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- FINAL FINDINGS -

EDP dialogue visit to Portugal
11-12 February 2008

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Executive Summary

During the EDP dialogue visit to Portugal the discussion covered several issues including issues relating to statistical capacity, the EDP tables reported in the October 2007 EDP notification round, the classification of public corporations, the issues of guarantees and capital injections into hospitals, the treatment of the sale and lease back operations, Public Private Partnerships and swaps.

Regarding the statistical capacity issues, INE informed Eurostat that the timely collection and flow of information from budgetary sources required for the compilation of National Accounts data has considerably improved owing to the cooperation of INE, the Bank of Portugal and the Ministry of Finance in the framework of a working group set up after an agreement among the three institutions defining the roles of each of them in the preparation of EDP notifications.

Moreover, an extensive discussion took place with respect to a series of ongoing developments on government accounting and their implications for the compilation of the National and Financial Accounts. The Portuguese authorities explained that although accruals based data are collected from municipalities, those data are not consolidated with data for local corporations and are still under evaluation. However, accruals based data are being compiled for some central government units but the completion of the project will require several years more.

In the discussion on the October 2007 EDP reporting several issues have been raised relating to "other accounts receivable and payable", revision analysis and military expenditure. Eurostat expressed its concerns regarding the observed pickup in other accounts payable following the substantial reduction in 2005 as well as for the high stock reported in 2007Q3. Eurostat took note of the explanations of the Portuguese authorities on the issue of the compilation of data on other accounts payable. It was also agreed that the Portuguese authorities will provide explanations on the value of the outstanding stock of this item.

Concerning the revision analysis, Eurostat pointed out the upward trend of the revisions in the general government deficit reported by Portuguese statistical authorities over successive notification rounds. The problem was recognised by the Portuguese authorities who explained that they were aware of the possible reasons which they expect to be significantly eliminated with the introduction of new data sources.

As for the military expenditure, the Portuguese authorities confirmed that they are following the Eurostat Decision of March 2006 both with respect to the time of recording and the treatment of leasing.

The discussion on the classification of local public corporations focused on the ongoing process of reclassification of several local public non-financial corporations to the general government undertaken by the Portuguese authorities and its expected relatively small impact on past deficit and debt data. INE provided Eurostat with a list of local public corporations and their classification and explained that the initial classification of those corporations has been mainly based on their legal status and that the decision for the final classification of these units will depend on the expected information from the new business register. Eurostat expressed the view that local public corporation should be appropriately classified as soon as possible and preferably within a year after their creation. The Portuguese authorities were invited to provide Eurostat with information on the accumulated debt of the local public units classified outside general government.

In the same context the analysis of INE concerning the public corporation Estradas de Portugal (EdP) was discussed. According to the conclusion of the analysis, EdP should remain classified inside general government. Eurostat expressed its agreement with the continuation of this practice, i.e., classification of EdP inside general government.

Before the October 2007 EDP notification, calls of guarantees used to be treated by the Portuguese authorities as financial operations. In the October 2007 EDP notification the Portuguese statistical authorities started treating calls as deficit increasing capital transfers. In the same notification round Eurostat identified also an issue of repeated calls on public guarantees which in some cases were significant. Eurostat considered the new approach of the Portuguese authorities regarding the treatment of guarantees appropriate but invited them to examine the observed cases of repeated calls and consider the recording of the total outstanding debt of the entities involved as government debt, as indicated by the rules of the Manual on Government Deficit and Debt.

The issue of capital injections into hospitals was extensively discussed as the Portuguese government continued the conversion of public hospitals previously belonging to government into corporate public enterprises. The Portuguese authorities provided Eurostat with a provisional analysis of these new injections. Eurostat took note of this research and during the discussion specified several reasons documenting why the capital injections undertaken by government in 2007 could not be treated as financial transactions. On the basis of these arguments Eurostat stressed that there can be no doubt that all recent capital injections undertaken by government as well as those to be undertaken in 2008, 2009 and 2010 (as indicated by the business plans) should be recorded as capital transfers.

Concerning the issue of the treatment of sale and leaseback operations arising from the ongoing restructuring/rationalisation of the government, involving Parpublica as well as other entities, Eurostat thanked the Portuguese authorities for providing information on the government buildings that have been sold to Sagestamo (a real estate subsidiary of Parpublica) and on the list of the buildings, indicating their status. It was also clarified that two real estate funds are involved in sales of government buildings. It was agreed that the Portuguese authorities will provide Eurostat with further information on the process of creation and the ownership of Fundo Estamo (owned by commercial banks) and of Fundiestamo I (owned by government via Parpublica and Sagestamo) as well as on the amount of assets transferred to them.

