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Deficit & debt

EUROSTAT RULES ON ACCOUNTING ISSUES

Eurostat, the Statistical Office of the European Communities in Luxembourg, has decided on eight important 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 (*see part 3 of this news release and annex*) 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 and implemented by 1 March 1997.

The way to record interest on Italian postal bonds, the sale of gold by the Belgian National Bank, the accounting of fungible bonds in France, financial leasing in the United Kingdom and swaps in Finland are just a sample of the practical cases which led to the general decisions that have now been taken.

Decisions were taken on the following subjects:

(*for details see part 2 below*).

- Capitalised interest on deposits and other financial instruments covered by ESA79
- Treatment of fungible bonds issued in several tranches (”coupons courus”)
- Swaps on interest rates and currency swaps
- Sales of gold by Central Banks
- Financial leasing
- Classification of national bodies acting on behalf of the EC (FEOGA etc)
- Pension funds
- Treatment of interest in the case of zero coupon bonds

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, and is consistent with the opinion of the Committee on Monetary, Financial and Balance of Payments Statistics (CMFB).

The impact of these decisions will be evident in some cases at the next official transmission of government data on deficit and debt made before the 1 March.

Eurostat's decisions

Having taken into account the opinion of the CMFB and other expert groups, Eurostat has decided on the following issues:

1. Capitalised interest on deposits and other financial instruments covered by ESA79

Eurostat has decided to record the interest separately from the principal and to record as interest the capitalised amount when it falls due for payment, rather than to distribute it among different periods. This means that, in the case of deposits or similar financial instruments which are liabilities of the general government, the capitalised interest will be recorded as general government expenditure when the interest is paid to the holders of these instruments.

2. Treatment of fungible bonds issued in several tranches (”coupons courus”)

Eurostat has decided in the case of fungible bonds (bonds which are issued in tranches at different points in time without change in the date of payment of the coupons) to treat the accrued coupon to be recorded as a short term liability under the heading ”Accounts receivable and payable” (code F72 of ESA 79), which does not enter into the calculation of debt based on the definition of Council regulation 3605/93.

In practice this means that, if a Government issues a bond in different tranches but with the same coupon, it will raise the issue price of the more recent tranches to provide the same yield to all holders of the bond. The difference between the original issue price and the higher issue price of the second tranche is recorded as a short term liability to the holder of the second tranche, which will be reimbursed when the coupon falls due.

3. Swaps on interest rates and currency swaps

In the case of interest rate swaps, Eurostat has decided that only the net payments (receipts) of interest between the two parties to the swap should be recorded. Therefore the influence on the deficit would be limited to the difference (positive or negative) between the interest flows that the two parties agreed to exchange.

In the case of currency swaps Eurostat has decided to value any outstanding foreign currency debt according to the market exchange rate and not at the exchange rate agreed in the swap contract. The existence of a swap agreement is neutral for the valuation of debt outstanding at the end of period according to regulation 3605/93.

4. Sales of gold by Central Banks

Eurostat has decided that the sale of gold and the subsequent transfer of the proceeds from this sale to the general government should be treated as a financial transaction. This means that the proceeds from this sale cannot be recorded as a receipt reducing the deficit in the same way.

5. Financial leasing

Eurostat has decided that all leasing transactions have to be treated as operating leasing. This means that if a government body sells real estate or other fixed asset and rents it back with the intention of acquiring it at the end of the lease (this operation therefore having many characteristics of a financial lease), the transactions must be treated as an operating lease. Therefore the receipts from the sale of the real estate are recorded as a receipt reducing the deficit. The obligation to buy back the assets at the end of the lease is a contingent liability which is not recorded in the debt of general government.

6. Classification of national bodies acting on behalf of the EC (FEOGA etc)

Eurostat has decided on the classification of those institutional units which perform market regulation activity and distribute subsidies. If these institutional bodies cannot be split into those which do the market regulation and those which do distribution of subsidies then these units should be classified in the sector general government if their costs incurred in market regulation compared to the total costs are less than 80%.

7. Pension funds

Eurostat has decided that certain pension funds which finance benefits mostly on a pay-as-you-go basis and to a minor extent on a capital funding basis have to be classified in the subsector social security funds of general government.

The classification criteria are that these funds are institutional units, as they have a complete set of accounts and autonomy of decision, and that they pay benefits to the insured without reference to the individual exposure of risk, which means that these employment based pension schemes are built on a collective financial balance principle.

8. Treatment of interest in the case of zero coupon bonds

Eurostat has decided to treat the difference between the issue price and redemption price of a zero coupon bond as interest, to be recorded as interest paid at the maturity of the bond.

