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Subject: Methodological treatment of the capital injections into ADIF

Dear Mr Gómez del Moral,

Following the discussions held in the EDP dialogue visit in Spain on 25-26 February 2007 and at the meeting of 8 March 2007 in Luxembourg as well as subsequent submissions of further documentation, I am in a position to provide you the view of Eurostat on the appropriate ESA95 accounting treatment of the capital injections of government into ADIF.

The accounting issue

Documentation provided

The documentation provided is as follows:

- Business plan of ADIF for the years 2006-2025
- Profit and loss accounts and balance sheets of the predecessor of ADIF (GIF) for the years 2004 and 2005
- Contract between the government and ADIF (*Contrato – Programa: Administración General Del Estado – ADIF 2007-2010*)
- National accounts analysis of the capital injections by the State into ADIF, dated 20 March 2007
- Report on the treatment in national accounting of ADIF and Renfe-Operadora, dated 20 March 2007
- Annual Report and Accounts of ADIF

Description of the case

The issue for which an opinion is being sought is a determination of the correct EDP accounting treatment of the capital injections of government into ADIF.

In 2004, a restructuring of the Spanish railway system took place, including the creation of a new unit called *ADIF* as the owner/manager of all profitable high speed infra-structure. ADIF was also entrusted the responsibilities for some specific tasks.

One of the main objectives of this re-organisation has been to ensure that the newly created body – ADIF – would be a profitable corporation, at some stage in the future. The restructuring of the railway system was organised also in a way to be in accordance with Community Directives.

From 1997 until now, ADIF received 11 billion EUR from government as capital injections classified by the Spanish statistical authorities as financial transactions. These capital injections were specifically earmarked for the construction of the high-speed railway infrastructures. It is foreseen that ADIF will have received from government a total of 14 billion EUR by 2010. ADIF is also receiving funding from the EU for the building the high speed train links (9 billion EUR), as well as 5 billion from borrowing and 4 billion from sale of land.

In the context of the restructuring of the railways, government assumed a large part of RENFE debt in 2004 and the amounts were recorded as follows in national accounts: assumption of the historical debt of RENFE of 3659 million Euro recorded as "other capital transfer" (D99) and debt associated with the transfer of conventional railways assets of 1800 million Euro recorded as "gross fixed capital formation" (P51), for a total impact on government deficit of 5459 million EUR in 2004.

After the re-organisation, there are three actors involved in the construction and running of the railway system: *RENFE-Operadora* as railway operator, a new unit called *ADIF* as owner of all profitable high speed infrastructure, and *Government* as owner of all conventional infrastructure and high speed railway links that are deemed to be unprofitable in the future.

ADIF is both an institutional unit and a market unit. Since there is at this stage agreement between Eurostat and the Spanish statistical authorities on this, there is no need to analyse this point further.

The issue of the recording of capital injections into ADIF, was first discussed in the *2004 EDP mission in Spain*, where it was concluded that the nature of the capital injections would be classified as capital transfers if, after future analysis, ADIF (GIF at that time) turned out not to be profitable. It was also concluded that, in the meanwhile, a financial transaction recording was possible. It is important to specify that at that time it was not clear that the capital injections into GIF were specifically earmarked for the construction of the high-speed infrastructure. Moreover, the initial business plan showed that GIF was supposed to be profitable even during the first years of its activity. No firm conclusion was therefore reached on the issue at that time.

The issue was further discussed in the *2007 EDP mission in Spain*. Eurostat received a copy of the business plan of ADIF for the years 2006-2025 as well as the contract signed between the government and ADIF. According to the business plan, ADIF will not be profitable until 2014. Moreover, the projected long-term rate of profitability (intended rate of return) in the business plan until 2025 is equal to 1–2 % p.a.

On 8 March 2007, a further meeting was organised in Luxembourg at the demand of the Spanish statistical authorities. The main aim of the meeting was to discuss more in detail the contract between the government and ADIF and the business plan prepared by ADIF.

