

## 2. Sectors of Economy

**I**nstitutional (economic) units, industries and sectors are the main components of economy. The economy is divided into domestic economy and the rest of the world. The domestic economy comprises all resident economic units (entities).

Institutional (economic) unit is an economic entity capable, in its own rights, of

- ✓ owning assets;
- ✓ incurring liabilities;
- ✓ engaging in economic activities<sup>2</sup> and in transactions with other entities;
- ✓ having a complete set of accounts.

There are two main types of institutional (economic) units: individuals or groups of persons in the form of households and legal or social entities (units) recognized legally or by society as existing independently of the units that own or control them.

**Household** is a group of persons, who share the same living accommodation, pool some or all of their income and wealth, consume certain types of goods and services collectively and may engage in production activity. In the case of engagement in production activity there is no segregation between the inventory of the enterprise created by household and the owners' private inventory, i.e. such an enterprise is subject to unlimited liability.

**Legal entity** is an entity, that engages in economic activities and transactions, take decisions and conclude contracts in its own right. Legal or social entities are divided into three groups: corporations or enterprises, government units and nonprofit institutions.

*Corporations or enterprises* are legal entities created for the purpose of producing goods and services for the market with the purpose of gaining profit for their owners.

*Government units* are unique types of legal entities that are established primarily to perform governmental functions and have legislative, judicial, or executive authority over other institutional units within a specific area. The principal functions of these units are to produce certain goods and public services for the community or for individual households, to redistribute the community's income or wealth by means of transfers, to produce nonmarket goods and services. Government units finance their transactions by collecting taxes or other compulsory payments from other institutional units.

*Nonprofit institutions* are legal or social entities created for the

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<sup>2</sup> Economic activity includes production of goods and services, as well as receiving income, making expenditures, investments and consumption, accumulation of savings, etc.

purpose of producing market or nonmarket goods and services, whose status does not permit them to distribute the profit to the units that establish, control and/or finance them<sup>3</sup>.

A distinction between the national (domestic) economy and the rest of the world is based on residence, and not on currency, citizenship or nationality criteria. Entities of a particular country may cooperate with both residents of that country and residents of other countries. The latter are treated as nonresidents for that particular country.

The concept of residence is based on two key concepts: an economic territory and a center of economic interest. A country's economic territory is the geographical territory administered by a government within which persons, goods and capital circulate freely. The economic territory may differ from administrative territory of a country.

An institutional unit is treated as a resident unit of the country, when it has a center of economic interest in the economic territory of that country. This presumes an existence of some location - dwelling, place of production, or other premises within the economic territory of the country on/ from which it engages and intends to continue to engage in economic activity and transactions with other units either indefinitely or over a finite but long period of time (usually one year or more).

Thus, the statistical concept of residency is not based on nationality, citizenship or other legal criteria, but on purely economic approaches and definitions. However, identification of residency is not always clear and is connected also with the type and the character of the unit in question. Criteria for identifying residency of units are often not clearly distinctive and hence complicate their classification.

There are a number of criteria to be used for identification of the residence.

**The residence of individuals and households.** A household is deemed to be a resident of the country within which it maintains a dwelling treated or used by the members of the household as their principle residence. All individuals who belong to the same household must be residents in the same country.

A member of a resident household who leaves the economic territory of the country to return to the same household after a limited period of time (less than one year) continues to be a resident of the country. There are some categories of individuals who leave the economic territory of the country and yet are treated as residents of the country:

- ♦ Visitors and travelers, i.e., individuals who temporarily (less than one year) leave the economic territory of the country for business, health, education or other purposes.
- ♦ Individuals who work some or all of the time in a different economic territory:
  - Seasonal workers who work for part of the year in another country and then return to their households;
  - Border workers who cross the frontier each day or week to work in a neighboring country and return;
  - The staff of international organizations who work in the enclave of those organizations;

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<sup>3</sup> The statistical definition of non-profit organizations is identical to the general definition of non-trade organizations (that do not have profit earning as an objective) given in the RA Civil Code (article 51).