The Portuguese authorities informed Eurostat that there have been no new PPP contracts. However, new concession contracts mainly for motorways are expected to be signed in 2008

but the amounts involved were not known to the Portuguese statistical authorities. Regarding the Alqueva Dam concession for which the Portuguese government received a large payment in 2007, the Portuguese authorities requested further time to prepare an analytical note on the arrangements, amounts and treatment in national accounts. A list with all the concessions signed in recent years by government was also agreed to be provided to Eurostat before the October 2008 EDP notification.

Regarding the use and recording of derivatives in the Portuguese accounts, the Portuguese statistical authorities confirmed that there have been no cases of options, off-market swaps, FOREX swaps or swaptions. In the case of swap cancellations they have indicated that the accrued interest would be recorded as affecting government deficit, but all other elements would be recorded as financial transactions.

Under other business, the discussion focused on the issue of the sale of Cahora Bassa dam. The Portuguese authorities informed Eurostat on the procedures followed for the sale of the dam to the Mozambique government and explained that the operation had proceeded as foreseen in the Memorandum of Understanding signed by the two governments. According to the provided information, the write-off of debt to Portugal would be recorded in the national accounts as an other economic flow. It was agreed that INE will send to Eurostat a table detailing the national accounts recording of the operations related to this sale.

Last, the Portuguese authorities confirmed that there have been no transfers of pension obligations to the social security scheme in the period between 2005 and 2007.

1. Statistical capacity issues

1a) Institutional responsibilities in the framework of the reporting of data under the EDP and government finance statistics compilation-inter-institutional Task Force

Introduction

The preparation of the EDP notification is shared among the Statistical Office (INE), Ministry of Finance (Ministério das Finanças e da Administração Pública) and the Central Bank (Banco de Portugal). On 10 January 2006 an agreement was signed between the three institutions aiming to clarify the role of each one of them in the notification process. Two working groups were set up to "analyse the accounts before each notification and to discuss the methodological questions related with the EDP notification". Bank of Portugal provided Eurostat with an English language copy of the agreement signed by the three institutions.

Discussion

The coordination of the work of the three institutions that have signed the agreement has been improved significantly in many aspects. The cooperation in the framework of the working group has facilitated the timely collection of information as well as the flow of information from budgetary sources needed for compiling National Accounts data. It has also contributed to the harmonisation of methodologies used by the institutions, and the coordination of Portugal's positions in various international fora.

Conclusions and action points

Eurostat congratulated the Portuguese authorities on the working agreement signed by the Ministry of Finance, Bank of Portugal and INE, which clarifies the role of each of them in the preparation of EDP notifications and allows them to cooperate in the context of methodological issues related to general government statistics.

1b) Evolution of data sources

Introduction

There are a number of ongoing developments in data sources for government in Portugal. An increasing range of financial accounts data is being compiled by the Banco de Portugal and included in the EDP notification. Progress has been made to reduce the discrepancies between the calculation of general government liabilities in financial accounts and the calculation of Maastricht Debt, although some discrepancies remain still significant. These are related with the maturity breakdown of Loans.

At the same time, the EDP inventory lists new accounting data sources which are coming on-stream. With the full implementation of the listed programmes, the Portuguese government budget reporting system will continue to move towards an accruals based system, abandoning progressively the elements of the system that still rely on cash information. This is expected to have positive implications on the coverage and quality of data available to National Accounts compilers.

Discussion

The Portuguese authorities agreed to further investigate and eliminate the unexplained discrepancies between general government liabilities in the financial accounts and Maastricht Debt (specifically for loans). They explained that the Banco de Portugal already makes certain adjustments to the data, notably for debt factoring operations.

The Portuguese authorities explained that accruals based data are becoming available from municipalities but they are not consolidated with data for local public corporations and are still being evaluated for quality. Nevertheless, a new simplified corporate-style reporting system for local government units had significantly improved quality and coverage. Accruals based data are available from some Central Government bodies (the National Health Service, Social Security and Public Universities) and the process of extending accruals based accounting to autonomous Central Government bodies is generating first results. However the implementation of a general accruals based accounting system for Central Government ministries is expected to take several years more.

