

Public investment: recording in EDP statistics and treatment under the SGP

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Abstract

This paper provides an overview of Eurostat's role in assessing the quality of EDP data. It focuses on the importance of having correct data for government investment and PPPs. It introduces the Investment Plan for Europe with its statistical implications. Some reflections are made concerning drawing a line between ESA 2010 statistical rules and the application of the SGP.

Keywords: EDP quality, Public investment, PPPs, Investment Plan for Europe.

1. Eurostat's role in the context of the Excessive Deficit Procedure (EDP)

1.1. *The Excessive Deficit Procedure*

The Maastricht Treaty (formally known as the Treaty on European Union or TEU) limits government deficits of EU countries to 3 % of GDP¹ and government debt levels to 60 %². The TEU was signed in 1992 and is one of the two primary Treaties on which the EU is founded, alongside the Treaty on the Functioning of the European Union³ (TFEU).

The 3% and 60% reference values set in the EU Treaties aim to ensure sound public finances in EU countries, necessary for the functioning of the Economic and Monetary Union (EMU).

¹ Gross Domestic Product

² See article 104c and the Protocol on the EDP in the TEU.

³ The deficit and debt reference values are defined also in the TFEU (see article 126 and Protocol 12 on the EDP).

The procedure to be followed in case of non-fulfillment of one or both of the criteria is detailed in Article 126 of the TFEU (and article 104c of the TEU).

The legislation governing the Stability and Growth Pact (SGP) was adopted in 1997, as the budgetary pillar of the EMU, applying for the whole EU without exception. It defined policy guidelines for the Member States (MS), the Council and the Commission, further enforcing the deficit and debt limits established by the Maastricht Treaty. The SGP is articulated in two branches: the preventive arm (setting budgetary targets, known as a Medium-Term Budgetary Objective (MTO)) and the corrective arm (aiming at the correction of excessive budget deficits or excessive government debt levels and known as the EDP). The SGP has been subject to several amendments in order to take economic circumstances and country-specific characteristics better into account.

The responsibilities in relation to the implementation of the EDP and SGP are shared between different bodies and Commission DGs. Eurostat (DG ESTAT) is responsible for (i) providing the deficit and debt figures to be used in the context of the excessive deficit procedure (ii) assessing the quality of the data reported by EU MS. On the other hand, the preventive and the corrective arms of the SGP are dealt with by DG ECFIN⁴, in cooperation with other Commission bodies and the Council.

In summary, Eurostat is responsible for providing the figures that will be used by the Commission in order to assess whether an Excessive Deficit Procedure should be opened or other measures implemented. It should be noted that being over the 3% (or the 60%) threshold in a specific year according to the figures provided by Eurostat does not automatically trigger the opening of an Excessive Deficit Procedure by the EC.

In determining whether a numerical breach as reported by Eurostat should lead to the opening of an EDP, the legislation specifies how all relevant factors should be taken into account. Special consideration can be given to countries whose fiscal positions have worsened due to

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exceptional events outside their control, such as in the case of natural disasters or as a result of a severe economic downturn, but under the double condition that the excess over the deficit is close to the reference value and temporary.

According to Eurostat's deficit and debt figures released in April 2016, seven Member States had deficit figures equal to or higher than 3% of GDP in year 2015: EL (-7.2%), ES (-5.1%), PT and the UK (-4.4% each), FR (-3.5%), HR (-3.2%) and SK (-3.0%).

At the time of April 2016, nine Member States (EL, ES, PT, UK, FR, HR, CY, SI and IE) were subject to an Excessive Deficit Procedure as assessed by the Council. This information is published in the website of DG ECFIN.

1.2. Eurostat's role in the EDP

The role of Eurostat in the EDP is established in Council Regulation (EC) No 479/2009 of 25 May 2009, as amended, which sets the framework for the application of Protocol on the excessive deficit procedure annexed to the Treaty. Broadly, this Regulation grants to Eurostat the responsibility of assessing the quality of the data and of providing the data to be used in the context of the EDP.

Chapter I of the Regulation clarifies the definitions of government, government deficit and government in investment. Also, it introduces the definitions of government debt (limited to some categories of liabilities) and of nominal value (equal to face value), which should be used for the valuation of the debt. Chapter II defines the rules, the timing⁵ and the coverage of the EDP data to be reported by EU MS to Eurostat.

