SECTORAL CLASSIFICATION OF INSTITUTIONAL UNITS

The economy of a country is a system in which institutions and people interact through exchanges and transfers of goods, services and means of payment (e.g. money) for the production and consumption of goods and services. Units interacting with each other are economic entities capable of owning assets, assuming liabilities and engaging in economic activities and transactions with other units. Such units are known as institutional units.

Defining the institutional units serves various purposes. First, units are the essential building blocks in defining economies in geographical terms. Second, they are the essential building blocks for grouping units into institutional sectors. Third, they are essential for defining which flows and stocks should be recorded.

The units which constitute the economy of a country and whose flows and stocks are recorded are those which are resident. An institutional unit is resident in a country when it has its centre of predominant economic interest in the economic territory of that country. Such units are known as resident units, irrespective of nationality, legal form or presence on the economic territory at the time they carry out a transaction.

It is necessary to make a distinction between resident and non-resident units. The economy of a country consists of resident units. An institutional unit is considered resident when it has a centre of predominant economic interest in the economic territory of that country, regardless of nationality, legal form or presence at the time of the transaction.

Economic territory consists of the following:

(a) the area (geographic territory) under the effective administration and economic control of a single government;

(b) any free zones, including bonded warehouses and factories under customs control;

(c) the national air-space, territorial waters and the continental shelf lying in international waters, over which the country enjoys exclusive rights;

(d) territorial enclaves, being geographic territories situated in the rest of the world and used, under international treaties or agreements between states, by general government agencies of the country (such as embassies, consulates, military bases, scientific bases, etc.);

(e) deposits of oil, natural gas, etc. in international waters outside the continental shelf of the country, exploited by the resident units.

Economic territory excludes extraterritorial enclaves as well as the parts of the country’s own geographic territory used by the general government agencies of other countries, institutions and bodies of the European Union and international organisations under international treaties between states.

Centre of predominant economic interest indicates that within the economic territory of a country exists a location where a unit engages in economic activities and transactions on a significant scale, either indefinitely or over a finite but long period (a year or more). The ownership of land and buildings within the economic territory is deemed to be sufficient for the owner to have a centre of predominant economic interest there.

An **institutional unit** is an economic entity characterised by decision-making autonomy in the performance of its principal function. A resident unit is regarded as constituting an institutional unit if it has decision-making autonomy and either keeps a complete set of accounts or is able to compile a complete set of accounts.

To have autonomy of decision in respect of its principal function, an entity must be:

(a) entitled to own goods and assets in its own right and able to exchange the ownership of goods and assets in transactions with other institutional units;

(b) able to take economic decisions and engage in economic activities for which it is responsible and accountable at law;

(c) able to incur liabilities on its own behalf, to take on other obligations or further commitments and to enter into contracts; and

(d) able to draw up a complete set of accounts, comprised of accounting records covering all its transactions carried out during the accounting period, as well as a balance sheet of assets and liabilities.

If the entity does not possess the characteristics of an institutional unit, the following principles are applied:

(a) households are deemed to enjoy autonomy of decision in respect of their principal function and are institutional units nonetheless, even though they do not keep a complete set of accounts;

(b) entities which do not keep a complete set of accounts, and are not able to compile a complete set of accounts if required to do so, are not institutional units;

(c) entities which, while keeping a complete set of accounts, have no autonomy of decision, are part of the units which control them;

(d) entities forming part of a group of units engaged in economic activities and keeping a complete set of accounts are deemed to be institutional units even if they have partially surrendered their autonomy of decision to the central body (the head office) responsible for the general direction of the group; the head office itself is deemed to be an institutional unit distinct from the units which it controls.

Macroeconomic analysis does not consider the actions of each institutional unit separately - it considers the aggregated activities of similar institutions. Therefore, units are grouped into the institutional sectors, which are further divided into the subsectors.