- The locally recruited staff of foreign embassies, military bases and other similar representations;
- The crews of ships, aircraft and other mobile equipment operating partly or wholly outside the economic territory;
- Students, who study abroad, even if the period of their education is more than a year.

**The residence of enterprises or corporations.** Enterprises are said to have a center of economic interest and to be resident units of a country, when they are engaged in a significant amount of production of goods and services there, or own land or buildings located there. Foreign owned enterprises are treated as resident units of a country if they operate or intend to operate within the economic territory of that country for a period of more than a year. In some certain cases (when an enterprise or its branch operates in another country) such conditions as the place of the entity's registration and tax payment, the entity's ability to independently attract funds and to maintain separate set of accounts (balance sheet, income statement, etc.) should be also taken into account.

**The residence of nonprofit institutions.** A nonprofit institution is said to be a resident in the country or economic territory under whose laws or regulations it was created and in which its existence as a legal or social entity is recognized and recorded. In cases a nonprofit institution maintains branches, the time of operation of the branch in a particular country is taken into consideration. If a nonprofit institution maintains a branch for one year or more in a particular country, that branch should be considered as a resident of that country, financed largely or entirely by transfers from abroad.

**The residence of government units.** All government units of a country are treated as residents of that country irrespective of the place of their location. The government units that are residents of the economy include:

- all departments, establishments, and bodies of its central and local governments located in its territory;
- the embassies, consulates, representations, military establishments of the particular country's general government located elsewhere.

Embassies, consulates, representations, military establishments of a foreign government located within a particular economy are deemed to be nonresidents of that country.

**The residence of international organizations.** International organizations are not considered residents of any national economy, including that in which they are located or conduct their affairs. The employees of international organizations are, nevertheless, residents of the economies on whose territory the international organization is located.

Thus, the economic entities whose center of economic interest is outside the economic territory of the country are considered nonresidents, and all transactions conducted with them are considered operations with nonresidents. In respect to a particular economy the relations with nonresidents are treated as relations with the rest of the world. Further distinction of nonresidents into sectors of economy (sectorization) is not of significant importance for a country's

statistics.

Sectorization of resident economic entities, on the contrary, is fundamentally important for the statistics since it permits to identify and reflect relations of a certain economic sector with other resident sectors. Sectorization is based on economic objectives, functions and behavior of entities.

The resident institutional units specified in this Manual are divided into:

- enterprises or corporations;
- government units;
- households;
- nonprofit institutions.

Proper sectorization of these units requires a number of further classifications. Enterprises or corporations, in particular, are divided into two groups: financial and nonfinancial corporations.

Nonprofit institutions may be of two types: producing market goods and services and producing nonmarket goods and services. Nonprofit institutions producing nonmarket goods and services in their turn are divided into state or government organizations and organizations serving households (NPISH).

The five sectors of the resident economy are composed in accordance with the table below:

Type of institutional unit	Sectors of Economy				
	Nonfinancial corporations sector	Financial corporations sector	General government sector	Households sector	NPISHs <sup>4</sup> sector
Enterprises or corporations	Nonfinancial corporations	Financial corporations			
Government units			Government units		
Households				Households	
Nonprofit institutions	Market nonprofit institutions	Nonprofit institutions serving the financial market	Nonmarket nonprofit institutions controlled and mainly financed by government		NPISH

Domestic economy may be divided into three larger sectors by encompassing nonfinancial corporations, households and NPISHs in the real sector. Hence, there are three sectors of domestic economy:

- General government sector
- Real sector
- Financial sector

Sectorization of domestic economy from the view of monetary statistics is important also to identify money issuing and holding sectors. Thus, the financial sector is the economy's money issuing sector; the real sector is the economy's money holding sector; the general government sector is not a money holder, despite it may influence the quantity of money through its operations.

<sup>4</sup> Non-profit Institutions Serving Households

## **2.1. General Government Sector**

The general government sector includes all government units specified above. The units' inclusion in the government sector is not based on the form of ownership, but is based on the objectives of the entity's activity and its functions. The general functions of the government units are as follows:

- provide the community or individual households with certain goods and public services by financing their transactions out of taxes or other incomes;
- redistribute the community's income or wealth by means of transfers;
- produce nonmarket goods and services.

