

Borderline between transfers and purchases of goods/services for transactions between government units

Introduction

1. The aim of this GFS interpretation is to provide guidance on the borderline between current transfers within general government (D.73) and payments for services (P.1/P.2) when there are transactions between two government units. This GFS interpretation also provides guidance on recording when one government unit pays another government unit to provide social transfers in kind to households.

References in ESA 2010, 2008 SNA and MGDD

Institutional units

2. ESA 2010 paragraph 2.12 defines an institutional unit as *“an economic entity characterised by decision-making autonomy in the exercise of its principal function”*.
3. In the ESA 2010 framework, 'output produced for own final use' (P.12) is recorded for all institutional sectors, including general government. ESA 2010 paragraph 1.69 also covers output for own intermediate consumption within the same institutional unit. This should be recorded in the system insofar as it occurs between different local kind of activity units (KAUs).
4. ESA 2010 paragraph 3.15 explains that such flows should be shown: *“When an institutional unit contains more than one local KAU, the output of the institutional unit is the sum of the outputs of its component local KAUs, including outputs delivered between the component local KAUs.”*
5. For general government, this is particularly relevant where public entities are classified to the general government sector as a result of failing the criteria for being an institutional unit. In this case, the public entity can be classified as a local KAU and we have then commonly the situation where one local KAU may provide a good or service (P.1) to another local KAU (which consumes that service as intermediate consumption, P.2) within the same institutional unit.

Principal party recording

6. ESA 2010 paragraph 1.78 instructs that *“When a unit carries out a transaction on behalf of another unit (the principal) and is funded by that unit, the transaction is recorded exclusively in the accounts of the principal.”*

Consolidation

7. ESA 2010 paragraph 1.107 states that *“As a matter of principle, flows and stocks between constituent units within subsectors or sectors must not be consolidated”*. However, ESA 2010 paragraph 1.108 explains that *“consolidated accounts may be built up for complementary presentations and analyses.”* In addition, general government accounts are commonly presented on a consolidated basis according to ESA 2010 paragraph 20.153.
8. ESA 2010 paragraph 20.155 explains that while consolidation of general government accounts should in principle apply to all flows and stocks, practical considerations need to be taken into account, notably for the production account, where consolidation may be difficult or impossible. ESA 2010 paragraph 20.157 further explains that *“Purchases/sales of goods and services between government units are not consolidated in the ESA”*, notably because sales and intermediate consumption are valued differently. Furthermore, output does not formally have a

counterpart sector, as distinguished from sales and purchases, as output is actually balanced through changes in inventories (internal to the unit).

9. Hence where such consolidated presentations of government accounts are produced, the degree of consolidation is restricted to selected transaction categories - property income (D.4), other current transfers (D.7) and capital transfers (D.9) as well as the financial accounts and balance sheets (ESA 2010 paragraph 20.156). Thus, transactions recorded as purchases of goods and services between government units are not consolidated in the GFS presentation.
10. As a result, any decision on the nature of transactions internal to general government (as either a purchase or a current transfer) thus impacts the level of consolidated general government total revenue and expenditure, sometimes for large amounts.

