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Accounting rules

EUROSTAT TAKES FURTHER DECISIONS ON DEFICIT AND DEBT

Following the first set of eight decisions taken at the end of January 1997, **Eurostat, the Statistical Office of the European Communities in Luxembourg**, has decided on three other 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 Annex 2*) 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.

Decisions were taken on the following subjects:

(for details see below)

- Treatment of certain taxes
- State guarantees on public enterprise debt
- Financing and exploiting of "public infrastructure" by the enterprises sector.

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 is supported by the opinion of the Committee on Monetary, Financial and Balance of Payments Statistics (CMFB) (*see Annex 1*).

Two decisions concern especially Italy: The case of the Italian tax on wage funds to be paid by enterprises (first decision) and the case of 'Ferrovie dello Stato's' debt (second decision).

The third decision, which is about whether or not the investment for "public infrastructure" carried out by the enterprises sector at the request of general government should be recorded in general government sector, refers to specific cases concerning Germany, Denmark, Sweden and the United Kingdom.

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

Eurostat's decisions

1. Treatment of certain taxes

Eurostat has decided that the Italian tax on wage funds (linked to the “Eurotax”) is a new tax and should be recorded as a receipt reducing the deficit, following the unanimous favourable opinion of the CMFB.

The Italian tax on wage funds (“*fondi di quiescenza*”) which are accumulated in the enterprise balance sheet obliges the employees to pay a tax at the time of withdrawal of these funds. In 1996, the Italian government introduced a law whereby 2 percent of the amounts accumulated should be paid in 1997 by enterprises, whereas the rest of the tax remains due when the employees leave the enterprise.

The question was to decide whether this tax is to be treated as a financial advance (no effect on the deficit) or as a new tax (reduces the deficit).

A financial advance is a payment agreed by both parties to be brought forward ahead of the original due date of the non-financial transaction that gives rise to the payment. Financial advances are to be recorded in the financial accounts as short term or long term loans (F70 or F80 in the ESA79 classification). They are not entered as a receipt in the distribution of income account of the sector general government and therefore have no effect on the deficit. A tax has to be recorded as such in the accounts only at that time it falls due, then reducing the government deficit.

In this case, Eurostat considers that the Italian government, by modifying the tax on wage funds, has introduced a new tax which is calculated on a new basis, with a new due date and to be paid by the enterprises instead of the employees.

Therefore the receipt from this tax which is due in 1997 is not a financial advance but a tax which reduces the deficit in 1997. The estimated amounts to be collected are 3,500 bn ITL, which represents 0.19% of GDP.

2. State guarantees on public enterprise debt

Eurostat has decided that public enterprises’ debt “guaranteed” by the State should be directly taken into account in the government debt under the following conditions:

- The law authorising issuance of the debt specifies the government’s obligation of repayment.
- The budget of the State specifies each year the amount of repayment.
- This debt, issued by the enterprise, is systematically refunded by the State (interest and principal).

It should be mentioned that Belgium already implements this rule for the debt of certain public enterprises.

The Italian Railways have traditionally raised funds on the financial markets with the agreement of the Italian government. Since 1981, each debt issue (for the purposes of maintaining and developing the infrastructures) was individually authorised by the Ministry of Treasury, by means of a public law. Such public law stated as well the obligation of the Treasury to serve this debt (interest and principal) and to identify for this purpose the funds in the Budget Law. Nevertheless, Italian national accountants used to consider this debt as that of the railway company. Eurostat is of the opinion that this debt should be regarded as that of the State, not the enterprise's, and therefore its stock should be included in the stock of government debt.

This decision has been taken following the favourable opinion of the CMFB by large majority.

A reclassification of the accounts should be done, showing for each year an increase in the government debt equal to the amounts of debt issued on behalf of the railways. The proceeds from the issue of these new debt are then transferred to the railways and recorded as a capital transfer, increasing the government deficit.

Symmetrically, the government deficit should be reduced each year for the amounts of amortisation of old debt. A recalculation of the debt and deficit figures is shown below.

Estimated impact on the Italian deficit and debt

(billion ITL)

	Deficit		Debt
1993	-2.499	Amortisation old debt	
	+2.129	Issue of new debt	
Net change	-370	Improvement of deficit	+2.129
1994	-4.279	Amortisation old debt	
	+4.856	Issue of new debt	
Net change	+577	Worsening of deficit	+4.856
1995	-3.347	Amortisation old debt	
	+4.369	Issue of new debt	
Net change	+1.022	Worsening of deficit	+4.369
1996	-2.098	Amortisation old debt	
	+2.158	Issue of new debt	
Net change	+ 60	Worsening of deficit	+2.158
1997	-3.687	Amortisation old debt	
	+0	Issue of new debt	
Net change	-3.687	Improvement of deficit	+0

In 1997, the General Government plans an increase in the capital of the Italian railway, such as to give financial autonomy to this enterprise. Therefore, the Italian Budget law does not foresee any issues of new debt on behalf of the Railways, the amount of 3,687 bn ITL which was before to be treated as a capital transfer can now be treated as a financial transaction and taken out of the Government deficit. This reclassification effect will reduce the deficit by 0.2% of GDP, as compared to the previous accounting treatment.

3. Financing and exploiting of “public infrastructure” by the enterprises sector

Eurostat has decided on the statistical treatment of the investment (Gross Fixed Capital Formation) made by the enterprises sector in public infrastructure (fixed assets).