Diagram 1 - Allocation of units to sectors

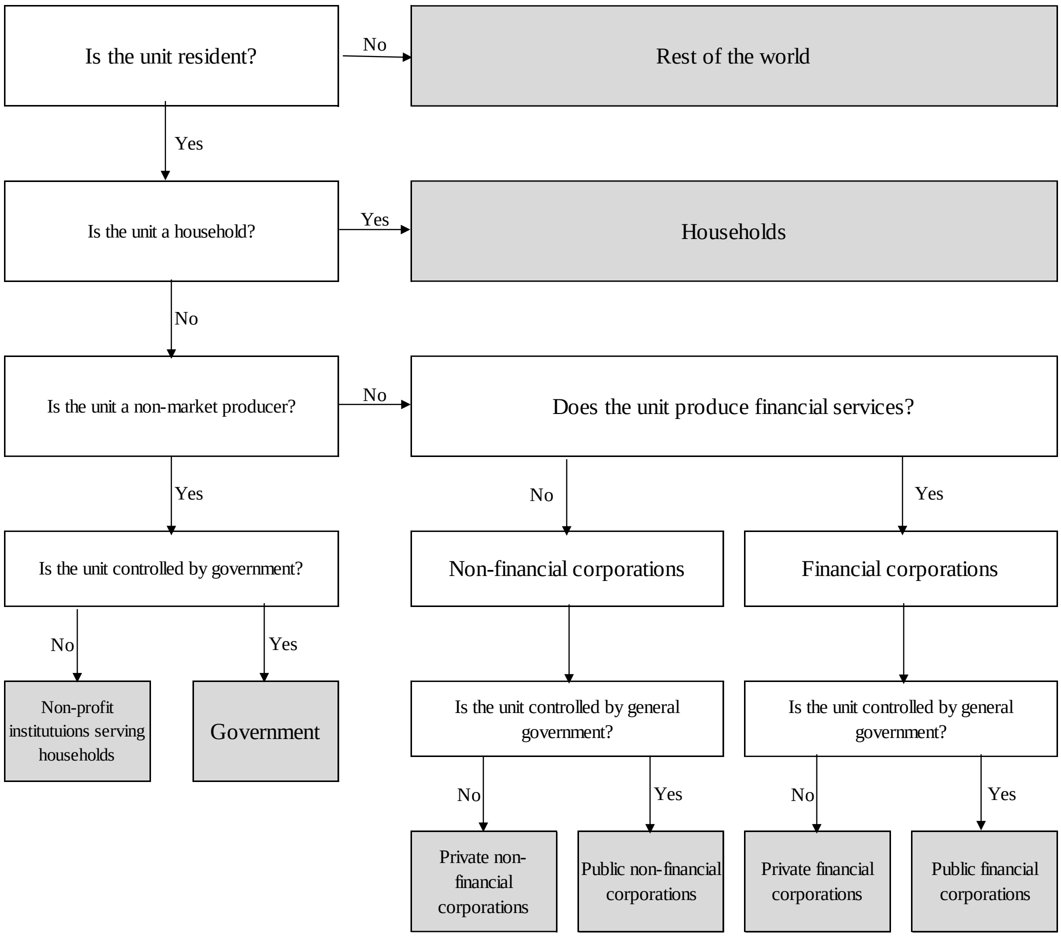

Diagram 1 shows how units are allocated to the main sectors. In order to determine the sector of a unit which is resident and not a household, it is necessary to determine whether it is controlled by general government or not, and whether it is a market or a non-market producer.

Control over a financial or non-financial corporation is defined as the ability to determine general corporate policy. A single institutional unit secures control over other institutional unit by owning more than half the voting shares or otherwise controlling more than half the shareholders' voting power. General government secures control over a corporation as a result of special legislation, decree or regulation which empowers the government to determine corporate policy.

The following indicators are the main factors to consider in deciding whether a corporation is controlled by government:

(a) government ownership of the majority of the voting interest;

(b) government control of the board or governing body;

(c) government control of the appointment and removal of key personnel;

(d) government control of key committees in the entity;

(e) government possession of a golden share;

(f) special regulations;

(g) government as a dominant customer;

(h) borrowing from government.

A single indicator may be sufficient to establish control, but, in other cases, a number of separate indicators may collectively indicate control.

For non-profit institutions recognised as independent legal entities, there are five indicators of control to be considered:

(a) government control over the appointment of officers;

(b) government control over the provisions of enabling instruments;

(c) contractual agreements;

(d) the degree of financing by government;

(e) the degree of government risk exposure.

As with corporations, a single indicator may be sufficient to establish control in some cases, but, in other cases, a number of separate indicators may collectively indicate control.

The distinction between market and non-market producers is carried out according to various (quantitative and qualitative) criteria, which determine whether there are market conditions and sufficient market behaviour of the producers, i.e. whether the sale of goods and services is carried out at economically significant prices. Economically significant prices are prices that have an impact on the amount of product that producers are willing to offer and the amount of products that customers want to purchase/. Such prices exist:

(a) when the producers are encouraged to adjust their offer, in order to achieve long-term profit, or at least to cover capital expenditures and other costs; and

(b) when consumers have the freedom to choose, based on an existing price, whether they will buy a particular product or service.