Conclusions and action points

Eurostat invited the Portuguese statistical authorities to monitor the ongoing developments on government accounting and assess their implications for the compilation of the National and Financial Accounts. Cases of other countries were noted where the introduction of accruals based government accounting had led to major improvements in the timeliness and completeness of data sources for the general government sector, provided that the integration of the new data sources had been handled carefully.

1c) EDP inventory

Introduction

The Portuguese consolidated inventory of sources and methods provides information on data availability and data sources for all subsectors of the general government. The main data source for all subsectors of general government is Budget reporting. The data reported are on a mixed (cash-accrual) basis except for few entities like the National Health Service (SNS) which are based on accrual information taken from the unit which administers the SNS resources. The Portuguese authorities have published the EDP inventory on the website of INE.

Conclusions and action points

Eurostat explained its plans for improving the structure and content of the EDP inventories and invited suggestions from the Portuguese authorities. Given the ongoing developments in data sources, if appropriate, Eurostat would welcome an update of the Portuguese EDP inventory before the end-September 2008 EDP notification round.

2) Follow up of the October 2007 EDP reporting-analysis of EDP tables

A number of specific issues were addressed under this point. In general Eurostat welcomed the timely and increasingly complete reporting of the Portuguese EDP notifications and questionnaires related to the EDP notifications. Eurostat invited the Portuguese authorities to complete EDP notification table 4 (notably for trade credits and debit arising from public undertakings) when the relevant data become available.

i) Other accounts receivable and payable

Introduction

Eurostat had examined the time series of other accounts payable by the Portuguese General Government and observed that there was a substantial reduction in 2005 followed by a build-up in subsequent years, with the stocks of other accounts payable reaching 4.2 billion euro (2.6% of GDP) in 2007Q3. An unusually high and positive change in other accounts payable had been observed in 2007Q1.

Eurostat wished to clarify the steps taken by the Portuguese authorities in compiling data on other accounts payable, which they had enumerated in a questionnaire during the last EDP notification round.

Discussion

Concerning trade credits, the Portuguese authorities reported that credits to public units are followed by the Banco de Portugal, through a set of information (money and banking statistics securities database and BOP data for information on credit from abroad) and the simplified corporate-style information system which is currently available.

Regarding the movements observed in other accounts payable in recent years, the Portuguese authorities explained that there had been an increased monitoring of government arrears

(including a new quarterly reporting obligation for government units) and that the large reduction in arrears which occurred in 2005 was due to a Supplementary Budget to settle health-related arrears. The restructuring of the Portuguese public sector may be a factor contributing to the accumulation of arrears and thus to an increase in the stock of other accounts payable. The unusual increase in other accounts payable in 2007Q1 may be due to incorporation of new data sources, but would need further investigation.

The Portuguese authorities explained the series of adjustments made to other accounts payable data (by the Banco de Portugal), notably:

- An adjustment for time differences in financial transactions (generally timing of capital injections when the share capital had been subscribed at end-year with subsequent cash payments in the following year);
- An adjustment for discrepancy in deposits between financial accounts and public accounts (where financial accounts use information from money and banking statistics);
- An adjustment for balancing the financial and non-financial accounts.

Eurostat mentioned the practice of another EU Member State which makes an adjustment to other accounts payable data to ensure full consistency between financial and non-financial accounts. For the purpose of EDP notification table 3, this country removes the adjustment from the row for other accounts payable and reports it as a statistical discrepancy, thereby ensuring full transparency.

Conclusions and action points

Eurostat took note of the explanations of the Portuguese authorities on the compilation of data on other accounts payable.

The Portuguese authorities will provide explanations on the value of the outstanding stock of other accounts payable. As regards the considerable and unusual increase of the stock reported in the first quarter of 2007, the Portuguese authorities mentioned that this data were compiled for the first time, on a quarterly basis, in the beginning of 2007, possibly implying a structural break with the previous estimates.

ii) Revisions analysis

Introduction

Eurostat had observed a pattern of upward revisions in the general government deficit reported by Portugal over successive notifications.

