Australian Bureau of Statistics

1218.0.55.002

Information Paper

Implementation of the Market/Non-Market Boundary in ABS Statistics

Australia

2009

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AUSTRALIAN BUREAU OF STATISTICS

EMBARGO: 11.30AM (CANBERRA TIME) THURS 14 MAY 2009

ABS Catalogue No. 1218.0.55.002

Produced by the Australian Bureau of Statistics

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CONTENTS

page

CHAPTERS

APPENDICES

PREFACE

The ABS released the Discussion Paper: Proposed Standard Economic Sector Classifications of Australia (SESCA), (Cat.no.1218.0.55.001) in March 2009. This paper outlined the proposed revisions to the existing SESCA, which aligns as far as possible with the revisions to the System of National Accounts as reflected in the System of National Accounts, 2008 (SNA08).

The SESCA will be published as the Australian Standard in June 2009 and the ABS is specifically seeking user views on the application of the market/non-market definition presented in Chapter 3 of the discussion paper. This information paper clarifies how both Not-for-profit institutions (NPIs) and Public sector units that receive income from both sales and transfers should be classified.

The market/non-market boundary has not changed conceptually for SNA08, however the issue has been further articulated in the latest edition. SNA08 is not prescriptive with regards to the practical application of the boundary and allows for different operational treatments across countries. In implementing the Australian standards articulated in SESCA, the ABS aims to operationalise the market/non-market threshold in the Australian context.

Two options for distinguishing between market and non-market operators are presented in this paper. The first option defines market operators as those recovering more than 50% of their production costs through sales. The second option defines market operators as those recovering more than 90% of their production costs through sales.

The ABS notes that the 90+% cost recovery threshold is more consistent with the concepts articulated in SNA but is cognisant that there may be some pragmatic considerations that would make the 50+% cost recovery threshold the preferred option.

Feedback is sought on the preferred option of users and the impact that this preferred option may have on the use of statistical classifications or data compiled on this basis.

The ABS will be using feedback from stakeholders to make an on-balance decision for the final version of the SESCA which is due for release in June 2009.

Users are invited to comment on this Information Paper by 10 June 2009.

Written submissions should be forwarded to <economic.classifications@abs.gov.au>. Further information and queries on this paper should be directed to Jenny Foster, Standards and Classifications, telephone (02) 6252 6634 or email: <jenny.foster@abs.gov.au>.

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ABBREVIATIONS

GFCE	government final consumption expenditure
GFS	Government Finance Statistics
GOS	gross operating surplus
HFCE	household final consumption expenditure
NPIs	non-profit institutions
NPISH	non-profit institutions serving households
PFC	public financial corporations
PNFC	public non-financial corporations
SNA	System of National Accounts

INTRODUCTION

BACKGROUND

The market/non-market boundary is used in the classification of institutional units to sectors. The current definition of units operating in the market is described in SESCA 2002. It states the criterion for market operators to be the generation of sufficient revenue to cover the costs of production, and this is consistent for NPIs and public sector units.

This criterion effectively constitutes a 100% cost recovery as the concept underpinning market production in SESCA 2002. However, despite the conceptual basis for determining market/non-market outlined in SESCA 2002, practical requirements in statistical processing areas led to variations in the application of this concept.

SNA08 describes market production in the following manner:

> "Fundamental to the distinction between corporations and government is the basis on which production is undertaken. Corporations produce for the market and aim to sell their products at economically significant prices. Prices are said to be economically significant if they have a significant effect on the amount that producers are willing to supply and the amounts purchasers wish to buy. These prices normally result when the producer has an incentive to adjust supply either with the goal of making a profit in the long run (or at a minimum, covering capital and other costs) and consumers have the freedom to purchase or not purchase and make the choice on the basis of the prices charged" (System of National Accounts 2008, 4.18)

Market operators produce outputs for the market and aim to sell their products at economically significant prices. Economically significant prices are determined by assessing the price charged for an individual product, whereas the market/non-market classification is applied to units. Units may produce numerous products which are sold on differing price bases. SNA and statistical agencies have used the ratio between sales income[1] and production costs[2] to determine whether the unit is charging economically significant prices and is therefore operating in the market.

