

## **Valuation of Assets and Holding Gains in National Accounts: Is Further Progress Needed?**

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This paper discusses the questions and criticism that non national accountants usually address to national accounts regarding revaluation and holding gains and losses. The purpose is to assess if the changes brought into the SNA 2008 are enough or if there is still something to do. The questions examined and answers are listed below:

**Question 1:** Is the revaluation at market value suitable while institutional unit may have no intention to sell shortly and while prices may be subject to bubbles?

**Answer:** Mark to market revaluation is used only for negotiable assets. Like business accounts that are used as a source for the national accounts, market value is an objective source. For this reason, it is more suitable than models, which are used when nothing else is available but which rely on unobservable parameters that depend on expert judgment. The choice of a discount rate for example may be debatable with considerable impacts on amounts. Furthermore, the models based on fundamentals are now replaced in financial theory by models based on the strategies of market participants that do not permit aggregated calculations.

**Question 2:** According to financial theory and more and more to business accounts, there is no difference between holding gains and property income that both participate to the return on assets. In fact, the former corresponds to a frontloading of the later, when compared to the “normal” rate of return at the date of valuation. Why national accounts do alone maintain the difference?

**Answer:** This results from the debtor view that was preferred to the creditor view in order to comply with the quadruple entry accounting of the national account. The debtor pays the scheduled interest and does not permanently reassess the amount and cost of debt. However, turning to more complex products (with profit insurance, swaps...) it becomes more difficult to split scheduled property income from holding gains. Business accounts gave up and do not provide the split anymore, which make it difficult for national account to do so. The creditor view made his path prudently in SNA 2008 with complementary data on impaired loans. Other complementary data may help to build a creditor view but the complexity of derivatives and collateralized operations may be an obstacle to a satisfactory result.

**Question 3:** Holding gains provide resources for consumption in case of households, for payment of bonuses, taxes and dividends in case of financial institutions. Should they not be recorded in revenue?

**Answer:** SNA 2008 retreats as production of financial institutions the holding gains that correspond to trade margins. For other sectors and assets other than shares, holding gains result in a revaluation of the own funds of the holding sector (of its net asset if a household) and as a net lending when realized, the later financing the uses of fund listed above. In case of shares, the mechanism is a bit more complex, as the revaluation of shares reflects the growth in the prospects of their issuer. It thus may be argued that revaluation of share is not an increase in price but an increase in quantity of shares that should give rise to an investment flow in financial

account. The mechanism of reinvested earnings in foreign direct investment reflects this analysis. In our view, it should be extended to all shares, whoever the investor is.

To conclude, valuation of assets and treatment of holding gains in SNA 2008 seems appropriate according to the aims assigned to national accounts: measuring economic flows objectively, providing a coherent description of these flows between sectors and operations. Some progress in coherence may still be made by extending the reinvested earning in foreign direct investment to any shares whoever is the investor. More supplementary data may help to build an alternative “creditor view” but the result may be disappointing due to the complexity of some financial products that really change the return of asset and the cost of debt.