Furthermore, Eurostat had noted a study of revisions in EDP deficit and debt data by DG ECFIN and the Banco de España¹, which had concluded, for the period under analysis, that Portugal had been one of the two EU Member States with the largest and most volatile observed revisions in reported EDP deficit data, and that the revisions exhibited an upward bias in terms of deficit increase throughout time. This might be due to a number of reasons,

¹Luis Gordo Mora (Banco de España) and João Nogueira Martins (Directorate-General for Economic and Financial Affairs) How reliable are the statistics for the Stability and Growth Pact?

for example the effect of Eurostat Decisions, changes in methodology and the incorporation of new source data.

Discussion

The Portuguese authorities explained that they take the issue of data revisions seriously, that they were aware of the range of possible explanations, and that the introduction of new data sources could be expected to improve the situation (this could already be seen in the reduced revisions observed in recent years). The Portuguese authorities informed Eurostat of their intention to re-base the national accounts in 2009 (to a base year of 2006), which would allow the incorporation of the impact of new data sources into the complete time series.

Conclusions and action points

Eurostat urged the Portuguese authorities to undertake an analytical work to identify the different elements included in the revision of data to overcome the problem of systematic upward revisions of the deficit in the past throughout time and to take action as necessary. In particular the Portuguese authorities were invited to identify any effects due to revised source data.

iii) Military Expenditure

Introduction

Eurostat's Decision of March 2006 on the recording of military equipment expenditure had established the principle that the time of recording of the acquisition of this equipment in national accounts should be at time of delivery. Furthermore, the leases of military equipment organised by the private sector should be considered as financial leases in national accounts.

Conclusions and action points

The Portuguese authorities confirmed that they are following the Eurostat Decision, both with respect to recording at time of delivery and treatment of leasing.

3. Methodological issues and recording of specific government accounts

3.1 Delimitation of general government, application of 50% rule in national accounts

3.1.1 Classification of local public corporations

Introduction

After the discussion of an observed case in the end-March 2007 EDP notification, where the debt of a local public corporation responsible for infrastructure development had been assumed by government, the Portuguese statistical authorities notified Eurostat of the ongoing process of reclassification of several local public non-financial corporations to the general government sector with expected (relatively small) impacts on past deficit and debt figures.

Discussion

Eurostat welcomed the provision of a list of local public corporations and their sector classification.

The Portuguese authorities explained that the initial national accounts classification of local public corporation has been largely based on their legal status. Thus, INE needs more information for deciding for the classification of the public units. This information is expected to be obtained by the new business register (annual survey covering 300000 public and private enterprises). Thus, the provided list of local public corporations could not be considered final and may change at the time of the 2009 re-basing exercise with the information from this new source. Nevertheless, the amounts involved could be expected to be relatively small. The Portuguese authorities also mentioned the difficulties encountered in sector classification of corporations which are dormant for several years after their creation.

Conclusions and action points

Eurostat highlighted its concerns that local public corporations are appropriately classified as soon as possible, preferably at the latest within one year of creation, and that the corporations which have been established to build new infrastructure should be closely examined. Eurostat mentioned that newly-created local corporations should generally be examined for their autonomy of decision and if they are simply operating and performing tasks in the same way as when the activity was carried out 'in-house' by the local government (i.e. acting on behalf of the government). This might be undertaken for groups of corporations performing similar functions (for example, tourism, cultural or education corporations). The Portuguese authorities were invited to provide Eurostat with some information on the aggregated debt of the local public corporations units classified outside general government, together with a marked-up example of the simplified business reporting system which is currently under consideration to test the 50% rule test for the market or non-market status of the body.

Issue: Estradas de Portugal

Introduction

Estradas de Portugal (EP) was created by a legal act on 1st January 2005. By the Decree-law no 374/2007, EP was transformed into a public corporation owned in total by the State. According to the Concession contract between EP and the State, established by the Decree-law 380/207, EP has the right to exploit the entire national road network including those roads that are currently under a concession agreement under specific circumstances. Under this arrangement, EP is responsible for constructing, planning, maintaining and operating all the roads included in the National Road Plan (NPR). EP will be the sole and general concessionaire of the roads of the NPR. The revenues of EP include (a) toll payments by users, (b) shadow toll payments based on traffic flow, (c) contribution of road service, and (d) other revenue. The analysis of the relevant information has led the Portuguese authorities to maintain the classification of the EP inside of the general government.

Discussion

INE's analysis had led to the conclusion that there is no relationship between Estradas de Portugal's receipts of contribution of road service and the service being provided to individual motorists. This therefore meant that the majority of EP revenue would not originate from the

sales of services and therefore application of the 50% rule would determine that EP remains a non-market unit.