Methodological analysis and clarification by Eurostat

After an examination of the documentation provided, Eurostat has reached the following views.

Applicable accounting rules

Council Regulation 2223/96 incorporates the national accounts concepts and definitions of the European System of Accounts (ESA 95) in Community Legislation in its entirety and directly applicable in all Member States.

ESA95 paragraph 4.152 applies in this case. In addition, the Eurostat ESA95 Manual on government deficit and debt (MGDD) chapter II.3 on capital injections is relevant.

Availability of national accounting analysis

The Spanish statistical authorities considered appropriate until now to record the capital injections as financial transactions, recording them under heading "*Shares and other equity*" (F5), without impact on government deficit.

Analysis

According to national accounts rules, in order for capital injections to be treated as financial transactions, Government must behave as a private investor and the investment must originate a market rate of return. This does not appear to be the case. According to the documentation ADIF will not be profitable at least until 2013/2014. It is to be underlined that the present rules stress that if there are "*doubts on the long-term profitability of the project, the capital injection is to be treated as a non-financial transaction for its full amount*"¹.

Although after 2014 ADIF might become profitable, the overall profitability rate will still be very low, between 1 and 2 %. While accounting rules do not provide an explicit indication of an exact profitability rate, the government is supposed to behave like a private investor in order for the capital injections to be treated as financial transactions.

It is also suggested by accounting practice that a pattern of repetitive payments would be an indication of an unrequited transfer. This is the case of ADIF and its predecessor, which has received capital injections in every single year between 1996 and 2007 (with more capital injections to be further undertaken by government in following years).

Government is the sole shareholder of ADIF and no private shareholders are participating in the capital injection. If private investors would take part in the capital injections, this would be evidence (pending certain conditions) that the investment is deemed to be a profitable one and the capital injection would likely be treated as a financial transaction. However, this is not the case.

Furthermore, it is noted that the EU is co-financing the building of the high-speed railway infrastructure. It is to be recalled that EU-financed projects are not expected to be necessarily

¹ MGDD chapter II.3, page 11

profitable. One of the main reasons for the EU to contribute to the raising of capital in such circumstances is precisely that government would have difficulties in involving private investors to invest in such projects. Such EU financing are recorded as EU expenditure and revenue of the beneficiary (i.e. ADIF). If government and the EU are co-financing the building of infrastructures, it would seem unjustified if this would be considered as expenditure of the EU but not of government. The position of Eurostat on this point is in accordance with similar cases examined in other Member States.

Finally, a key point moreover, is the fact that the capital injections are explicitly earmarked for building of high-speed infrastructure. This is clearly showed in the *Contract between the government and ADIF (Contrato – Programa: Administración General Del Estado – ADIF 2007-2010)*. This suggests recognising an investment grant (D.92). ESA 95 specifies that (§4.152) "*Investment grants (D.92) consist of capital transfers in cash or in kind made by government or by the rest of the world to other residents or non-resident institutional units to finance all or part of the costs of their acquiring fixed assets*". The manual on government deficit and debt further indicate that "*A capital injection that is conditional on the public corporation spending the funds on fixed capital formation, but does not commit the recipient any further, such as in making future payments (this seems to be the case for ADIF) should be recorded as a capital transfer – in this case an investment grant (D.92)*".

Conclusion

On the basis of the above considerations, Eurostat considers that the capital injections into ADIF should be classified as non-financial transactions. It is Eurostat's view that the capital injections into ADIF are to be classified as a *capital transfer (D.9) – in the form of investment grants (D.92)*.

Procedure

We would like to remind you that Eurostat is committed to adopting a fully transparent framework for its decisions on debt and deficit matters in line with the amended Council Regulation 3605/93. Eurostat therefore publishes all official methodological advice (ex-ante and ex-post) given to Member States, on the Eurostat web site. In case you have objections concerning this specific case, we would appreciate if you let us know. In any case (regardless of whether you have objections or not) we would like to receive an answer from you on the issue, no later than 16 August.

Yours sincerely,



Laurs Nørlund