The quality of data is defined in Chapter III (articles 8-13). According to article 8, Eurostat shall regularly assess the quality of actual data reported by MS and the underlying government

⁵ Twice a year, before 1st April and before 1st of October.

accounts compiled according to ESA 2010. Quality of actual data means compliance with accounting rules, completeness, reliability, timeliness and consistency of the statistical data.

For this purpose, MS shall provide Eurostat with the relevant statistical information requested for the data quality assessment. This comprises the following: data from national accounts, inventories, EDP notification tables, additional questionnaires and clarification related to the notifications. Article 11 defines the EDP dialogue visits, which are carried out regularly by Eurostat in all MS in order to examine methodological issues, review data and sources and assess compliance with accounting rules.

The following are mandatory in order to ensure the quality of deficit and debt data:

- (i) Existence of clear accounting rules → The rules to be applied are defined in ESA 2010⁶, Eurostat MGDD and Eurostat guidance notes. It is the responsibility of Eurostat to interpret/clarify the rules when needed and to provide guidance on specific or complex methodological issues and borderline cases.
- (ii) Data availability → It is the responsibility of MS to have in place appropriate data sources that provide all the necessary data for the compilation of government accounts.
- (iii) Compliance with accounting rules → This is the responsibility of MS and is regularly monitored by Eurostat.

Chapter IV enables Eurostat to express a reservation on the quality of the actual data reported by the MS and to amend such data. Also, this chapter sets the deadline⁷ for Eurostat to assess the figures reported by MS and to provide the final deficit and debt data to be used for the application of the EDP.

⁶ ESA 2010 (European System of Accounts) is a regulation that has been approved by all the Member States. ESA 2010 derives from SNA 2008 (System of National Accounts), which sets the national accounts framework at international level.

⁷ The data shall be published by Eurostat within three weeks after the reporting by MS.

Table 1 below provides a simplified summary of the actors involved in the EDP and their responsibilities.

Table 1: Summary of the EDP

MEMBER STATES: Compilation	EUROSTAT: Assessment & validation of MS data Provision of official figures	DG ECFIN/EC/Council Decision on launching an EDP
1. Compile government accounts: - ESA tables	3. Assesses figures reported by MS	7. EC examines figures published by Eurostat
- Deficit & debt figures	4. Possible corrections by MS	8. If no fulfillment by a MS--> EC Issues report
- EDP tables & questionnaire	5. Possible amendments/reservations by Eurostat	9. Council decides if EDP existsn for that MS
2. Transmit data to Eurostat (before 1st April and 1st October)	6. Publication official deficit & debt figures of EU MS (around 20-23 April and 20-23 October)	10. Council opens EDP with recommendations
		11. Deadline set to comply with recommendations
		12. EC assesses if effective action taken by MS
		13. If no action: new recommendations & back to point 11
		14. If action: EC propose EDP abrogation
		15. Council takes final decision
		16. EDP closed

2. Public investment and PPPs

2.1. Government investment and link with quality of deficit and debt data

Government investment is defined in Regulation 479/2009 as the gross fixed capital formation⁸ of the general government sector. This concerns the acquisition of fixed assets (assets used in production for more than one year such as dwellings, buildings, infrastructure, machinery, equipment, etc.).

Investment is recorded as expenditure in national accounts. It constitutes an important part of government expenditure and should be closely monitored to ensure a correct calculation of government deficit and debt.

⁸ P.51g ESA 2010 code

Government investment can be undertaken directly by government, under traditional procurement contracts signed with the private sector. In national accounts, expenditure is normally spread over the period of construction, independently of when the actual payments take place. For example, if a road with a contractual capital value of 300 mn is built over three years, government expenditure will be impacted over the three years of construction, as the works take place (for instance with 50 mn the first year, 100 mn the second year and 150 mn the third year). Therefore, the building of government infrastructure through such procurement contracts impacts the government deficit during the short time span in which the asset is built, independently of when the corresponding payments will be made by government. This constitutes a fundamental difference of national accounts as compared to business accounts, according to which roads (and assets in general) impact expenditure (and deficit) gradually over their entire economic life as they are amortized⁹.