The Portuguese authorities noted that EP might be part-privatised in future and there is an intention to shift from shadow-toll based systems to actual tolls charged to road users.

Conclusions and action points

Eurostat expressed its agreement with the continuation of this practice, i.e. classification of EP inside general government.

3.2.1 Guarantees

Introduction

Before the October 2007 notification, the Portuguese authorities have treated calling of guarantees as financial operations in national accounts – the government acquired a loan asset in exchange for settling a call (this continues to be the treatment in public accounts). However, in the October 2007 notification the Portuguese authorities changed this approach, to treat calls as (deficit increasing) capital transfers in national accounts.

In October 2007, Eurostat became aware for the first time of repeated calls on public guarantees in Portugal. During the October 2007 EDP clarifications, it became clear that repeated calls have been significant in some cases.

Examining the table provided by the Portuguese authorities on guarantees, Eurostat was particularly concerned with those guarantees subject to repeated calls which were on the debts of a single entity.

Conclusions and action points

On the issue of guarantees, Eurostat found the decision of the Portuguese authorities to treat calling of guarantees as non-financial operations as fully appropriate given the fact that repayments on guarantees called during the last year were negligible.

Eurostat also invited the Portuguese authorities to examine the cases where repeated calls on guarantees to single entities have been observed (especially in the cases of GESTNAVE and CASA DO DOURO) and consider the recording of the total outstanding debt of these entities as government debt in line with the rules of the Manual on Government Deficit and Debt, current practices in other Member States and recent decisions of Eurostat. In the particular case of CASA DO DOURO, the Portuguese authorities mentioned that this entity has considerable assets that may be called to pay debts. Eurostat expressed doubts on whether this would have any impact on the recording of the repeated calls, according to national accounts rules.

3.2.2 Capital injections into hospitals

Introduction

In Portugal, general government has undertaken capital injections into hospitals starting in 2002, in the context of the transformation of hospitals into corporations.

The conversion of public hospitals previously belonging to general government into corporate public enterprises continued in 2007 with the ten newly created corporations receiving capital injections amounting to EUR 150 million (0.09% of GDP). The Portuguese statistical authorities had made a provisional analysis of these injections.

Eurostat took note of research by the Portuguese authorities on the activities of private hospitals in Portugal and of explanations of the analytical approach taken to statistical classification of injections into hospitals. Eurostat acknowledged the significant improvement in quality brought about by this analysis, compared to the notable lack of information verified in the past.

Discussion

Eurostat specified several reasons for which the capital injections undertaken by government in hospitals in 2007 could most likely not be treated as financial transactions. These were as follows:

1. Non payment of dividends: no dividend has ever been paid to government by any of the many hospitals that received capital injections from government from 2002 onwards, and dividends are not expected to be paid by those which have received capital injections in 2007. This is also shown in the business plans, where no dividend to government is ever mentioned, neither is in the foreseen profit and loss accounts nor in the accompanying texts in the document. The payment of dividends is in fact one of the main elements for assessing the treatment of the capital injections, according to provisions in the MGDD (see pages 62 and 63 in chapter II.3).
2. Investment grants: The MGDD (page 63) specifies that "*an unrequited payment made to a corporation under the condition of using the cash to acquire an asset should be recorded as an investment grant*". The same concept is similarly repeated also in the updated chapter. In many of these hospitals in fact, the amount of capital injections received from government is equal, or very close, to the amount that will be used to finance investment. In some cases not only this can be seen by comparing the figures between the two amounts, but it was even made explicit in the business plan.
3. Cover of losses of past years. Most of the hospitals were bearing losses in the past years and they have incurred debt. In some cases, additionally, the business plans showed even negative own funds. The MGDD specifies that "*a capital injection made to cover accumulated losses should be recorded as a capital transfer (D.99)*", in application of ESA 4.165b.
4. Participation of private shareholders in the capital injection or intended privatisation. The participation of private shareholders is an important indicator to judge whether a capital injection should be classified as a capital transfer or as a financial transaction. This is specified in the MGDD (page 65) as well as in the updated chapter. In the case of the Portuguese hospitals, they are fully owned by government at present, their capital will not be opened to shareholders, and there are no intentions for them to be privatised in the short term. These factors would therefore also lead to the recording of a capital transfer.