The areas of government units' activity are governance, defense or army, education, health, national and social security, etc.

The government sector is divided into the following sub-sectors:

- Central government
- Regional government
- Local government
- Social security funds

The central government consists of those government units, which have power over the country's whole territory as well as nonprofit institutions controlled and mainly financed by central government. The government implements its fiscal policy mainly through the central government. The central government may also make transfer payments to other sub-sectors of the government.

The regional government exists only in a number of countries. It includes government units that independently from the central government perform some governance functions in certain regions of the country. Some nonprofit organizations that are controlled and financed by the regional government are also included in the regional government sub-sector.

The local government consists of the government units that exercise independent administrative authority (e. g., collection of taxes and making expenditures) in certain cities and areas of the country. The local government may comprise of district authorities and authorities of large cities and towns. Some nonprofit organizations that are controlled and financed by the local government are also included in the Local government sub-sector.

Social security funds are specific units operating at all levels of the government. The social security funds are separate entities aimed at the social insurance schemes covering the entire or large sections of the community.

The general government sector in Armenia is divided into:

- Central (Republican) government
- Local government
- Social security fund

According to the Law on the Budgetary System of the Republic of Armenia the budgetary system in Armenia is a two-level structure that is governed by regulatory norms and is based on economic relations and public structure of the Republic of Armenia. The first level involves the state budget, the second level involves local budgets. Budgets of the

central government and local governments are based on the unified financial and tax policy.

Budgetary organizations are state and municipal entities that are financed from the budget (state and local).

## **2.2. Real Sector**

The real sector of the economy, as it has been already noted, consists of enterprises (nonfinancial corporations), households and nonprofit institutions serving households. From the point of view of monetary and financial statistics the households and nonprofit institutions serving households are in some cases combined into one sub-sector named "Other resident sectors".

### *2.2.1. NonFinancial Corporations Sector*

Nonfinancial organizations comprise all resident units involved in production of market goods and nonfinancial services. Market goods and services are those goods and services that are sold at market prices (economically significant prices). Inclusion of a certain corporation into the nonfinancial sector is not related to the sector to which the owners belong. The owners of such organizations may be residents or nonresidents, individuals or legal entities; it may also be a government. The only criterion here is that these organizations should engage in the production of market goods and nonfinancial services. In accordance with this definition the nonprofit institutions producing market goods and services are also included in nonfinancial sector.

Depending on the form of ownership the sector of nonfinancial corporations is divided into two subsectors: public and private. An enterprise is treated as state owned (public) in two cases: when the government's share in the capital of this enterprise is 51% and more, and when the government as a result of special legislation or regulation is empowered to determine corporate policy and to appoint the directors.

According to legislation of the Republic of Armenia there are six types of enterprises:

- Full partnership;
- Limited partnership;
- Share holding companies;
- Companies with limited liability;
- Companies with additional liability;
- Trade cooperatives/

### *2.2.2. Households Sector*

This sector consists of all resident households. Households are those individuals or groups of persons, who

- share the same living accommodation;
- pool some or all of their resources, income and wealth;
- consume certain types of goods and services collectively;
- may engage in production activity.

Thus, the individuals who engage in production of goods and services

for own final consumption or for sale in the market also belong to the households sector.

By sources of income the households sector is divided into four sub-sectors:

- Self-employed or entrepreneurs (employers);
- Own-account workers;
- Employees;
- Recipients of property and transfer income.

### *2.2.3. Nonprofit Institutions Serving Households Sector*

This sector comprises noncommercial organizations engaged in production of nonmarket goods and services. These goods and services are provided to individual households or to the entire community without charge or at prices that are not economically significant. The institutions that are controlled and financed mainly by government units are not included in this sector, since they are included into the general government sector.

Examples of NPISHs are political parties, churches, religious organizations, charities, professional and other unions, cultural organizations, some educational and research institutions, etc.

## **2.3. Financial Sector**

### *2.3.1. General Overview of Financial Sector*

In respect of monetary and financial statistics the financial sector is the most important one since it includes money-issuing units of economy.