Prices that are not economically significant are calculated in a way that allows for a certain income or a reduction in excessive demand that could occur if the services were provided free of charge

According to the quantitative criterion, the unit is considered a market producer if the sales revenue of their goods and services covers more than 50% of the production costs (sum of intermediate consumption, compensation of employees, consumption of fixed assets, other production taxes and capital costs[1]). Minor fluctuations in the ratio of sales revenue and production costs from year to year do not necessarily need to result in a reclassification of institutional unit; this relationship is followed for at least three consecutive years.

However, the quantitative criterion is not the only relevant criterion for determining the sectoral classification of the institutional unit. It should also consider the specificity of the activities of the institutional unit and its relationship with the general government sector. In other words, it should be taken into account whether the unit sells its goods and services exclusively or predominantly to the units of the government sector.

Resident institutional units are grouped into five institutional sectors:

1. Non-financial corporations sector (S.11)
2. Financial corporations sector (S.12)
3. General government sector (S.13)
4. Households sector (S.14)
5. Non-profit institutions serving households sector (S.15).

Classification of units into institutional sectors is carried out in accordance with international standards[2] and serves exclusively for statistical purposes.

Non-financial corporations sector (S.11)

The non-financial corporations sector consists of institutional units which are independent legal entities and market producers, and whose principal activity is the production of goods and non-financial services. This sector includes the following units:

(a) private and public corporations which are market producers principally engaged in the production of goods and non-financial services;

(b) cooperatives and partnerships recognised as independent legal entities which are market producers principally engaged in the production of goods and non-financial services;

(c) non-profit institutions or associations serving non-financial corporations, which are recognised as independent legal entities and which are market producers principally engaged in the production of goods and non-financial services;

(d) head offices controlling a group of corporations which are market producers, where the predominant type of activity of the group of corporations as a whole

[1] Capital costs represent net interest paid, i.e. the difference between interest expenses and interest income.

[2] European System of National and Regional Accounts (ESA 2010), System of National Accounts (SNA 2008) and Manual on Government Deficit and Debt.

(measured on the basis of value added) is the production of goods and non-financial services;

(e) special purpose entities whose principal activity is the provision of goods or non-financial services.

The non-financial corporations sector is further divided into three subsectors:

(a) public non-financial corporations (S.11001);
(b) national private non-financial corporations (S.11002);
(c) foreign controlled non-financial corporations (S.11003).

Financial corporations sector (S.12)

The financial corporations sector consists of institutional units which are independent legal entities and market producers, and whose principal activity is the provision of financial services. Such institutional units comprise all corporations that are principally engaged in:

(a) financial intermediation (financial intermediaries); and/or
(b) auxiliary financial activities (financial auxiliaries).

Financial intermediation is the activity in which an institutional unit acquires financial assets and incurs liabilities on its own account by engaging in financial transactions on the market. Auxiliary financial activities are activities related to financial intermediation but which do not involve financial intermediation themselves.

The financial corporations sector is subdivided into the following subsectors:

(a) **the central bank (S.121)**, which in the Republic of Serbia includes the National Bank of Serbia;
(b) **deposit-taking corporations except the central bank (S.122)**, which includes all financial institutions which are principally engaged in financial intermediation and whose business is to receive deposits and/or close substitutes for deposits from other institutional units and to grant loans and/or to make investments in securities;
(c) **money market funds (MMFs) (S.123)**, which includes all financial institutions which are principally engaged in issuance of investment fund shares or units, and to make investments primarily in money market fund shares/units, short-term debt securities and/or deposits. This subsector includes investment funds including closed-end investment fund, mutual investment funds and other collective investment systems whose shares or units are closely related to the deposit/
(d) **non-MMF investment funds (S.124)**, which consists of all collective investment schemes, whose business is to issue investment fund shares or units which are not close substitutes for deposits and, on their own account, to make investments primarily in financial assets other than short-term financial assets and in non-financial assets (usually real estate), with the aim of generating

income and reducing the investment risks. This subsector includes closed-end investment funds, mutual investment funds and other collective investment schemes whose shares or units are not considered as close substitutes for deposits;

(e) **other financial intermediaries, except insurance corporations and pension funds (S.125)**, which consists of financial intermediaries dealing mainly with long-term financing. In most cases, this predominant maturity distinguishes this sub-sector from the sub-sectors of other monetary financial institutions (S.122 and S.123). This subsector includes financial leasing, factoring and forfeiting companies, companies for managing securitization funds, legal entities involved in consumer loans and corporate finance companies, specialized financial companies, as well as companies engaged in the financing of exports/imports;