Borderline between purchases of goods/services and current transfers

11. ESA 2010 paragraph 1.71 explains that the provision of goods/ services for money is a requited transaction ('something for something') whereas "*unrequited transactions are payments in cash or in kind from one institutional unit to another without counterpart*" ('something for nothing'). These "*unrequited transactions are called transfers.*"
12. ESA 2010 does not contain a specific section on the distinction between purchases and current transfers but indirectly addresses this borderline in some paragraphs. For private non-profit institutions serving businesses (market producers classified as S.11 or S.12), ESA paragraph 3.35 describes that the "*[...] subscriptions are treated not as transfers but as payments for services rendered, i.e. as sales. [...]*". In contrast, for non-profit institutions serving households (non-market producers) such subscriptions are recorded as transfers, the definition of D.751 in ESA paragraph 4.125 describing that "*current transfers to NPISHs include all voluntary contributions (other than legacies), membership subscriptions and financial assistance which NPISHs receive from households (including non-resident households) and, to a lesser extent, from other units.*" Accordingly, the sale/transfer borderline seems in this case related to the type of units that the producer serves.
13. ESA 2010 paragraph 3.36 contains one illustrative example on the distinction between sales and current transfers (including within general government): "*In applying the criterion [...] of private or public NPIs, including in sales [...] all the payments linked to volume of output may be misleading in some specific cases. This can be the case, for example, in relation to the financing of private and public schools. Payments by general government can be linked to the number of pupils but be the subject of negotiation with general government. In such a case, those payments are not recorded as sales, although they may have an explicit link with a measure of the volume of output, such as the number of pupils. This implies that a school mainly financed by such payments is a non-market producer.*" This is an illustration that, for a service flow to be considered to exist, its volume should be reasonably clearly defined.
14. ESA 2010 paragraph 3.88 defines intermediate consumption as consisting of "*goods and services consumed as inputs by a process of production, excluding fixed assets whose consumption is recorded as consumption of fixed capital. The goods and services are either transformed or used up by the production process.*"
15. Current transfers within general government (D.73) are described in ESA 2010 paragraphs 4.118 to 4.120. These paragraphs distinguish the recording of D.73 from principal party recognition: "*[...] Current transfers within general government (D.73) do not include transactions on behalf of another unit; these are recorded only once in the accounts, in the resources of the beneficiary unit on whose behalf the transaction is made (see paragraph 1.78) [...]*". This applies notably for cases of agencies collecting taxes on behalf of another government unit.
16. ESA 2010 paragraph 4.126c specifically states that current transfers to NPISH (D.751) includes "*assistance and grants from general government [...]*". These are examples of transfers from one non-market producer to another non-market producer, which the system treats as transfers.

Borderline between subsidies on production and current transfers

17. The recording of subsidies is another example of where ESA considers the economic behaviour by the unit involved when deciding on the nature of the transaction as a subsidy or a transfer.
18. ESA 2010 paragraph 4.36 specifies that non-market producers “*can receive other subsidies on production only if payments from general government depend on general regulations applicable to market and non-market producers as well.*”
19. This is complemented by ESA 2010 paragraph 4.38b, which explains that “*current transfers between different parts of general government in their capacity as producers of non-market goods and services, except other subsidies on production (D.39) [...] are recorded as current transfers within general government (D.73).*”
20. MGDD 1.2.4.3 paragraph 52, on the quantitative market/ non-market test, reads “*payments made to a producer irrespectively of the actual amount of tickets sold to final users, under the form of a global lump sum to cover operating deficit resulting [from] the insufficient coverage of costs by pricing, would not be added to the sales for the 50% criterion*” and “*any subsidy for which the total amount to be paid has been fixed ex-ante (possibly already partially or totally paid before the whole activity has been carried out) – generally in the context of global budget negotiations focusing on factors such as maintenance of buildings, investment in technical equipment, payment for compensation of employees, etc. – must not be considered as ‘sales’ when applying the 50 % criterion*”.¹ Thus, any kind of lump-sum payments to cover costs are not sales.

Final consumption expenditure

21. ESA 2010 Table 3.2 indicates that government individual consumption (P.31) is equal to social transfers in kind (D.63). Therefore, irrespectively of whether social transfers in kind are procured from market (D.632) or non-market (D.631) producer units, any such transfers in kind must be recorded as government individual consumption expenditure.

Social transfers in kind

22. Social transfers in kind (D.63) are shown in *account II.3, the redistribution of income in kind account*. D.63 is the transaction that moves disposable income (B.6) to adjusted disposable income (B.7). *Account II.4.2, use of adjusted disposable income account* describes the transition from B.7 to saving (B.8) mainly via actual final consumption (P.4)².
23. An alternative presentation is in *account II.4.1, use of disposable income*, which moves directly from balancing item disposable income (B.6) to saving (B.8) mainly via final consumption expenditure (P.3).
24. The need for these alternative presentations is explained, particularly, in 2008 SNA paragraphs 8.141 to 8.144. In essence, the reasons for government to provide individual services to households can be linked either to economies of scale or to government exercising a normative purpose: to ensure that households consume these particular services, to ensure the quality of the services, or to ensure a relatively low price. Thus, while households consume both goods and services that they choose freely in addition to those provided to them via social transfers in kind, nonetheless the goods and services freely chosen by households and the service provided via social transfers in kind differ in the underlying demand frameworks.
25. ESA 2010 paragraph 4.109 explains that “*Social transfers in kind (D.63) are subdivided into: Social transfers in kind – general government and NPISHs non-market production (D.631) [...] individual goods and services provided directly to the beneficiaries by non-market producers [...] Social transfers in kind – market production purchased by general government and NPISHs (D.632) [...] in the form of reimbursements by social security funds of approved expenditures made by households on specific goods or services; or provided directly to the beneficiaries by*

¹ See also ESA 2010 paragraph 4.30 and 4.36.

