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Accounting rules

COMPLEMENTARY DECISIONS OF EUROSTAT ON DEFICIT AND DEBT

Following the decisions of 3 and 21 February 1997, **Eurostat, the Statistical Office of the European Communities in Luxembourg**, has once more decided on two 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[1] 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 following subjects:

(for details see below)

- Treatment of deep-discounted bonds and index-linked bonds
- 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*).

As concerns bonds Eurostat has pursued its examination of some special cases the treatment of which is not explicitly stated in the ESA79.

ESA 79 specifies the treatment of “conventional” bonds, other than index-linked bonds which are covered by this decision. Conventional bonds are issued at their nominal value or a value very close to their nominal value and give rise to interest payments (coupons).

However the ESA79 did not foresee a treatment for other types of bonds, “non-conventional” bonds which it was therefore necessary to examine. Non-conventional bonds include in particular zero-coupon bonds, bonds whose interest is capitalised and deep-discounted bonds.

Eurostat has already decided[1] on the treatment of zero-coupon bonds and bonds whose interest is capitalised. The decisions in this note therefore relate to deep-discounted bonds.

Concerning **public infrastructures**, Eurostat has decided that, when the State gives an enterprise the right to exploit a public infrastructure for a particular period of time, no impact on the deficit should be recorded. This applies in particular to the concession given by the Portuguese State to the company Lusoponte for the construction of a new bridge of Lisbon, as well as the exploiting of the two bridges (the old one - ‘25 April’ - and the new one - ‘Vasco da Gama’).

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.

Eurostat's decisions

1. Treatment of interest in the case of deep-discounted bonds and in the case of index-linked bonds

ESA 79 (paragrah 706) indicates that the treatment of the difference between the issue price and the nominal value for bonds that can be qualified as “conventional” (those for which this difference is small):

- for short term bonds, the difference between the issue price and the nominal value is to be regarded as interest recorded at the issuance of the bonds; this difference has therefore an impact on government deficit;
- for medium and long term bonds, the difference between the issue price and the nominal value is not to be regarded as interest but as holding gains and losses; this difference has therefore no impact on government deficit.

It is then necessary to set up the following distinctions:

- Distinction between short term and medium-long term: this is decision 1 below.
- Distinction between bonds for which the difference between the issue price and the nominal value is considered as small (conventional bonds) and bonds for which this difference is large (non-conventional bonds); this is the case of bonds with a deep discount or a large premium.

  Decision 2 below deals with bonds issued with a deep discount.

1. The distinction between short-term and medium and long-term

Eurostat has decided that bills and short-term bonds are those with a maturity of up to and including 12 months.

This will ensure among EU countries perfect comparability of treatment for conventional bonds issued close to the nominal value and this is consistent with ESA 79; thus for short-term bonds the recording of interest payments cannot be shifted from one year to another, with an impact on the government deficit.

2. Deep-discounted bonds

It should be recalled that deep-discounted bonds are bonds issued below the nominal value, bearing interest at a rate below the the market rate.

Eurostat has decided to define deep-discounted bonds as those whose nominal coupon is less than 50% of the corresponding yield to maturity (calculated on the basis of the issue price).

For these deep-discounted bonds, the difference between the issue price and the nominal value is to be regarded as interest, and this interest is to be accounted for at the time of redemption of the bond. This is consistent with the decision taken over the treatment of zero-coupon bonds.

Deep-discounted bonds are instruments which are rarely used among EU member countries.

3. Index-linked bonds

Eurostat has decided that in the case of ‘index-linked’ bonds, two distinct treatments should be applied, depending on whether the bond is linked to a consumer price index or whether linked to a financial asset such as a foreign currency or gold.

In the case where the bond is linked to a consumer price index, the ‘capital uplift’ due to the movement of the index is to be regarded as interest. The interest should be recorded at redemption of the bond. This confirms the treatment of such bonds by the UK authorities.

In the case where the bond is linked to a financial asset such as a foreign currency or gold, the ‘capital uplift’ should not be regarded as interest but as a ‘capital gain / loss’, as is the case for bonds issued in foreign currency. This confirms the treatment of such bonds by the Greek authorities.

The rationale behind this treatment is the following: when linked to a consumer price index, the capital uplift ensures a purchasing power: this uplift has thus the characteristic of interest. Such is not the case when the capital of the bond is linked to a financial asset submitted to market prices variation and thus with more uncertainty.