5. Repeated capital injections: When reading the business plans provided by the Portuguese authorities, Eurostat found out that all the ten hospitals under investigation would have received capital injections not only in 2007, but also in additional years (most of them also in 2008 and 2009, but in one case also in 2010). The MGDD specifies clearly that (page 65) repetitive payments should give rise to capital transfers. In addition to this, it was recalled that on 20/04/06 a letter signed by Mr. Nørlund addressed to INE, specified that "*for coming years... future capital injections to those hospitals which have received past injections... should be recorded as capital transfers.*" Moreover, it was also shown that some capital injections were for the benefit of hospitals resulting from mergers with other hospitals that had already received capital injections.

6. Government behaving as a private shareholder. Another criterion which would determine the recording of the capital injection as a financial transaction would be when "*government is obviously acting similarly to a private shareholder*" (updated chapter MGDD page 11), and government expects to earn a market rate of return (MGDD page 36). An analysis of the business plans of the hospitals provided by INE, showed in fact that this was not to be the case for at least 9 out of ten of them (where rates of return seemed to vary from a negative value to just up to 3%, with some hospitals showing negative returns for all years).

7. Continuous transfers by government. It is evident that in undertaking the test of whether a government would be behaving like a private investor, subsidies and transfers by government would not have to be taken into account in the calculation of the market rate. The continuous support by government in the calculation of the market rate of return would be an additional factor to be taken into account.

8. EU grants. From the examination of the business plan of the hospitals, it is shown that, gross fixed capital formation in the hospitals for the next years would be financed not only from the government investment grants above, but also by EU grants (FEDER fund). This shows that the EU expects that gross fixed capital formation would be co-financed by government. According to rules, the part co-financed by government has always been considered by Eurostat and by the EU Member States as government expenditures.

9. Degree of uncertainty. In some business plans, or in documentation provided by the Portuguese authorities, it is mentioned that the hypothesis made in the business plans might be too optimistic and that there would be doubts on the assumptions of the business plans. The updated chapter of the Manual specifies clearly that when "*there are doubts on the long-term profitability of the project, the capital injections is treated as a non-financial transaction for its full amount*".

10. Performance of similar operations in the past. One of the criteria used to determine how to classify the capital injections undertaken by government in the hospitals would have necessarily to be the performance and results of similar operations in the past, taking into account the profitability of those hospitals for which there would be a longer time series of profit and loss accounts to be analysed. It was recalled that the first capital injections were undertaken in the Portuguese hospitals in the year 2002, where no less than 34 public hospitals were converted into public corporations. It was explained by INE that of all these hospitals which received such capital injections in 2002, the vast majority of them have been in fact bearing losses.

11. Consideration of similar operations in other Member States. One of the main duties of Eurostat is to harmonise the statistical treatment of similar operations across EU Member States. Eurostat was not aware of cases where capital injections undertaken in hospitals classified in the non-financial corporation sector were classified as financial transactions.

The Portuguese authorities pointed out that the recording in National Accounts of the capital injections into hospitals by their shareholder would have to take into consideration the

treatment that it is given to similar operations when the shareholder is from the private sector. As the private shareholder would naturally expect that every financial investment will tend to be profitable (unless the risks associated to unfavourable developments materialize), the key question for a final assessment would be to evaluate the profitability of the concerned hospitals. The only element available to do that was the business plans of the concerned hospitals which have a short time horizon (3/4 years). However, some representative private agents of the wealth sector told the Portuguese authorities that the pay off of this type of investments usually take longer periods to happen. Additionally, restructuring processes set in business plans point to adjustments similar to those expected to be attained under PPP management contracts proposals, or in hospitals ran by private entities. Therefore, in this sense, it can not be concluded that Government is not acting as a private shareholder.

The non distribution of dividends was also mentioned as a reasonable option, since any increase in the value of corporations is to be used to reinforce their assets in the form of reinvestment. As a result, the Portuguese authorities noted that it can not be claimed that government, as shareholder, is behaving differently from a private shareholder. As a matter of fact, although payment of dividends represents a valuable element for assessing the nature and treatment to award to capital injections, it is not considered a crucial one in the new chapter of MGDD on Capital injections (page 3, footnote5)², that is, the absence of dividends' payments does not preclude the classification of a capital injection as a financial operation.