² See for example ESA 2010 chapters 8 and 24, as well as ESA 2010 paragraph 3.101 on individual consumption of households (P.41).

market producers from which general government purchases the corresponding goods and services [...]"

26. ESA 2010 paragraph 4.111 explains that: "[...] *Social transfers in kind (D.63) are recorded:*
 (a) *among uses in the redistribution of income in kind account of the sectors granting the benefits;*
 (b) *among resources in the redistribution of income in kind account of households. [...]*"

Discussion of the issue

27. The classification of transactions between government units as purchases or current transfers has an impact on the levels of government revenue and government expenditure in the GFS presentation (see ESA 2010 paragraphs 20.68-20.104), which is shown consolidated. As explained in the previous section, purchases/sales (or to be more exact: the production accounts) are however not consolidated in this presentation, whereas current transfers are consolidated. Due to differing impact of recording transfers and recording payments for services on key GFS aggregates such as total revenue and total expenditure, as well as on output and intermediate consumption and on COFOG, a uniform application of the distinction between transfers and payments for services needs to be ensured, including for borderline cases.
28. The conceptual difficulties with a consolidation of the production account are mainly: in determining the counterpart transactor and in different valuations (basic and purchaser prices, respectively) used for output and intermediate consumption (ESA 2010 paragraph 20.157).
29. While transfers are generally unrequited payments and purchases of services are required (ESA 2010 paragraph 1.71), a simplistic approach of only considering whether a service is provided or not is insufficient here to determine the correct classification. In particular, the 'something for something' criteria cannot be interpreted as 'anything for something', because the good/service and the cash paid (or other consideration provided) should in principle be of equal value, if the payment is required. Otherwise or alternatively, a partitioning of the transaction may need to be envisaged.
30. While ESA 2010 does not explicitly describe the specific case of distinguishing between transfers and sales within general government units, the key distinction between sales and other current transfers is described at a more general level in ESA.
31. Current transfers within general government are described in ESA 2010 paragraphs 4.118 to 4.120. Aside from the general definition, and exceptions related to taxes, no further examples of what to include in current transfers within general government (D.73) are given.
32. In the ESA 2010 framework, 'output produced for own final use' is recorded for all institutional sectors, including general government (see for example ESA paragraph 1.69). ESA paragraph 1.69 also covers output for own intermediate consumption within units. These should be recorded in the system, insofar as they are between different local KAUs, but not if these are merely events within a same local KAU. For general government, this is relevant where public entities are classified to the general government sector because they fail the criteria for being an institutional unit.
33. ESA 2010 paragraph 3.36 on the financing of non-market government schools gives a first rule for the borderline between sales and current transfers: payments by general government that are the subject of negotiation within general government are not sales, even when they have an explicit link with a measure of the volume of output. In the case of schools, if there is negotiation, the payment made is neither intermediate consumption nor a subsidy on production. It must therefore be classified as a current transfer within general government. MGDD 1.2.4.3 paragraph 52, which discusses sales in the context of the quantitative market test, also guides that amounts paid that have been fixed *ex ante* in the context of budget negotiations are not considered to be sales.
34. It is possible that government payments to non-market entities could be subsidies on production,

although ESA 2010 paragraph 4.36 restricts such subsidies to cases where there are general regulations that also apply to all relevant market and non-market producers alike. When there are no such general regulations, these payments are recorded as current transfers within government. By analogy, it can be hypothesised that purchases of goods/services within general government should also only be recorded in cases where the purchase transactions actually are, or can be in a material manner, equally made from market producers in a similar fashion.