Sales income includes government funding provided on a volume or fee for service basis. This recognises the changes in the delivery of government services. Services once provided directly by governments are being contracted out to other service providers including NPIs. Currently the ABS provides no guidance to the treatment of these transactions and SESCA 2008 provides this guidance.

The text in SNA08 allows for different interpretations of the ratio to be applied in determining market and non-market activity by statistical agencies. Two groups of units are affected:

- NPIs; and
- Public sector units with market activity.

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1 Sales income excludes taxes applicable to the products

2 Production costs are the sum of intermediate consumption, compensation of employees, consumption of fixed capital and other taxes on production

MARKET/NON-MARKET THRESHOLD

IMPACT ON STATISTICS

The identification of a unit as either a market or non-market operator has an impact on:

1. classification of institutional units;
2. valuation of output; and
3. calculation of consumption expenditure.

The clarification of the market/non-market boundary will change the classification of some institutional units. This in turn will impact on the statistics compiled on an institutional sector basis. For example, where the classification of public sector units changes from the Corporations sectors to the General Government sector or vice versa, there would be some impact on the composition of these sectors in the relevant jurisdictions. Consequently this will impact on the compilation of Government Finance Statistics (GFS), as well as the levels of some key outputs such as net operating balance, net lending/borrowing, and net worth.

Treasuries in each jurisdiction classify government transactions using the Source/destination classification (SDC) which records the institutional sector of the unit for which revenues are receivable or to which expenses are payable. As a result, the market/non-market boundary will have an impact on the recording of the institutional sector of the counterparties for these transactions.

Output values are used in the derivation of key macroeconomic aggregates such as Value Added and Gross Operating Surplus (GOS). Different methods are used for valuing the output of market and non-market operators. Output for market operators is valued on the basis of sales, whereas output for non-market operators is valued on the basis of production costs. As a result, units that change classification will have their output valued on a different basis and this will impact on estimates of Value Added and GOS.

Consumption expenditure statistics will be impacted by the clarification of market income and particularly sales income. The size of this impact is dependent upon how jurisdictions are currently reporting transactions between Government units and public sector corporations and NPIs. For example, if jurisdictions are already treating transactions as sales rather than transfers where appropriate, the impact will be minimal. Government grants to NPIs classified to the Not-for-profit Institutions Serving Households (NPISH) sector are transfer expenses and are treated as Household Final Consumption Expenditure (HFCE), whereas government purchases of services are treated as Government Final Consumption Expenditure (GFCE). It is estimated that this change could cause a movement at the Australian level from HFCE to GFCE.

Regardless of the cost recovery threshold adopted, temporary fluctuations based on minor shifts in transfers will not be reflected in the unit's sector classification. Resistance factors will be applied which reduce 'flipping' of units between sectors from year to year. This will ensure that any changes in classification reflect relatively permanent changes in the function of the business. Any relatively minor changes to a unit's cost recovery ratio which puts it above or below the chosen threshold must remain in place for a minimum of two years before sectoral classification changes can be applied.

50+% COST RECOVERY THRESHOLD

This option defines market operators as those that recover more than 50% of the costs of production through sales. This is known as the 50+% cost recovery threshold.

SNA describes non-market operators as those that 'rely principally on funds other than receipts from sales to cover their costs of production or other activities' (System of National Accounts 2008, 4.90).

Chapter 22 of Volume 2 of SNA08 explicitly associates market production with the recovery of at least half of the production costs through sales:

> "Although there is no prescriptive numerical relationship between the value of output (excluding both taxes and subsidies on products) and the production costs, one would normally expect the value of goods and services sold (the sales) to average at least half of the production costs over a sustained multi-year period." (System of National Accounts 2008, 22.29)

The adoption of a 50+% cost recovery threshold impacts the sector classification of institutional units. It is anticipated that the classification of many NPIs would change from the Not-for-profit Institutions Serving Households (NPISH) sector to the Corporations sectors. The impact on public sector units would be smaller. The introduction of the 50+% threshold may necessitate a review of the existing Public Financial Corporations (PFCs) and Public Non-Financial Corporations (PNFCs) and a net movement of some units from the Corporations sectors to the General Government sector.