The financial sector consists of corporations principally engaged in financial intermediation or in auxiliary financial activities that contribute to financial intermediation. Financial intermediation may be defined as a productive activity in which an institutional unit incurs liabilities on its own account to acquire financial assets through financial market transactions.

These are some examples of financial intermediation:

**Example 1:** A corporation accepts deposits from different institutional units and extends credits.

**Example 2:** A corporation attracts borrowings and extends credits and loans.

**Example 3:** A corporation attracts funds from its shareholders to make equity investments.

**Example 4:** A corporation invests in securities from the funds raised from policyholders.

Corporations engaged in the above-mentioned operations are included in the financial sector.

Those corporations that engage in provision of auxiliary financial services are not financial intermediaries since they do not incur liabilities on their own account for acquiring financial assets, but provide services that are auxiliary to financial intermediation. Among these corporations are:

- Stock exchanges and organized foreign exchange and securities markets;
- Depositaries and clearing organizations;

- Brokers and dealers;
- Foreign currency exchange companies;
- Organizations dealing with financial guarantees;
- Organizations dealing with financial derivatives, etc.

Nonprofit institutions serving financial market are also included in auxiliary financial corporations.

Thus, financial sector can be divided into two major sectors:

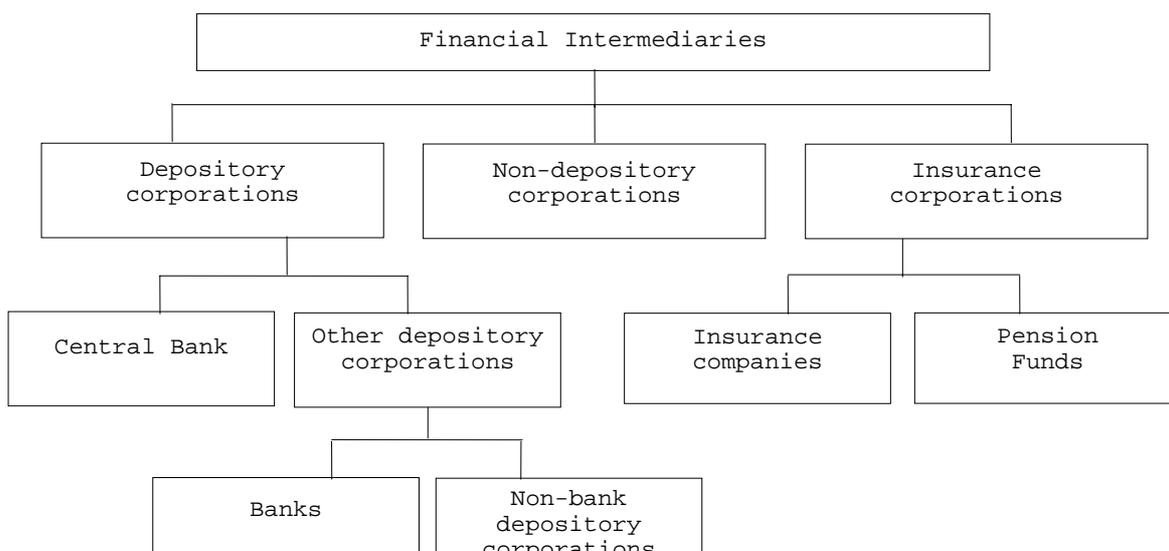
- Financial intermediaries, and
- Financial auxiliaries.

Financial intermediaries are of greater interest from the view of monetary and financial statistics since they participate to a certain extent in the process of money creation.

### 2.3.2. Types of Financial Intermediaries

Corporation is treated as a financial intermediary when financial intermediation is its principal activity. There might be cases when the government or other units perform some financial intermediation transactions, which are, however, out of the scope of their activity. In such cases these units are not treated as financial intermediaries.

The sector "Financial intermediaries" is the major sector subject to our discussion. It is divided into sub-sectors presented below:



#### **Central Bank**

The central bank is a unique financial institution that exercises regulation and control over key aspects of the financial system. The central bank has an exclusive right of issuing money of the economy, which determines main functions of the central bank. Along with this, the central bank operates as a financial intermediary. The main functions of the central bank are as follows: issuing currency, managing international reserves, transacting with the IMF and extending credits to other depository corporations (commercial banks).