35. As a first summary, based on the elements discussed so far, for the payments between government units to be considered as purchases the amount paid must depend on the volume of output produced rather than cost of production, not subject to negotiation, and there should be or could be similar sales transaction made to/from other market producers, the latter indicating the existence of a market price. Examples could be purchases of health services (see MGDD 1.2.4.6 on public hospitals) or purchases of transport services. Complementing this, any amounts determined *ex ante* in the context of budget negotiations should be recorded as current transfers between government units.
36. Payments made by non-market producers to other non-market producers may lack a market price, since we should not expect a non-market producer to always charge one. Therefore, the price paid may possibly have more of the features of a current transfer than a purchase. Payments for non-market output (P.131) are therefore generally expected to be made by market producers or households or at least similar payments should exist between a market and a non-market unit (see wording "if any" in ESA 2010 paragraph 20.30).
37. The idea that sales generally involve a market producer is also consistent with the notion that subscription³ revenue of private NPI serving businesses paid by market producers are recorded as sales (ESA 2010 paragraph 3.35) while subscription revenue of NPI serving households are regarded as transfers (ESA 2010 paragraph 4.125).
38. A payment can only be considered a subsidy on production if it meets the conditions in ESA 2010 paragraph 4.36, i.e., it is based on general regulations applicable to all producers (both market and non-market) providing that good/service. This in itself is sufficient to generally preclude the recording of a subsidy on production in the case of bilateral negotiations between units. Following a similar logic, the recording of a purchase can only be considered if the government entity purchasing decides on the basis of prices charged by both market and non-market producers. In this case such a service or good could also have been provided by a market producer on similar terms.
39. In summary, payments between government units are recorded as current transfers within general government (D.73) where at least one of the following conditions holds (each one being sufficient by itself):
- the amounts are based on the cost of production, rather than the output produced;
 - the amounts are determined *ex ante* such as being the subject of a legislative negotiation (budget);
 - there are no similar payments to private or public sector market producers;
 - where the payment is the principal funding source for the recipient government unit (further discussed below).
40. The introduction of the fourth criterion related to the payment being the "principal funding source" ensures a similar treatment to some cases where payments to other units outside government would also be treated as other current transfers (D.751) despite being volume-based, e.g., those to private non-market schools (NPISH) according to ESA 2010 paragraph 3.36.

³ Subscription or contributions, e.g. for membership

The case of a government unit purchasing from another government unit to provide social transfers in kind

41. Government may provide social transfers in kind to households either via market or non-market producers. As a result, social transfers in kind (D.63) has two sub-categories, which may be described as those provided directly by non-market producers, i.e., general government or NPISH (D.631), and those provided through market production that is purchased by the non-market producers on behalf of the household beneficiaries (D.632). Thus, ESA 2010 paragraph 4.109 foresees two types of social transfers in kind: a non-market producer providing the services directly, or a market producer providing the services and the non-market producer purchasing it. The case of a non-market producer purchasing services related to social transfers in kind from another non-market producer is not explicitly foreseen, such that one needs an interpretation of the rule to follow.
42. Recognising a purchase/sale relationship between government units when providing a social transfer in kind to households implies that there must be a production process by the unit financing the social transfer in kind in addition to the production of the supplier. The purchase within general government option is then reflected in intermediate consumption in the accounts of the financing unit that thus records the social transfer in kind (D.631).
43. Whether procured from market or non-market producers, if recorded as purchases of services related to social transfers in kind, the payment must also be recorded as government individual consumption expenditure (P.31). In the case of one government unit providing the service (supplier) and another government unit (financing) purchasing it, the question is whether the D.631 and P.31 should be recorded in the paying or alternatively in the supplying government unit (depending on whether the payment can be seen as a sale or a transfer respectively). In case the payment is seen as a sale, the recording would imply payments for non-market production (P.131) of the supplying government unit and intermediate consumption (P.2) and D.631/P.31 of the paying unit. When not considered a sale, it constitutes a current transfer (D.73) between the two government units, with D.631/P.31 reflected in the supplying unit.
44. One argument for recording a purchase would be that the paying government unit is buying a service as an input to producing social transfers in kind, i.e. that there is a transformation. When government pays others, such as market producers, to provide goods and services used as an input to a productive activity, it is recorded as a purchase and there does not seem to be a basis for considering such payments as transfers merely because the seller is non-market. In particular, where such payments for a service or good are dependent on the volume of output produced and these services or goods could equally be purchased from market producers on the same terms, this may be an indication that the payments should be classified as sales. An example is if a general government unit pays another government unit for the printing of its books. For a transformative activity (production) to occur, the paying government unit should have other costs associated with the production.
45. When, instead, the paying government unit is responsible for the provision of goods or services that have the nature of social transfers in kind to households, it can theoretically choose to do so in a number of ways: a/ own-account production, b/ purchase from a market producer or c/ delegation to another non-market unit in government. In the case of a purchase from a market producer, no P.2 is recorded in the paying government unit (instead, D.632 is recorded). It would thus be unjustified to record in the third case a P.2 in the paying government unit only because the delegated producer is non-market. This is because in both cases (b and c) the paying government unit, seen as a purchaser, does not sufficiently transform the good/service provided.
46. There are also other arguments to consider that the payment between the two government units constitutes (nearly always) a transfer and hence to record the individual consumption and transfer in kind in the accounts of the supplying unit. When government pays another government unit (or NPISH) to provide a social transfer in kind, it is for the benefit of households (ESA 2010 paragraph 4.108). As the ultimate recipients are households and not the government unit paying, the intra-government transaction is just a link in the chain of the provision of a social benefit,

