards, and can be enhanced, these rewards cannot be sold to another unit or even necessarily retained in the unit where the skills were acquired. This is another area where supplementary information would be useful to analysts.

Other issues

Related issues which would need to be adjusted if the above suggestions are accepted are

The distinction between operating and financial leasing (basically that if the production risk is passed to another unit, this should be a financial lease; if it retained by the legal owner it is an operating lease);

The distinction between rent, rentals and sale (this will depend also on the discussion on leases).

Tidying up terminology

The following is proposed (and partly subsumed above).

Ownership rights - replace by ownership

Environmental assets – make reference to the meaning in SEEA, explain it is not used in SNA

Benefits – replace by rewards

Naturally occurring assets, natural assets – replace by natural resources

Economic asset – replace by asset