Thus, the sub-sector Central Bank of Armenia's financial sector includes only the Central Bank of Armenia since all of the above mentioned functions are performed by this particular institution.

Central Bank of Armenia performs the following functions:

- Develops, approves and implements the monetary policy program.
- Participates in the development of the economic policy program of the Government and coordinates monetary policy with the fiscal policy of the government.
- Provides banking services to the Government and acts as the Government's financial agent and advisor.
- Issues the Armenian national currency, organizes and regulates currency circulation.
- Manages international reserves of Armenia.
- Executes currency regulation and control.
- Licenses banks, credit institutions and other entities entitled by the legislation of Armenia, regulates and supervises their activities.
- As a lender of last resort provides credits to commercial banks.
- Regulates and controls payment and settlement system.
- Collects, compiles, analyses and disseminates economic statistics.
- Carries out transaction with the IMF.

#### **Other Depository Corporations**

This sub-sector includes all resident corporations engaged in financial intermediation whose liabilities mainly consist of deposits<sup>5</sup> or close-to-deposits financial instruments and are included in the national definition of "money". These corporations serve as depositories of money.

Deposits accepted by depository corporations may be transferable and nontransferable<sup>6</sup>. Transferable deposits comprise all deposits that are repayable on demand at par and without penalty or restriction, and directly usable for making payments by draft, check, card or other direct payment facility.

Nontransferable deposits comprise all deposits or close-to-deposits liabilities of financial intermediaries, the use of which is subject to a certain restrictions:

- they are repayable after a certain period of time or on demand but with some penalty or other extra payments;
- they cannot serve as an instrument for direct payments;
- other types of restrictions exist (frozen accounts, pledged assets, etc.).

Other depository corporations' sub-sector is divided into two groups - banks and nonbank depository corporations - depending on two types of liabilities described above.

In the context of this Manual the banks consist of all financial intermediary depository corporations that accept both transferable and nontransferable deposits and other liabilities.

Nonbank depository corporations are financial intermediaries that cannot accept transferable deposits. They accept only nontransferable deposits and other liabilities.

Nonbank depository corporations may perform the following functions:

- attract nontransferable deposits;
- issue shares;

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<sup>5</sup> The concept of "deposit" used in this Manual includes "accounts" as well as defined in the Armenian Civil Code.

<sup>6</sup> The definition of transferable and non-transferable deposits is given for the purpose of dividing financial intermediary organizations into categories. More detailed explanation of this concept may be found in Chapter 4 of this Manual.

- may act as development banks, offshore banks,
- may be specialized intermediaries that are widely spread in the developed countries - building societies , credit unions, discount agencies.

Money market mutual funds are widely spread in international practice. They mainly engage in attracting the funds of their shareholders and investing in financial assets. Despite the fact that investments in these funds are legally treated as equity they are highly liquid and hence are very close to transferable deposits.

Financial corporations are classified as nonbank depository corporations if their liabilities are included in the monetary aggregates. They shall be treated as such even if their liabilities are not legally defined as "deposits".

Thus, the depository corporations sub-sector of Armenia's financial sector consists of the Central Bank of Armenia and other depository corporations Armenian commercial banks form the predominant part of other depository corporations sub-sector, since nonbank depository corporations virtually do not exist in Armenia. Mutual funds are not foreseen by the Armenian legislation, and hence there are no mutual funds and similar organizations in Armenia.

#### ***Nondepository financial corporations***

Liabilities of nondepository financial corporations are less liquid than those of depository corporations'. Therefore, these corporations' liabilities are not included in monetary aggregates.

Pawnshops represent nondepository financial corporations in Armenia. However, pawnshops' share in the financial market is insignificant.

Different types of nondepository financial intermediaries exist in international practice.

*Finance companies.* These companies mainly engage in the extension of credit to nonfinancial corporations and households. Many finance companies are captive subsidiaries that raise funds to be used by the parent corporations. Finance companies' liabilities are normally illiquid.