which ESA paragraph 1.71 considers is an 'unrequited' payment.

47. This is explicitly described for transactions between general government and NPISH (ESA 2010 paragraph 4.126c): "*assistance and grants*" from general government to NPISH are indeed recorded as other current transfers. While it could be argued, to justify this, that "*assistance*", in this context, is presumably 'unrequited' and hence cannot comprise purchases, in addition, recording payments for non-market output (P.131) rather than transfers (D.75) might then imply a classification outside the NPISH sector insofar as payments for non-market output are considered sales⁴ (which is presumably not intended and would be in contradiction with ESA 2010 paragraph 3.36).
48. The only difference between NPISH and general government units is public control, for activities in which both public and private non-market producers can be active. As such, given that payments by general government to NPISH are part of other current (or capital) transfers, it is difficult to justify treating differently payments between government units when they have the same nature.
49. Cases in point are examples where, for some services forming part of individual consumption expenditure of a government unit, there is likely to be no market alternative. In many countries, this is the case of rescue services, for example. If the service suppliers are not controlled by general government, they will probably be classified as NPISH (S.15). According to the definition of current transfers to NPISH (D.751) in ESA 2010 paragraph 4.126c, assistance and grants from general government (which are not to finance capital expenditure) are part of D.751. If such rescue services were supplied by government while financed by another government unit, the financing should be recorded as D.73 by analogy to ESA 2010 paragraph 4.126c.
50. Therefore, it can be argued that the payment of the financing government unit does not relate to intermediate consumption used as an input in the production process of the paying unit. Furthermore, the recording of intermediate consumption implies "*the goods and services are either transformed or used up by the production process*" (ESA 2010 paragraph 3.88) of the paying government unit. As the good or service is delivered directly by the supplying government unit to the household, it should be argued that such a production process does not take place at the paying government unit.
51. Also, recording a purchase would inflate government revenue and expenditure as well as output without sufficient justification.

Conclusions on the recording in government finance statistics

52. This GFS interpretation guides on two matters: the borderline between the recording of purchases between government units and current transfers; and the recording of social transfers in kind when a government unit purchases such services from another government unit.

Borderline for purchases between government units and current transfers

53. Payments between government units are recorded as current transfers within general government (D.73) where at least one of the following conditions holds (each one being sufficient by itself):
- the amounts are based on the cost of production, rather than the volume of output produced;
 - the amounts are determined *ex ante* such as being the subject of a legislative negotiation (budget);
 - there are no similar payments to private or public sector market producers;

⁴ It is also debatable whether payments for non-market production should be part of sales if they constitute the majority of output (ESA 2010 paragraph 3.24).

