



16 January 2013

## Decision of Eurostat on government deficit and debt

### **The statistical recording of low interest rate loans**

#### **1. Context**

As a part of public policy activities, governments provide loans at a lower interest rate than the market rate observed at the time of loan issuance (sometimes called "concessional loans"). The previous discussions and work carried out in this context confirmed that national practices and the methodologies applied for recording of low interest rate loans in national accounts are heterogeneous across Member States. There is therefore a need of guidance.

The issue was initially linked to a particular case of sale of well-performing loans at discount by the government. These loans had been issued by the government at a low interest rate and later sold at a price below the nominal value. Therefore, this Decision concerns (i) the recording of a benefit to debtors due to the lower than market interest rates and (ii) the recording of a discount at time of sale of the loans to a third party.

The Eurostat's Decision relates to well-performing loans only. It does not concern the treatment of sale of non-performing loans which was analysed in a Eurostat note on foreign claim restructuring.

This Decision is consistent with the opinion of the Committee for Monetary, Financial and Balance of Payments statistics (CMFB) as described in annex.

It has to be mentioned that the issue of recording of concessional loans is on the SNA 2008 research agenda. In this respect, further guidance on these issues might be expected in the future.

#### **2. Loans provided by government at lower than market interest rates**

A granting of low interest rate loans is a specific public policy activity carried out by government, which frequently results in transactions not undertaken at market conditions. Some examples are loans directly provided by government to students at low interest rate, real estate loans provided to households in specific circumstance, loans to newly created companies, etc.

When government provides a loan to households or companies at a lower interest rate than the market rate in order to support their activities, the operation implies a benefit for the debtor. The benefit reflects the difference between the contractually agreed interest rate and the market interest rate that would have been paid by the debtor if the loan was granted at the market interest rate.

The current ESA95 rules do not require to record in national accounts the implicit benefit element, i. e. the difference between the market interest rate and the interest rate contractually agreed, in order to reflect all transactions undertaken by government by reference to market conditions. As set out in ESA95, the amount of interest recorded on an accrual basis follows the contractual interest rate agreed between the creditor and the debtor.

The impact on deficit is already reflected implicitly in national accounts as a difference between the cost of government financing and the low interest revenue received from the loans granted by government in the context of its public policy.

In this context, Eurostat considers that, for low interest rate loans granted by a government unit in the context of its usual public policy activities, the interest has to be recorded on the basis of the contractually agreed interest rate. Consequently, no implicit benefit for the debtor is recorded in national accounts.

### **3. Sale of the low interest rate loans to a third party**

The issue refers to the cases when the well-performing loans, provided by government under public policy activities, are sold to a third party at discount (i.e. below their nominal value). At the time of the sale of the loan, the discount reflects the difference between the current market interest rate and the lower interest rate contractually agreed between the debtor and the original creditor at time of the loan issuance.

Paragraph 6.51 of ESA 95 indicates that "*...when an existing loan or trade credit is sold to another institutional unit the difference between the redemption price and the transaction price should be recorded under the revaluation account of the seller and the purchaser at the time of transaction.*"

Eurostat considers that in the case of sale of low interest rate loans to a third party below the nominal value, the discount as a difference between the nominal value and sales price, has to be recorded as revaluation.

This Decision concerns only the sales of loans that are not a subject to any rescheduling or other change in the contractual conditions for the debtor.



## **CMFB opinion on the recording of low interest rate loans**

1. At Eurostat's request the CMFB Chairman, with the assistance of the CMFB Executive Body, asked the CMFB Members on 16 November 2012 to state their opinion on the recording of low interest rate loans. The deadline for replies was 30 November 2012. Twenty-one (21) national statistical institutes and twenty-three (23) national central banks from the EU Member States returned the questionnaire within the specified time. A total of forty-seven (47) institutions, including the ECB, the Norwegian and Swiss National Statistical Institutes provided their opinion.

The consultation concerned the treatment in national accounts of low interest rate loans (i.e. below market interest rate for the debtor) granted by a government unit in the context of its usual public policy activities and of the sale of those loans to a third party. It was emphasised that government is a non-market producer in national accounts.

### *Main results of the consultation*

2. The CMFB agreed, based on a large majority, that the interest of such loans should be recorded on the basis of the contractually agreed interest rate. In other words, the implicit benefit for the debtor, by means of lower interest rate than market interest rate for the debtor's loan, should not be imputed as revenue of the debtor and expenditure of government in national accounts. It was noted that such imputations would not change the net lending / net borrowing of general government as they would impact in equal amounts the expenditure and revenue of government.
  - Many CMFB members recognised the implicit benefit element (implicit transfer component) but noted that ESA95 does not require thorough imputations in order to record all transactions undertaken by government by reference to market prices.
  - Some members noted the need for consistency in the accounts, emphasising that non-tradable debt (loans) – unlike tradable instruments – are to be recorded at nominal value in the national accounts and interest is to be recorded at the contractual interest rate.

- Some members noted that this issue is on the SNA2008 research agenda, that further work is required to clarify the recording of concessional loans in national accounts, and that the recording could be made in supplementary tables.
3. Concerning the case in which a loan, as specified above, is sold by government to a third party at a discount with no change in the contractual conditions for the debtor, a majority of CMFB members agreed that the discount (difference between nominal value and sales price) should be recorded as a revaluation for both the third party and the government.

*Supplementary information*

4. In case the main results of the consultation would have required the recording of an implicit transfer component (see para. 2) or that the discount in case of sale would be recorded as government expenditure (see para. 3), the CMFB provided the following supplementary information:
  - a majority of CMFB members supported the view that the benefit to the debtor, if it were to be imputed, should be allocated to the respective reporting periods over the life time of the loan.
  - some CMFB members noted that, if the sale with a discount to a third party were to be recorded as expenditure for government, and not as a revaluation, the discount should be (retroactively) imputed at the time of issuance as a revenue for the debtor instead of at the time of sale as a revenue for the third party.
  - a majority of CMFB members supported the view that government expenditure reflecting benefits to the debtor, if it were to be recorded, should be made with reference to an interest rate at which government can borrow funds.
5. The CMFB recommends that Eurostat take account of the specific remarks raised.
6. In addition to this opinion, all the anonymised answers from CMFB Members have been transmitted to Eurostat and will be kept in the records of the CMFB secretariat.

*(Signed)*

João Cadete de Matos  
CMFB Chairman

Lisboa, 18 December 2012