In an ESA 2010 framework, the recourse to specific long-term contracts, such as public private partnerships (PPPs) and concessions, represents a possible way for government to spread the impact on government deficit over a longer period of time, making it easier to deal with fiscal constraints.

2.2. Public private partnerships (PPPs) and concession contracts

PPPs and concession contracts are long-term contracts between a government unit and a private corporation (known as the partner) for the construction of specific assets designed to render some public services (normally infrastructure such as motorways, tramway systems, schools, hospitals, prisons, etc.). In such projects, after the construction phase, the corporation

⁹ A road with a contractual capital value of 500 mn with an economic life of 50 years and which is built over 5 years will impact expenditure and deficit as follows:

- In national accounts, the 500 mn would be recorded over 5 years as the road is built (100 mn per year on average).

- In business accounts, the 500 mn would be recorded over 50 years as the road is amortised (10 mn per year on average).

is responsible for operating and maintaining the assets over a long period of time (30-50 years) and receives in exchange periodical payments (tolls or fees) for the services provided.

The difference between a PPP and concession stems from the source of revenue of the partner. If the payments received by the partner come mainly from government, the contract will normally qualify as a PPP. On the contrary, if the payments come mainly from final users (as for instance in a tolled road), the contract will qualify as a concession.

In national accounts, the recording of the infrastructure assets built through a PPP or a concession contract depends on which party (the partner or government) is considered to be the economic owner of the assets. The economic owner¹⁰ of an asset, as opposed to the concept of legal owner, is the unit which accepts the risks and rewards of using the goods in production.

If risks and rewards are transferred to the partner, it will be considered the economic owner of the assets built (government off-balance sheet recording). Government expenditure will be impacted only after construction, during the exploitation phase (normally up to 30 years) and for the regular payments based on availability of the asset or demand, made by government in the case of a PPP. In the case of a concession, there could even be no government expenditure whatsoever, as the regular payments are made by users.

If risks and rewards are kept by government, it will be considered the economic owner of the assets built (government on-balance sheet recording). In this case, government expenditure will be impacted during the construction years (exactly as in the case of a normal procurement contract). In addition, a loan from the partner to government equal¹¹ to the value of the assets will need to be imputed, increasing government debt. In the case of a PPP, the regular fees paid by government would need to be split between redemption of the principal of the loan,

¹⁰ ESA 2010 1.90

¹¹ The actual borrowing by the partner can be used as a proxy.

accrued interest and service fees. Only the last two will be treated as expenditure during the exploitation phase.

ESA 2010 has introduced the issue of control of the asset when the analysis of risks and rewards would not be conclusive. ESA 2010, as SNA 2008, recommends a case by case approach, taking into account the facts and circumstances of each contract.

2.3. National accounts rules for the treatment of PPP/concession projects

Given the different impact on government accounts resulting from the recording of the assets on or off government balance sheet, it is crucial that a PPP contract is evaluated in order to decide which unit is the economic owner. The incorrect treatment of PPP contracts could most likely lead to underestimated deficit and debt figures for government.

The general national accounts rules for PPPs applicable in the EU are defined in ESA 2010 chapter 20 (20.276-20.290). Eurostat MGDD and Eurostat explanatory note on PPPs enable a more detailed analysis of these projects.

The main features to be examined in order to assess the treatment of a PPP contract are the following: whether it really qualifies as a PPP, the sector classification of the private partner, the provision of government financing or guarantees, the termination clauses, the analysis of risks (construction and availability/demand) and rewards, the allocation of the assets at the end of the contract, the force majeure events and special circumstances, which entity benefits from the rewards in case of debt refinancing, etc.

3. Investment Plan for Europe

Since the economic and financial crisis, the level of investment decreased in the EU. As an initiative for economic recovery, in November 2014 the Commission launched its Investment Plan for Europe. The Plan aimed at mobilizing EUR 315 bn of investment over three years by the use of public money to attract private investors. In this context, the investment support

would be provided by the European Fund for Strategic Investments (EFSI). The EFSI Regulation entered into force in July 2015.