- where the payment is for a good/service that is a social transfer in kind, if this amount is the principal funding source for the recipient government unit.
54. Payments between government units where at least one of the aforementioned conditions holds are neither genuine purchases of goods or services nor other subsidies on production. Rather they depend on the division of responsibilities between different units in general government, which is determined by the legal structure and resulting distribution of government funds in every country.
55. Current transfers between different levels of government (D.73) should then be recorded unless the payment results from holding assets (D.4) or relates to fines, compensation or penalties (D.75) or has the nature of a capital transfer (D.9).
56. Payments between government units are recorded as purchases of services (i.e., a sale for one unit and intermediate consumption for the other) where both the following conditions hold (sufficient conditions):
- the amount paid depends on the volume of output produced, are not determined *ex ante*, and does not constitute the principal funding source of the supplying unit; and
 - there are similar payments to private or public sector market producers (e.g., private hospitals, social transfers in kind related to transport).
57. Unrequited payments from one general government unit to another could be recorded as other subsidies on production (D.39) in the case where the payments depend on general regulations applicable to market and non-market producers alike, so where there are similar payments to market producers (e.g., private hospitals, transport providers of social transfers in kind), unless one of the last three conditions to consider it as a current transfer within general government (D.73) holds (paragraph 53).

Recording of social transfers in kind when two government units are involved

58. When a government unit supplies a social transfer in kind (D.631) that is financed by another government unit, the social transfer in kind must be recorded as individual final consumption expenditure (P.31) either of the supplying unit or of the financing unit.
59. There are hence two recording cases, depending on whether the payments meet the conditions for being considered a general sale of the supplying unit or not (see paragraphs 53 and 56).
60. The first case relates to when the criteria to be a current transfer are met. The paying unit records a transfer expenditure (D.73) to the service supplier. The service supplier records non-market output (P.132) and the social transfer in kind (D.631, P.31). In terms of COFOG allocation, this implies the recording of individual consumption expenditure in the accounts of the service supplier. Hence, in the service supplier's accounts, an amount equal to the social transfer in kind must be recorded within an 'individual' COFOG group. This case is expected to be the most prevalent case as no transformative production process typically takes place by the financing unit.
61. The second case relates to when the criteria to be a purchase are met. The paying unit records intermediate consumption (P.2) as an input to a production process (P.132) equal to the social transfer in kind (D.631, = P.31). The unit supplying the services incurs production costs and receives a payment for output (P.1), usually non-market output (P.131).
62. In consequence, the government unit where the individual final consumption expenditure (P.31) and social transfer in kind (D.631) is recorded changes, depending on whether a transfer or a sale is recorded.

Illustration/T-accounts

The following T-accounts illustrate the two cases for social transfers in kind described above. In all cases, the service provided to the household (S.14) is of value 80, with the payment between the government (S.13) units being in cash for the same amount and taking place in the same period that

the household receives the transfer in kind (for example a transport journey). The first government unit is the one that supplies the service (for example a transport operator) and is labelled as the 'supplier'. The second government unit is the government unit that finances the operation by paying the supplier'. For simplicity we assume that the only production costs associated with providing the service are wages and salaries (D.1).

Case 1 illustrates the case where the government payment to the government unit that provides the social transfer in kind meets the criteria to be recorded as a current transfer (a D.73 transfer from the main unit to the supplier). Here, the social transfer in kind (D.631) to the household is recorded as made by the supplier, the household again recording the actual final consumption expenditure (P.4). In the production account, the supplier records other non-market output (P.132).

Case 2 illustrates the case where the payment by the financing unit to the government supplier of the social transfer in kind meets the criteria to be recorded as a purchase. A payment for non-market output (P.131) is recorded as a resource for the supplier, which is intermediate consumption (P.2) of the main unit. This financing government unit makes the social transfer in kind (D.631) to the household, which has actual final consumption expenditure (P.4).

In both cases, the government unit making the social transfer (D.631) also records individual consumption expenditure (P.31) in the alternative presentation (use of disposable income account).

Case 1: The payment meets the criteria to be a current transfer

S.13 supplier				S.13 financing unit				S.14 household			
U		R		U		R		U		R	
D.1	80	0	P.131						80	D.1	
D.631(=P.31)	80	80	P.132						80	D.631	
		80	D.73	D.73	80						
P.4	0			P.4	0			P.4	80		
B.9	0			B.9	-80			B.9	80		
F.2	+80-80			F.2	-80			F.2	80		

Case 2: The payment meets the criteria to be a purchase

S.13 supplier				S.13 financing unit				S.14 household			
U		R		U		R		U		R	
D.1	80	80	P.131	P.2	80				80	D.1	
				D.631(=P.31)	80	80	P.132		80	D.631	
				P.4	0			P.4	80		
B.9	0			B.9	-80			B.9	80		
F.2	+80-80			F.2	-80			F.2	80		