The adoption of the 50+% cost recovery threshold would ensure international comparability with statistical agencies including those in the European Union. While international comparability of such a concept is a desirable rather than necessary criterion of the practical implementation of SNA, maintaining comparability would enable users to more readily compare Australian statistics.

90+% COST RECOVERY THRESHOLD

This option defines market operators as those that recover more than 90% of the costs of production through sales. This is known as the 90+% cost recovery threshold.

The SNA states that market units operate "with the goal of making a profit in the long run (or at a minimum, covering capital and other costs)". (System of National Accounts 2008, 4.18) This statement would require that market units should recover 100% of their costs, which is consistent with the existing standard articulated in SESCA 2002.

SESCA is a classification of the long-term economic behaviour of units. Both NPIs and government units classified as market operators should behave in a similar way to corporations. Given that the objectives of corporations are to make profits, a higher threshold should lead to consistent behaviour.

Both the ABS and SNA08 recognise that a small amount of subsidisation can occur without affecting the behaviour of the unit. SNA08 also states that units "receiving substantial government financial support [...] will act differently from corporations" (System of National Accounts 2008, 22.32). Rather than blindly applying a 100% threshold, the ABS has allowed for a small amount of subsidisation leading to the 90+% cost recovery threshold.

The adoption of a 90+% cost recovery threshold would impact on the sector classification of institutional units. In comparison to the 50+% cost recovery threshold, the implementation of the 90+% cost recovery threshold would result in:

- more units classified to the NPISH sector;
- more units classified to the General Government sector; and
- less NPI and public sector units classified to the Corporations sectors.

SUMMARY IMPACTS

A comparison of the impacts of both cost recovery thresholds shows that under the 50+% cost recovery threshold there would be:

- 8,000 MORE employing units classified to SISCA 1009 Other Non-Financial Corporations than if the 90+% cost recovery threshold were to be adopted.
- 8,000 LESS employing units classified to SISCA 5000 Not-for-profit Institutions Serving Households (NPISH) than if the 90+% cost recovery threshold were to be adopted.
- $2.5 b LESS Net Value Added than if the 90+% cost recovery threshold were to be adopted.

The table in the Appendix highlights the differences to key economic aggregates and administrative processes under the two options.

CONSULTATION PROCESS

Users are invited to comment on this Information Paper by 10 June 2009.

Written submissions should be forwarded to <economic.classifications@abs.gov.au> and should include the preferred option of users and the impact that this preferred option may have on the use of statistical classifications or data compiled on this basis.

The ABS will be using feedback from stakeholders to make an on-balance decision for the final version of the SESCA which is due for release in June 2009.

APPENDIX SUMMARY IMPACTS

SUMMARY IMPACTS

	50+% Market Threshold	*90+% Market Threshold*
Number of PNFCs & PFCs	Higher	Lower
	Under this option more public sector units would be considered market and classified to the Corporations sectors. Less work would be required by the jurisdictions to change classification	Under this option less public sector units would be considered market and classified to the Corporations sectors. Additional work would be required by the jurisdictions to change the classification of current PNFC and PFC units. GFCE is likely to be higher in this option.
Number of private sector NPISH units	Lower	Higher
	Under this option more NPI units would be considered market and classified to the Corporations sectors. Under this option, GFCE will be lower depending on the number of units receiving government funding and the volume.	Under this option less NPI units will be considered market and therefore classified to the Corporations sector.
Training in Jurisdictions	Training is required under both options to implement the threshold in SDC coding	Training is required under both options to implement the threshold in SDC coding
GDP	Lower	Higher
	Under this option more NPI and Public sector units would be considered market and classified to the Corporations sectors. GDP for market units is valued on the basis of sales plus subsidies on production. Expect GDP to be slightly lower. Transfers from the household sector from donations and memberships are not considered part of output for market units. In contrast, these are represented in the output derivation for non-market units which is valued on a cost basis.	Under this option less NPI and Public sector units would be considered market and classified to the Corporations sectors. GDP for market units is valued on the basis of sales plus subsidies on production. Expect GDP to be slightly higher because more units will be classified to the NPISH and General Government sectors. GDP for these units is valued on a cost basis

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