The Portuguese authorities also added that the announced intention of capital injections was to make funds available to each new enterprise-hospital as a part of a process of reorganization and restructuring, as presented in their business plans, leading to an increase of their capital value. This could be considered as being covered by the definition provided in the new chapter of MGDD on Capital injections (page 3³). Moreover, capital injections in enterprise-hospitals are not conditional on using them to acquire a specific asset. As any private corporation, enterprise-hospitals have all the legitimacy to use capital injections in the way it serves best the execution of their business plans, which may comprise investment activity. Also, as any private shareholder, government should only make the funds available when they are needed for the development of the business plans⁴.

In those business plans, the way the market rates of return were computed is in line with the common rules and practices that apply to all corporations, irrespective of the nature of their shareholders.

Concerning EU grants, the Portuguese authorities noted that their respective national counterpart can have a private or public nature. As any private investor, the enterprise-hospitals, in the execution of their business plans, are free to apply for EU grants and, if they are granted, to use them in their investment activity, seeking the best execution of business plans. Acting in this way, enterprise-hospitals are behaving as it would be expected from any other private agent.

Regarding the past, the Portuguese authorities pointed out that nine of the ten new enterprise-hospitals incorporate hospitals that belonged before to General Government. Consequently, the capital injections conducted in 2007 were directed to cover accumulated losses of former enterprise-hospitals. However the total amount of the capital injection for each hospital is

² ESA95 MGDD Chapter II.3 Capital Injections (Edition 2003)

³ ESA95 MGDD Chapter II.3 Capital Injections (Edition 2003)

⁴ Otherwise, the shareholder is incurring in a financial cost without any benefit. That is not a typical behaviour of an optimizing economic agent.

planned not be concentrated only in 2007. Again, this situation is not unusual in the private sector as it may reflect several aspects like, for example, the current financial situation of the shareholders. So by spreading the whole amount of capital injection across some years in the future it is not "per se" an evidence of lack of profitability.

Finally, the Portuguese authorities expressed their support for the Eurostat efforts to harmonize the classification of operations in national accounts in order to make them fully comparable, not only the case of capital injection, but also in the sources and detail of information used to compile national accounts.

Conclusions and action points

Eurostat considered that on the basis of the above considerations there were major doubts on whether the capital injections undertaken by the Portuguese government in public hospitals, as well as those to be undertaken in 2008, 2009 and 2010 (as indicated by the business plans) could be classified as financial transactions.

INE (in cooperation with the Bank of Portugal and the Ministry of Finance) will provide to Eurostat a revised analysis of the operations involved in good time, in order to allow Eurostat to react before the next EDP notification.⁵

The Portuguese authorities considered that the key question for a more definitive assessment would be to evaluate the profitability of the concerned hospitals. Since the actual assessment is based only in a short time horizon (3/4 years), this issue should be more carefully looked and eventually lead to further investigation. Eurostat agreed that this matter justifies continuing the discussion taking on board new developments and information provided by the Portuguese authorities or by Eurostat based on further investigation into similar cases.

3.2.3 Parpublica and the treatment of sale-and-leaseback operations

Introduction

After conducting an analysis of the accounts of the Portuguese state holding company (Parpublica), Eurostat noticed that significant operations in real estate have been recorded, including the purchase of properties from the Portuguese government. There have been major property sales by the Portuguese government over recent years, some to Parpublica (to its real estate subsidiary "Sagestamo") but also to other parties, arising from the ongoing restructuring/rationalisation of the government. In certain cases the Portuguese government occupied the buildings for "a limited time".

Discussion

Eurostat thanked the Portuguese authorities for providing information concerning the process by which government buildings have been sold to Sagestamo and a list of the buildings with their status. It was noted that the Portuguese government did not retain any rights over the buildings once sold to Sagestamo, beyond the general planning system rights it could exercise on any building. Sales were at prices determined by independent valuers, in some cases reduced when the Portuguese government wished to continue occupation. During the

⁵ The information was provided on 18 March 2008. Eurostat's conclusion was that all capital injections into hospitals in 2007 and following years should be classified as capital transfers for the reasons referred to above. The Portuguese authorities accepted Eurostat's position and notified accordingly in the April 2008 EDP notification.

discussion, the Portuguese authorities confirmed that in the cases where the government continues to occupy the buildings, the contracts which provide for that continued occupation over a limited number of years are not automatically renewable, and that the buildings are put in the market either during or at the end of the contract.

The Portuguese authorities mentioned that two real estate funds are involved in sales of public buildings: (1) Fundo Estamo (set up in 2003) owned by commercial banks and (2) Fundiestamo owned by government (via Parpublica and Sagestamo).

