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## **Deficit and debt**

# **THREE COMPLEMENTARY DECISIONS BY EUROSTAT ON ACCOUNTING RULES**

Following the decisions of 3 and 21 February 1997, and 26 March, **Eurostat, the Statistical Office of the European Communities in Luxembourg**, has once more decided on three complementary accounting issues setting the guidelines to ensure a better comparability for the deficit and debt procedure in Member States.

Following specific requests from some Member States seeking clarification, Eurostat has undertaken a wide consultation process<sup>1</sup> at **EU**-level with the relevant technical groups involved. Having heard their opinion, Eurostat has decided on methodological rules which must now be applied by all Member States.

### **Decisions were taken on the three following subjects:**

*(for details see below)*

- Treatment of **linear bonds**
- Financing and exploiting of **public infrastructure** by the enterprise sector.
- Treatment of **export insurance guaranteed by the State**.

The decision on **linear bonds** follows decisions already taken by Eurostat concerning non-conventional bonds, i.e. those whose treatment is not explicitly indicated in ESA 1979<sup>2</sup>. For tranches issued twelve months after the first issuance, all of the difference between the nominal value and issue price must be considered as interest recorded at the time of the payment of coupons. This difference therefore has an impact on the public deficit.

On the subject of financing and exploiting of **public infrastructure** by the private sector, Eurostat has been examining several types of cases<sup>3</sup> since the beginning of 1997. The case which is the object of the present decision, in the context of the systematic examination of case types, concerns in particular some contracts in the **United Kingdom**: in this case, Eurostat has decided that only the annual payments of the State to the enterprises should have an impact on the public deficit.

Finally, **export insurance guaranteed by the State** concerns practically all Member States of the **EU**, although the modes of operation may differ from one country to another. Eurostat has taken a decision of general orientation: all the payments relating to export insurance must be treated as non-financial transactions influencing the public deficit. The effect of applying this decision will depend on the specific operational framework in each country.

In all these cases the decision of Eurostat is in conformity with the European System of Accounts (ESA79), to which regulation 3605/93 on the excessive deficit procedure refers; it takes into account the opinion of the Committee on Monetary, Financial and Balance of Payments Statistics (CMFB)<sup>4</sup>.

Eurostat will in the near future examine the impact of all these measures on government deficit through bilateral contacts with the **EU** Member States.

1. See news release 10/97 of 3 February 1997.
2. See news releases 10/97 of 3 February and 24/97 of 26 March.
3. Decisions have already been taken on several cases: see news releases 16/97 of 21 February and 24/97 of 26 March.
4. See annex.

## Eurostat's decisions

### 1. Linear bonds

Eurostat has completed its examination of non-conventional bonds, i.e. bonds whose treatment is not explicitly indicated in ESA 1979<sup>5</sup>, and has decided on the treatment for linear bonds.

Linear bonds are, like fungible bonds, bonds issued in several tranches from the same lineage, i.e. with the same nominal interest rate as well as identical dates for the payment of coupons and for reimbursement at maturity.

They are characterised by the fact that new tranches can be issued several years after the first issuance. They are therefore issued with discounts and premia which can be significant as a result of changes in market interest rates in the intervening period since the first issuance.

The question is to know how to treat the difference between nominal value and price at issue (discount or premium) at the time the new tranche is issued.

A distinction must be made between tranches issued within twelve months of the first emission, and tranches issued beyond twelve months.

For each tranche issued in the twelve months after the first issue, the difference between nominal value and issue price (discount or premium) must be treated as a capital gain or loss, without an impact on the public deficit.

For each tranche issued beyond the twelve months following the first issue, the difference between nominal value and issue price (discount or premium) must be treated as interest. This therefore has an impact on the public deficit: the discounts increase the deficit, and premia reduce it. The whole amount of interest recorded at the time of payment of coupon is therefore calculated as follows: the actuarial rate of interest of the tranche multiplied by the value of the tranche issue.

Linear bonds exist particularly in countries where the financial markets are relatively thin, as in **Belgium, Sweden, Finland, and Portugal**.

Eurostat will examine the treatment being used by the countries concerned through bilateral contacts.