Two cases are involved :

- Case 1 is where an enterprise is required to build and to prefinance a fixed asset for general government and where general government becomes the owner of the asset as it is being built: Gross Fixed Capital Formation should then be recorded in the general government sector. This investment contributes to an increase in the government deficit. It has no impact on government debt as defined in Council Regulation N° 3605/93 because this regulation foresees that medium and long term trade credit liability recorded in the general government account towards the enterprises sector is excluded from the measurement of debt for the purposes of the convergence criteria.
- Case 2 is the case where an enterprise is required to build a fixed asset and exploit it for all its life, while the ownership of the asset is given to the enterprise: Gross Fixed Capital Formation should then be recorded in the enterprises sector and thus has no effect on the government debt and deficit.

This decision has been taken following the unanimous favourable opinion of the CMFB.

Concrete examples are given below:

Case 1 applies in particular to the construction and prefinancing of roads in Germany by the private sector: there are at least twelve projects under way in 1995/1996 at the level of the Federal Government and a number of projects concerning the *Länder* and the communes. Moreover a high-speed railway track is planned to be financed in the same way. Government deficit includes payments which are due as work is completed. The estimated amounts, 4-5 bn DM in 1997, are still small as a percentage of GDP.

One example of case 2 is the bridge between Denmark and Sweden (Öresundbridge): starting in 1996, the bridge is being built by a public corporate consortium owned by the Swedish and Danish governments. The consortium finances the operation through borrowing on the market, backed by State guarantees. The bridge is planned to be ready in the year 2000. The consortium will then have the concession of operating the bridge and will receive the tolls raised. The debt is estimated to be paid-off in the year 2026, and after that the consortium will continue to operate the bridge without any time limit. The Gross Fixed Capital Formation is recorded in the enterprises sector, with no impact on the government deficit.

Another example of case 2 is given by the intentions of some of the “Private Finance Initiative” contracts in United Kingdom: instead of the government buying an asset and operating it, the government buys services from a private sector operator. Such operators may equip themselves with assets to provide the services. Gross Fixed Capital Formation is recorded in the enterprises sector with no impact on government deficit; the general government account shows the purchase of services provided by the enterprise, which contributes to an increase in the government deficit every year.

Eurostat confirms that the treatments described above, and recorded as such in the accounts of Germany, Denmark, Sweden and United Kingdom, are correct. These amounts are already correctly accounted for in the notifications that Member States send to the Commission twice a year in the framework of the excessive deficit procedure.

Opinion of the CMFB on the cases decided

TREATMENT OF CERTAIN TAXES (EUROTAX)

The issue: A payment made in advance of a due date for an existing tax.

In the specific case of the new Italian tax on wage funds (“Eurotax”), the Italian government by law changed the date due for payment, the tax payer and the tax rate. Therefore this tax is to be recorded as a new tax and not as a financial advance.

The CMFB endorsed this view unanimously.

STATE GUARANTEES OF PUBLIC ENTERPRISE DEBT

The issue: Treatment of debt repaid by an institutional unit obliged by law to fully repay debt and interest from the very start of the loan in lieu of the recipient of the funds.

The CMFB recommends by large majority that in cases where the government is responsible by law for interest and principal repayment of debt of an other institutional unit from the very start of the loan, the debt is that of the government.

As a specific case, the Italian Railways has traditionally raised funds on the financial markets with the agreement of the Italian government. Since 1981, each debt issue (for the purposes of maintaining and developing the infrastructures) was individually authorised by the Ministry of Treasury, by means of a public law. Such public law stated as well the obligation of the Treasury to repay this debt (interest and principal) and to identify for this purpose the funds in the Budget Law. Nevertheless, in the National Accounts, the debt was classified as debt of the Railways.

In the light of the above, the debt of the Italian Railways should be reclassified. This reclassification affects the stock of the Italian government debt, and the deficit according to the ESA rules. This means that in 1981 an increase in the government debt is shown and a capital transfer from the government to the enterprise sector affects the deficit. In the following years, no transactions affecting government deficit are shown, except for the interest payments.

FINANCING AND EXPLOITING OF “PUBLIC INFRASTRUCTURE” BY THE ENTERPRISES SECTOR

The issue: The private sector builds and prefinances public infrastructure.

If this infrastructure is built for the government and if the government becomes the owner as it is being built, the gross fixed capital formation is recorded as taking place within the general government sector. The government will record in its accounts the outlays for the acquisition of the infrastructure, and in the case where there is a pre-financing by the private sector, the government incurs a liability to the enterprises sector in the financial accounts.

For infrastructure which is produced by the private sector and which remains in the ownership of the private sector, there is no entry for the gross fixed capital formation of general government. The general government pays for a service in using this infrastructure.

This treatment was supported unanimously by the CMFB.

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 Union¹, 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 evaluation² 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 evaluated³ 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, EMI, 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 below

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 EMI, 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.

Issued by:

**Eurostat Press Office
Jean Monnet Building
L-2920 LUXEMBOURG**

Tel: +352-4301-33 444

Tel: +352-4301-33 496

Fax: +352-4301-32 594

pressoffice@eurostat.cec.be

For further information:

Jean-Pierre DUPUIS

Tel: +352-4301-34 983

Christine COIN

Tel: +352-4301-33 722

Ettore KOVARICH

Tel: +352-4301-34 275

Fax: +352-4301-32 929