Conclusions and action points

Eurostat took note of the explanations of the Portuguese authorities on the process of sale of real estate assets by the Portuguese government followed by rent or leaseback. It was agreed that the Portuguese authorities will provide information on the process of creation and ownership of Fundo Estamo and Fundiestamo I (a real estate fund owned and operated by Sagestamo), as well as on the amount of assets transferred to them.

3.2.4 Public Private Partnerships (PPP)

Introduction

The Portuguese authorities reported that no PPP deals were signed between 2004 and 2007, though they expect two new deals (Tunel do Marão, a road tunnel and a hospital, Hospital de Cascais) to be signed in 2008.

However, the Portuguese government has received a large concession payment in 2007 for the Alqueva Dam (in the Alentejo region of South-Central Portugal). The dam concessionaire is EDP Energias de Portugal.

Discussion

According to the information provided by the Portuguese authorities during the discussions, there have been no new PPP contracts recently signed. Some concession contracts, mainly for motorways are being prepared to be signed in 2008 but the amounts involved were not known to the Portuguese authorities. It was also mentioned that there were two cases of concessions in 2007 but the amounts and other details were not known.

Regarding the Alqueva Dam, the Portuguese authorities requested further time to prepare an analytical note on the arrangements, amounts and treatment in national accounts. The concession payment received by the Portuguese government in 2007 was believed to be EUR 195 million, with ongoing annual concession payments of around EUR 13 million.

Conclusions and action points

The Portuguese authorities will provide Eurostat before the October 2008 notification with a list of concessions signed by government in recent years by amount, year of signature and counterpart, as well as information on their recording in national accounts. The list will include only the concessions for which a tender procedure has been launched. A specific analytical note will be prepared on the Alqueva Dam concession.

3.2.5 Swaps (swap cancellations, off-market swaps, FOREX swaps, options)

Introduction

Eurostat has been developing a guidance note on the treatment of derivatives, which has been discussed in the Financial Accounts Working Group. It was therefore considered useful to learn more about the use and recording of derivatives in the Portuguese accounts.

Discussion

The Portuguese authorities confirmed that there have been no cases of the government using options, off-market swaps, FOREX swaps or swaptions. In the case of swap cancellations, they noted that accrued interest would be recorded as affecting the EDP deficit, however all other elements would be recorded as financial transactions.

Conclusions and action points

Eurostat noted that it will provide guidance on the appropriate way of recording swap cancellations in the coming weeks.

4. Other issues

4.1 ESA95 Transmission Programme

Eurostat congratulated the Portuguese authorities on their timely and consistent transmission of ESA transmission programme data to Eurostat.

4.2 Any other business

Sale of Cahora Bassa

Introduction

The Cahora Bassa dam in Mozambique was constructed in the early 1970s and upon Mozambique's independence from Portugal was operated by the company Hidroelectrica de Cahora Bassa (HCB), owned jointly by the Portuguese (82%) and Mozambique (18%) governments. Until recently, the dam has operated at a loss and therefore accumulated very large debts (including accrued interest) with the Portuguese government.

In 2006, a Memorandum of Understanding was signed between Portugal and Mozambique. Eurostat was consulted and after several exchanges, provided the Portuguese authorities with its provisional views on how to record the operation in national accounts waiting for the completion of the operation and the examination of the arrangements in detail.

On November 27, 2007 the operation was completed and the dam passed to Mozambique ownership, with Portugal retaining a 15% equity stake.

Discussion

The Portuguese authorities explained that the operation had proceeded as foreseen in the Memorandum of Understanding (and previously explained to Eurostat). The Mozambique government has created a special purpose vehicle to purchase shares from Portugal (for USD 700 million), financed by borrowing. The write-off of debt to the Portuguese government (USD 2.1 billion) would be recorded in the national accounts as an "other economic flow". A second SPV was established by the Mozambique government to securitise future electricity revenues, and this process had led to an extra payment (USD 123 million) being made to the Portuguese government in 2007 as a 'distribution of reserves'.

Conclusions and action points

It was agreed that INE will send to Eurostat, before the next EDP notification, a table detailing the national accounts recording of the operations relating to the sale of Cahora Bassa to Mozambique.

Transfers of pension obligations

The Portuguese authorities confirmed that there have been no transfers of pension obligations to the social security scheme in 2005-2007.

Annex 1

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