## 2. Financing and exploiting of public infrastructures by the enterprise sector

Eurostat has completed its examination of the different ways in which general government grants to enterprises the right to finance, construct and exploit public infrastructures.

The case examined is the following. An enterprise first constructs the infrastructure; it then operates it for a certain period during which it receives each year payments from the State: the annual payments of the State represent the purchase of services produced with the infrastructure. When the period of exploitation expires, the infrastructure is handed to the State without the latter making any additional payment.

Eurostat has decided to treat this case in the following manner:

- the initial investment (gross fixed capital formation, GFCF) must be recorded in the accounts of the enterprise, without any impact on the public deficit;
- the annual payments of the State constitute the purchase of services which increase the public deficit each year;
- At the end of the period of exploitation, the State acquires the infrastructure: this positive GFCF has as a counterpart a non-financial transaction, recorded at the same time in the accounts of the State. The acquisition of the infrastructure therefore has no impact on the public deficit.

This case concerns particularly the **UK** where contracts are being established according to which, at the end of a certain period, the State takes control of infrastructure built and operated by enterprises.

Eurostat will examine the impact of this decision through bilateral contacts with the Member States of the **EU**.

## 3. Treatment of export insurance guaranteed by the State

In each Member State there are institutions which specialise in export insurance and can operate with the guarantee of the State. According to the particular circumstances in each country, they are classified in the insurance sector (S50) or the general government sector (S60).

These specialised institutions receive premia from exporters. They pay out indemnities in the case of default, but may also recover debt.

Eurostat has decided that, generally, all of these flows should be recorded as non-financial transactions. Following this, coverage by the State of losses realised on risks which it guarantees must be recorded in the non-financial accounts, with an impact on the general government deficit.

This decision conforms to the treatment applied in the majority of countries. Eurostat will examine how to apply this measure in different Member States of the **EU** while taking into account each specific national framework.

5. Please refer to news releases 10/97 of 3 February and 24/97 of 26 March.

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## CMFB's opinion on the decided cases

### Linear bonds

In the case of bonds which are issued in fungible tranches throughout the life of the bond and pay coupon interest, significant discounts or premia can arise because of longer-term changes in market conditions and demand for particular bonds. The issue is whether these bonds, which we call "linear bonds" need a special treatment or if the treatment already decided upon by Eurostat for conventional and non-conventional long term bonds should be applied.

If a special treatment were to be applied, this would be to impute interest payments equal to the market interest rate (defined as the yield to maturity calculated at issue) multiplied by the issue value (issue price x amount issued), and record at the time of coupon payments. This treatment would be applied to all tranches of bonds issued more than x months after the first tranche (time threshold).

#### *CMFB opinion*

CMFB was split on whether to treat linear bonds as a special case. If Eurostat were to decide in favour of treating these bonds as a special case, then a large majority of CMFB members favoured a time threshold of 12 months.

### Financing infrastructure

An enterprise incurs capital expenditure to create infrastructure to provide services to general government for a limited period of time in exchange for regular payments; the infrastructure reverts to general government without further charge at the end of the period. During the period, the enterprise is responsible for maintenance and repairs and assumes most of the benefits and risks normally associated with ownership.

#### *CMFB opinion*

CMFB unanimously agreed and recommended to Eurostat that the counterpart to the acquisition of the infrastructure when it reverts to general government is a non-financial transaction of equal amount so that there is no impact on the general government deficit.

### Export guarantees

A government insurance unit reimburses an exporter when it fails to receive payment for exports, or the government reimburses an insurance enterprise for claims made by exporters. The question is how these payments by government should be treated in the government sector accounts within the national accounts - as a financial transaction or as a non-financial transaction.

#### *CMFB opinion*

A majority of CMFB agreed that, in the case of an insurance unit classified to general government, all of the units' insurance activity should be recorded as non-financial transactions.

A large majority of CMFB agreed that, in the case of an insurance unit classified to insurance enterprises, all of the governments payments to the enterprise and receipts from the enterprise, in respect of its insurance activity should be recorded as non-financial transactions.

Given the diversity of situations in member states, CMFB recognised that this general framework would need to be elaborated for specific cases.