A long process of prior consultation

The convergence criteria on public deficit and debt are an essential element for the admission of Member States into economic and monetary union. In conformity with the Treaty on European Union[1], the European Commission monitors the development of the budgetary situation in Member States and the extent to which the criteria are respected. The statistical data used for evaluation[2] are provided by the directorate general responsible, **Eurostat, the Statistical Office of the European Communities in Luxembourg.**

The statistics required to measure the convergence indicators clearly have to be strictly comparable. This is why Eurostat, in close collaboration with the statistical institutes of the Member States and statisticians of the central banks, has compiled **texts** setting out the **accounting treatment for transactions**, and put in place a **consultation procedure** to prepare rulings.

Evaluation on the basis of ESA79

Statistical information on Member States' budgetary transactions are presented by Member States and evaluated[3] by Eurostat on the basis of the national accounts manual **ESA79**. Following a decision of the Council the new version (ESA95) will not enter into force before the year 1999. In certain cases, however, the ESA95 is being used as the basis for classifying certain budgetary transactions.

The final decision belongs to Eurostat

In recent years problems have arisen when trying to classify, in a harmonised way in all the Member States, economic and financial transactions which are not clearly defined in the ESA79. Therefore, with the aim of assuring good comparability between the statistics, Eurostat has for the past three years engaged in **consultations** with Member States, in the framework of a well-defined procedure.

This **consultation over methodology** is prepared by a task force. The issues are then submitted to two groups of experts: the national accounts working party and financial accounts working party. Following this, Eurostat consults the Committee on Monetary, Financial and Balance of Payments Statistics (CMFB)[4], comprising senior representatives of the central banks, national statistical institutes, the European Monetary Institute, and Eurostat.

After having heard the position of its members on each point for consultation, the CMFB formulates its opinion in conformity with its rules of procedure and presents it to Eurostat. As a consultative committee, the CMFB's **opinion is not binding on Eurostat**. In its final decision Eurostat does, however, take the utmost account of the opinions expressed by the CMFB and the other consultative expert groups on the accounting treatment of a transaction. The decision is made in complete **independence** and **neutrality**, according to **purely technical criteria**.

Eurostat does not decide on the individual cases of Member States, but on the **principles** of accounting treatment of specific budgetary transactions. Every decision in this area applies automatically to similar cases in all the Member States.

The decision on each issue is recorded in a **methodological note** addressed to the institutions concerned, notably the Commission, CMFB, central banks, and national statistical offices.

1 Article 104c of the Treaty on European Union
2 Protocol on the excessive deficit procedure
3 Regulation EC 3605/93
4 See annex

Annex

Committee on monetary, financial and balance of payments statistics (CMFB)

Principles and procedures for assessing the opinion of the CMFB (advisory committee of senior statisticians from government statistical offices, central banks, the Commission and the EMI) when an opinion is required from Eurostat on the calculation of government debt and deficit.

Background

a) Eurostat makes the final decision on debt and deficit statistics.

b) Gross domestic product estimates are approved by the Gross national product committee.

c) Member States provide the Commission with an early warning of transactions that are likely to raise questions concerning statistical treatment; and provides full information about those transactions.

d) Eurostat draws up a timetable for consideration of each case which is consistent with timetables set up by the Council. This leads to a work plan for the totality of cases.

e) The work plan is given to the Statistical programme committee, to CMFB and other official institutions and regularly updated.

f) Eurostat consults widely as it thinks fit.

Consultation of CMFB

g) Eurostat consults the CMFB and notifies its proposals including a timetable.

h) The process aims to identify the "best" technical solution for which there is a large support.

i) The CMFB seeks advice from its working party, Financial accounts working party, from National accounts working party and from any other expert source it considers appropriate.

j) The CMFB opinions are based on three criteria:

- the solution must be in conformity with ESA79;
- when ESA79 does not describe the problem or cannot lead to a solution, reference should be made to ESA95.
- if two or more solutions satisfy the previous criteria, reference should be made to the guiding principles of economic accounts as outlined in the opening chapters of the world-wide systems of national accounts 1993.

k) The CMFB consults its members, analyses results and informs Eurostat of the outcome of the consultation.

The process is transparent

l) Eurostat makes its decision and informs at the same time, the Commissioner, the National statistical institutes (NSIs) concerned and the CMFB.

m) Eurostat informs the CMFB and the NSIs on which methodological grounds the decisions are based.

n) The outcome of the consultation of CMFB and the final decision of Eurostat are made publicly available at the same time.

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