2. Financing and exploiting of public infrastructures by the enterprises sector

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

First the two cases for which decisions have been taken[1] should be recalled :

- the case where an enterprise is required to build and to prefinance an infrastructure for the State and where the State becomes the owner of the infrastructure as it is being built: the investment should be recorded in the general government accounts contributing then to an increase in the government deficit;
- the case where an enterprise is required to build an infrastructure and exploit it for all its life: the investment should be recorded in the accounts of the enterprises and thus has no effect on the government deficit.

Two cases have been analysed, which show the following common characteristics:

- the State grants to an enterprise the right to exploit an asset during a certain period, at the end of which the enterprise gives the asset back free of charge to the State;
- no payments take place between the State and the enterprise during the period of exploitation.

The first case concerns a **new infrastructure** financed and built by the enterprise, the second an **existing** one.

Eurostat has concluded that, in both these cases, the government deficit is not affected.

Case of a new infrastructure: the enterprise finances and constructs an infrastructure, which it is given the right to exploit.

No transaction is recorded in the State’s accounts before the handing over of the infrastructure; instead, the investment is recorded in the accounts of the enterprise which receives, moreover, toll receipts.

[1] Please refer to news release 16/97 of 21 February 97

At the end of the period of exploitation, when the State acquires the infrastructure, which results in the recording of gross fixed capital formation in the accounts of general government, this acquisition has as a counterpart a non-financial transaction of the same amount and recorded at the same time in the accounts: globally, there is no impact on the government deficit. This treatment reflects correctly the fact that no payment has taken place between the State and the enterprise.

This case is applicable to the financing, construction and exploiting of the new Vasco-da-Gama bridge over the Tagus in Portugal by the company Lusoponte. It concerns also in Spain the construction and exploiting by the GIF (railway infrastructures agency) of the high-speed train between Madrid, Barcelona, and the French border.

Case of an existing infrastructure: the enterprise acquires the right to exploit an infrastructure which already exists.

Eurostat has also decided that, in this case, the government deficit is not affected; in particular it cannot be reduced at the beginning of the period of exploitation if the infrastructure is handed over free of charge to the enterprise for a length of time.

This case refers in particular to the granting by the Portuguese State to Lusoponte of the right to exploit the ‘25 April Bridge’ for a period of around 33 years.

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Annex

Opinion of the CMFB on the cases decided

1. The distinction between bills and short-term bonds, and long-term bonds

CMFB agreed by a large majority that, for the purpose of comparability of statistical treatment of interest, bills and short-term bonds with a maturity up to and including 12 months should be considered as short-term. Instruments with a maturity of more than 12 months should be considered long-term.

2. Deep discounted bonds

For the treatment of deep discounted bonds, half of CMFB members agreed that there should be a specified threshold to define deep discounted bonds. Furthermore, a majority agreed that this threshold should be defined for all bonds for which the nominal coupon is less than 50% of the corresponding yield to maturity, and that the difference between the issue and the redemption price should be recorded as interest at the time of the redemption of the bonds, consistent with Eurostat's decision on zero coupon bonds. In the case of other medium and long-term bonds, the difference between issue and redemption price should be recorded as holding gains/losses.

A significant minority of CMFB members considered that the difference between issue and redemption price should always be treated as interest recorded at redemption for all medium and long-term bonds. A small number considered that the difference between issue and redemption price should be treated as holding gains/losses for all medium and long-term bonds.

Although there has been consultation and substantial discussion on this issue, no clear cut outcome has emerged, and no further consultation of CMFB will be undertaken.

3. Index linked bonds

CMFB agreed by a large majority that, for the treatment of capital uplift due to the evolution of an index, a distinction should be made between bonds linked to consumer price indices (or other measures of inflation) and those linked to foreign exchange, gold or other financial assets.

For bonds linked to consumer price indices, capital uplift should be treated as interest and recorded at redemption of the bond. For bonds linked to foreign exchange, gold or other financial assets, capital uplift should be recorded as holding gains (or losses).

4. Financing and exploiting of public infrastructure by the private sector

CMFB agreed by a large majority that in the case of a new fixed asset, which is built and financed by a corporation which is also in charge of maintenance and repairs of the asset and assumes most of the risks and benefits normally associated with the ownership, the asset should be recorded so that there is no impact on the general government deficit.

CMFB agreed by a large majority that, in the case of an existing fixed asset, for which the Government gives the right to exploit to a corporation without any up-front payment, there should be no impact on the general government deficit.