*Financial leasing companies.* These companies engage in financing the purchase of tangible assets. They are legal owners of the acquired goods, but ownership is effectively conveyed to the lessee, who incurs all benefits, costs and risks associated with ownership of the assets. Attraction of funds by financial leasing companies is regulated in different ways. Depending on this, financial leasing companies may be defined as leasing companies with liquid or illiquid liabilities.

*Investment pools.* These organizations consolidate investor funds for the purpose of acquiring financial assets. Generally, liabilities of investment pools are illiquid. Examples of investment pools are capital market mutual funds, investment unions. Alternatively, investment funds may be represented by money market mutual funds whose shares are liquid. As it was mentioned above, in case that the liabilities of mutual funds are included into the monetary aggregates they should be classified as depository corporations.

*Securities dealers and underwriters.* These organizations include the

companies specialized in security market transactions by assisting other firms in market placement of new security issues and/or trading in securities on their own account and risk. Security brokers that arrange trades between security buyers and sellers but do not purchase or sell securities on their own account are not classified as security dealers and underwriters and belong to financial auxiliaries.

*Financial derivative intermediaries.* Financial derivative intermediaries engage in issuing or taking positions in financial derivatives.

*Specialized financial intermediaries.* This category includes organizations engaged in certain types of financial intermediation, such as export/import finance companies, factoring companies, venture capital funds, holding corporations.

In Armenia nondepository financial corporations include credit institutions and pawnshops that have a very small share in Armenian financial market.

Armenian Law on "Credit Institutions" has become effective since 2003 and this area is just developing. According to the Law and the CBA Regulation 14 "Regulation of Credit Institution Activity: Prudential Standards for Credit Institution Activity", credit institutions can implement the following financial operations or part of them:

a) attract borrowings and/or conclude similar transactions (transactions can be carried out exclusively with legal entities, individuals and their participants),

b) extend credits, loans, implement debt or commercial transaction financing, factoring (credit institution can extend exclusively business loans or borrowings, and also consumer loans and borrowings, as determined by the CBA),

c) issue guarantees,

d) issue, buy, sell securities, traveler's cheques, cards and other instruments, implement similar operations,

e) provide financial agent's service, manage other persons' investments, implement trust management, specialized activity in T-bills market (dealership, brokerage, factorships, sub-depository services),

f) carry out financial leasing operations,

g) buy and sell foreign currency, including dram and FX futures, options and similar operations, etc.

Credit institutions fall into five groups. Each of the groups is allowed to implement certain operations. These groups are:

1. credit unions that attract funds from legal entities, their participants, the Republic of Armenia and communities, and that extend loans and borrowings,
2. savings unions that attract funds from their participants and extend loans and borrowings to them,
3. financial leasing firms, the main activity of which is to conclude financial leasing transactions,
4. factoring institutions, the main activity of which is to conclude factoring transactions,
5. universal credit institutions that can carry out almost all operations for credit institutions as provided by law.

Credit institutions are not entitled to open and operate banking accounts for their customers and participants. Credit institutions implement non-cash monetary settlements through the bank servicing the credit institution.

The Central Bank of Armenia implements the supervision of credit institutions and sets the prudential standards for them.

Armenian Law on "Pawnshops and Pawnshops activity" has become effective since the end of 2003. The Ministry of Finance and Economy carries out the supervision of pawnshops. Taking into account small share of pawnshop operations in Armenian financial market, their indicators are not considered in this Manual.

### ***Insurance corporations***

This sub-sector consists of insurance companies and pension funds. Insurance corporations are distinguished among other financial intermediaries due to specific features of their functions and hence make a separate sub-sector. The principal function of insurance company is to provide life, health, accident and other forms of insurance to individual institutional units or groups of units.

The pension funds included in this sub-sector are different from social security funds of the general government sector. The pension funds exist separately from their owners, they are not controlled or financed by government and, unlike social security funds they cover arrangements related to provision of retirement benefits for specific groups of employees, but not for the entire community.

It should be noted that there are no pension funds in Armenia yet, hence the insurance corporations sub-sector consists only of insurance companies.

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