EFSI is set up within the European Investment Bank (EIB). To establish EFSI, a guarantee of €16 billion was created from the EU Budget. The EIB committed additional €5 billion, giving EFSI a risk absorbing capacity of €21 billion. It was expected that € 1 of protection by the fund would generate € 15 of private investment in the real economy. According to the Communication from the Commission to the European Parliament and the Council of 22 July 2015, eight¹² MS and 11 promotional banks announced their participation in the EFSI.

MS would be able to participate in the EFSI at three different levels: (i) directly into the EFSI through cash payments and/or guarantees (ii) into EFSI through investment platforms, investing into a specific area or sector (iii) alongside the EFSI in individual projects (normal investment projects or via PPPs).

The statistical implications of each of the options have been analyzed by Eurostat. The usual national accounts rules will be applicable to the EFSI framework. In particular, in the third case (investment projects undertaken by government or PPPs) the general investment and PPP rules will apply, possibly leading to government on-balance sheet recording of some projects. In the case of cash provided by MS in the EFSI, the impact on government accounts will depend on which entity provides the cash and on the type of transaction. The direct provision of guarantees by MS into the EFSI should in general have no impact on deficit and debt unless the guarantee is called.

¹² BG, SK, PO, LU, FR, IT, ES and DE.

4. Conclusions and way forward

4.1. State of play as regards PPPs/concessions

Due to the complexity and variety of PPP projects, Eurostat has tried over the past months to clarify the existing rules and provide a transparent communication to users, compilers and practitioners. A specific PPP explanatory note was published in March 2016. A more detailed guidance is under preparation in cooperation with the European PPP Expertise Center (EPEC)¹³. In February and March 2016, Eurostat organized two meetings (PPP Expert Group) to explain in detail how to analyze infrastructure contracts, underlining the main issues that could trigger an on-balance sheet recording of the assets.

The situation as concerns the use and the recording of PPP contracts varies across EU MS. Some are quite active in the use of these projects for the construction of infrastructure (for instance, UK, IE, BE, ES, DE, FR, PT, NL, EL) while the recourse to these projects is not so common in other MS. As concerns MS which are active in the use of PPPs, the statistical implications may also be different. In DE and FR, all assets built through PPPs are by default considered on-government balance sheet (although for different reasons). In Spain a case by case analysis is undertaken leading to an on-government balance sheet recording of around 75% of the assets built through PPPs. Belgium follows a specific approach and infrastructure assets are normally built only if the statistical treatment of the project leads to a classification of the PPP assets off-government balance sheet.

It should be noted that the ESA framework for PPPs allows more flexibility than other accounting standards. PPP rules applied by Eurostat have often been criticized by other international institutions for allowing off-balance sheet recording and incentivizing the use of PPP to circumvent spending ceilings and fiscal rules. In this respect, ESA 2010 rules for PPPs

¹³ EPEC is a collaboration between the European Investment Bank (EIB), the EC, MS and candidate countries of the EU.

should rather be considered as an opportunity rather than a burden. However, a few Member States often put pressure on the statistical treatment of PPPs and complain on ESA 2010 rules.

4.2. Statistical recording vs application of the SGP

For the statistical recording of transactions in national accounts, the compliance with ESA 2010 rules is compulsory. ESA 2010 is a Regulation, voted and approved by EU MS. A potential change would entail a slow process and would require the agreement of a qualified majority. Moreover, changing ESA 2010 would also mean to deviate from international national accounting rules as set in SNA 2008.

However, some flexibility is allowed concerning the application of the SGP. This flexibility is represented by the so-called "one-off measures", which are defined as measures (with an impact of at least 0.1% GDP) having a transitory budgetary effect that does not lead to a sustained change in the budgetary position of a MS.

Measures labelled as one-off by the EC are not taken into account for the computation of structural deficit under the Stability and Growth Pact. Some examples of one-off measures on the revenue side are tax amnesties and the sale of non-financial assets. Some examples of one-off measures on the expenditure side are Member States' contributions to the EFSI, short-term costs associated with emergency response to major natural disasters or exceptional events and government interventions to support financial institutions (the latter is applicable only in those countries subject to an economic adjustment programme). One-off measures partly explain the fact that a MS with a deficit figure above the 3% threshold as reported by Eurostat may not be the object of an Excessive Deficit Procedure.