(f) **financial auxiliaries (S.126)**, which includes financial corporations principally engaged in activities closely related to financial intermediation, but which are not themselves financial intermediaries. The following institutional units are classified into this subsector: securities and financial derivatives brokers and dealers; corporations that provide infrastructure for financial markets, corporations issuing guarantees; managers of (voluntary) pension funds, mutual funds and investment funds; authorized exchange offices (not registered as entrepreneurs); non-profit legal entities serving financial corporations, but not engaged in financial intermediation, etc.;

(g) **captive financial institutions and money lenders (S.127)**, consisting of all financial corporations which are neither engaged in financial intermediation nor in providing auxiliary financial services, and where most of either their assets or their liabilities are not transacted on open market. The following financial corporations are classified in this subsector: holding companies; financial service institutions using solely own funds or funds received from sponsors; and special purpose government funds, if classified as financial corporations;

(h) **insurance corporations (S.128)**, which includes all financial corporations primarily engaged in financial intermediation as a consequence of the pooling of risks, mainly in the form of direct insurance or reinsurance. Insurance corporations provide life and non-life insurance services to individuals or groups of units and reinsurance to other insurance corporations;

(i) **pension funds (S.129)**, consisting of all financial corporations which are principally engaged in financial intermediation as the consequence of the pooling of social risks and the needs of the insured persons (social insurance). Pension funds as social security systems provide income after retirement, and often benefits for death and disability.

Within the financial corporations sector, each subsector (except S.121)[3] could be further subdivided into public, private and foreign controlled financial corporations.

General government sector (S.13)

The general government sector (S.13) consists of institutional units that are non-market producers whose output is intended for individual and collective consumption, and are financed by compulsory payments made by units belonging to other sectors, and institutional units principally engaged in the redistribution of national income and wealth.

The institutional units included in sector S.13 are the following:

(a) general government units which exist through a legal process to have judicial authority over other units in the economic territory, and administer and finance a group of activities, principally providing non-market goods and services, intended for the benefit of the community;

(b) corporations which is the government units, if their output is mainly non-market and a government unit controls it;

(c) non-profit institutions recognised as independent legal entities which are non-market producers and which are controlled by general government;

(d) autonomous social security funds, where there is a legal obligation to contribute, and where general government manages the funds with respect to the settlement and approval of contributions and benefits.

The general government sector is divided into four subsectors:

(a) central government (S.1311);

(b) state government (S.1312);

(c) local government (S.1313);

(d) social security funds (S.1314).

Central government includes all administrative departments of the state and other central agencies whose competence extends normally over the whole economic territory, except for the administration of social security funds. This subsector also includes non-profit institutions which are controlled by central government.

Central government subsector consists of the ministries and other government institutions and agencies, as well as institutions of higher education. This subsector also comprises certain public companies that, in accordance with quantitative and/or qualitative criteria, fall into the government sector and are controlled by central government units (e.g. JMU Radio-televizija Srbije, "Železnice Srbije" a.d., "Infrastruktura železnica Srbije" a.d., "Srbija voz" a.d., JP "Putevi Srbije", "Koridori Srbije" d.o.o., etc.).

[3] According to international standards, this subsector is a part of the public sector.

State government consists of those types of public administration which are separate institutional units exercising some of the functions of government, except for the administration of social security funds, at a level below that of central government and above that of the local governmental. Subsector S.1312 also includes non-profit institutions which are controlled by state governments.

This subsector does not exist in the Republic of Serbia.

Local government includes those types of public administration whose competence extends to only a local part of the economic territory, apart from local agencies of social security funds. This subsector also includes those non-profit institutions which are controlled by local governments.

In this subsector included are bodies and agencies of provincial, city and municipal authorities, as well as schools, cultural institutions, municipal centers for social work and the like. This subsector also includes public companies that, in accordance with quantitative and/or qualitative criteria, fall into government sector and are controlled by the local government units (e.g. JMU Radio-televizija Vojvodine, public utility companies whose quantitative criteria is less than 50% and others).

Social security funds include central, state and local institutional units whose principal activity is to provide social benefits and which fulfil each of the following two criteria:

(a) by law or by other regulation certain groups of the population are obliged to participate in the social security scheme or to pay contributions; and
(b) general government is responsible for the management of the institution in respect of the settlement or approval of the contributions and benefits.

There is usually no direct link between the amount of the contribution paid by an individual and the risk to which that individual is exposed.

This subsector includes compulsory social security organizations, as well as health institutions under the government control. According to international recommendations, when health institutions are predominantly financed from social contributions (through social security funds), and given that control over them can be carried out by different levels of government, for practical reasons these units are classified into a subsector of social security funds.

Public units in bankruptcy or liquidation

Bankruptcy and liquidation[4] are processes in which an corporation reduces/suspends its activity, and these processes may take a certain time period. During this period, the

[4] Liquidation is a form of suspension of the business activities of the entity that is carried out when the entity has sufficient financial resources to cover all its obligations. In contrast, bankruptcy is carried out when the assets of the entity are insufficient to settle all claims of creditors. Liquidation is under the control of members of the company, while bankruptcy is under the control of the bankruptcy court.

unit may still have a certain production activity and, based on that, generate some revenues.

If a public non-financial corporation in bankruptcy or liquidation does not meet the previously stated quantitative criteria for classifying units into institutional sectors, it is considered as non-market producer and is classified into sector S.13[5].

As regards public financial companies in bankruptcy or liquidation, their classification in S.13 is done based on the government control of the bankruptcy or liquidation process and/or the expectation that government would take out most of the costs and risks of bankruptcy or liquidation. Financial corporations in the process of brankruptcy or liquidation are classified into subsector S.1311, due to the fact that these corporations are under the control of a central government unit.

Public sector

According to international standards, the public sector consists of the general government sector units and public (non-financial and financial) corporations. Institutional units that make up the public sector are resident units which are under the government control, directly or indirectly through the control of other public corporation. Whether a company controlled by government belongs to the general government sector or is part of the public sector is determined based on the quantitative criteria.

Diagram 2. Public sector and its relation to other institutional sectors of the economy

General government sector	Nonfinancial corporations sector	Financial corporations sector	Households sector	Nonprofit institutions serving households sector
Central government	Public non-financial corporations	Public financial corporations	Private	Private
State government				
Local government	Private non-financial corporations	Private financial corporations		
Social security funds				

Public sector

The legal form of the corporation is not a criterion for the sector classification. In other words, a particular corporation, according to national legislation, can represent a public company, but for statistical purposes, and in accordance with international standards, it can be classified into the general government sector.

An example for this are public corporations registred for the railroad transport. By the status change, new companies were formed from the "Železnica Srbije": „Železnice Srbije“ a.d., „Infrastruktura železnice Srbije“ a.d., „Srbija kargo“ a.d. i „Srbija voz“ a.d. In accordance with the quantitative and qualitative criteria, "Srbija kargo" a.d. is

[5] The adequate subsector is determined based on the control criteria.

classified into subsector S.11001, while the other three companies are classified in subsector S.1311.

Households sector (S.14)

The households sector consists of individuals or groups of individuals as consumers and as entrepreneurs producing market goods and services (market producers). It also includes individuals or groups of individuals as producers of goods and non-financial services for exclusively own final use.

Households as consumers may be defined as small groups of persons who share the same living accommodation, who pool their income and wealth and who consume certain types of goods and services collectively. The principal resources of households are the following: compensation of employees, property income, transfers from other sectors, receipts from the disposal of market products, and imputed receipts from the output of products for own final consumption.

The households sector includes:

(a) individuals or groups of individuals whose principal function is consumption;
(b) persons living permanently in institutions who have little or no autonomy of action or decision in economic matters (e.g. members of religious orders living in monasteries, long-term patients in hospitals, prisoners serving long sentences, old persons living permanently in retirement homes). Such group of persons are treated as a single institutional unit, i.e. a single household;
(c) individuals or groups of individuals whose principal function is consumption and that produce goods and non-financial services for exclusively own final use;
(d) sole proprietorships and partnerships without legal status, and which are market producers.

Non-profit institutions serving households sector (S.15)

The non-profit institutions serving households (NPISHs) sector consists of non-profit institutions which are separate legal entities, which serve households and which are private non-market producers. Their principal resources are voluntary contributions in cash or in kind from households in their capacity as consumers, payments made by general government and property income.

The NPISHs sector includes the following main kinds of NPISHs that provide non-market goods and services to households:

(a) trade unions, professional or learned societies, consumers' associations, political parties, churches or religious societies (including those financed but not controlled by governments), and social, cultural, recreational and sports clubs;

(b) charities, relief and aid organisations financed by voluntary transfers in cash or in kind from other institutional units.

Rest of the world sector (S.2)

The rest of the world sector consists of non-resident units[6] insofar as they are engaged in transactions with resident institutional units, or have other economic links with resident units. Its accounts provide an overall view of the economic relationships linking the national economy with the rest of the world. The EU institutions as well as international organisations are included in this sector.

[6] Non-resident units represent institutional units with a center of predominant economic interest outside the economic territory of the country for more than a year.