School of Business, Economics and Law
GÖTEBORG UNIVERSITY

WORKING PAPERS IN ECONOMICS

No 268

Statistical Implications of the Stability and Growth Pact: Creative accounting and the role of Eurostat

by

Lena Frej Ohlsson

September 2007

ISSN 1403-2473 (print)
ISSN 1403-2465 (online)

SCHOOL OF BUSINESS, ECONOMICS AND LAW, GÖTEBORG UNIVERSITY

Department of Economics
Visiting adress Vasagatan 1,
Postal adress P.O.Box 640, SE 405 30 Göteborg, Sweden
Phone + 46 (0) 31 786 0000

Working Paper No 268:
Statistical Implications of the Stability and Growth Pact: Creative accounting and the role of Eurostat

Lena Frej Ohlsson (Lena.Frej-Ohlsson@ec.europa.eu)

Abstract: This study covers the relation between the political and accounting implications of the Stability and Growth Pact, which entered into force in 1996. It describes the underlying legal framework and accounting rules and the role of the European Commission and Eurostat in this respect. Additionally, a complete description of the work in the context of the excessive deficit procedure is provided, including the provision of data by Member States, the validation process by Eurostat, the procedures in case of disagreements and the main methodological decisions taken by Eurostat in recent years. Furthermore, the implementation of the statistical framework and rules by the Member States is analysed in detail.

Apart from a general chapter on the concept and use of creative accounting, a range of case studies are presented, based on the national accounts framework ESA95. The countries included in the study are Portugal, Italy, France, Germany and Sweden. A separate chapter is devoted to Greece, due to the importance and consequence of the case. The results of the analysis in the case studies show not only the complexity of the statistical framework as such and its implementation, but also the political influence.

Finally, as an outcome of the developments in some countries, and in particular in Germany and France in 2003, as well as the Greek tragedy, the SGP was revised. The content and outcome of this revision are also covered.

Keywords: Stability and Growth Pact; SGP; excessive deficit; creative accounting; Eurostat; European Union

JEL-Codes: E01; E62; E63

95 pages

Statistical implications of the Stability and Growth Pact
Creative accounting and the role of Eurostat

Lena Frej Ohlsson
Department of Economics
Göteborg University

Abstract

This study covers the relation between the political and accounting implications of the Stability and Growth Pact, which entered into force in 1996. It describes the underlying legal framework and accounting rules and the role of the European Commission and Eurostat in this respect. Additionally, a complete description of the work in the context of the excessive deficit procedure is provided, including the provision of data by Member States, the validation process by Eurostat, the procedures in case of disagreements and the main methodological decisions taken by Eurostat in recent years. Furthermore, the implementation of the statistical framework and rules by the Member States is analysed in detail.

Apart from a general chapter on the concept and use of creative accounting, a range of case studies are presented, based on the national accounts framework ESA95. The countries included in the study are Portugal, Italy, France, Germany and Sweden. A separate chapter is devoted to Greece, due to the importance and consequence of the case. The results of the analysis in the case studies show not only the complexity of the statistical framework as such and its implementation, but also the political influence.

Finally, as an outcome of the developments in some countries, and in particular in Germany and France in 2003, as well as the Greek tragedy, the SGP was revised. The content and outcome of this revision are also covered.

Disclaimer: The opinions expressed in this thesis are the author's opinions and may not be considered to be necessarily those of the European Commission.

Acknowledgements

First of all I would like to thank my supervisor Professor Bo Sandelin at the Department of Economics at the School of Economics and Commercial law, Göteborg University, for his great support, both in terms of the content and scope of the thesis. His enthusiasm from the moment I presented my first ideas until the very end was invaluable.

Secondly I wish also to thank Luca Ascoli, Head of Unit "Public Finance" at Eurostat. Without his encouragement and sharing of experience and knowledge, this thesis would not have been the same.

Finally, I would also like to thank John Verrinder for reviewing the English.

Lena Frej Ohlsson

Abbreviations

Financial operation – operations involving exchange of financial assets, with no impact on the deficit according to ESA95 (sometimes referred to as "below the line" operation)

Non-financial operation – operation which are not financial and which normally have an impact on the deficit according to ESA95 (sometimes referred to as "above the line" operation)

CBP	Code of Best practice
CMFB	Committee of Monetary, Financial and Balance of Payment Statistics
DCF	Defined Contribution funded pension scheme
DG ECFIN	Directorate General for Economic and Financial Affairs
DPP	Deferred Purchase Price
EC	European Communities
ECB	European Central Bank
EEA	European Economic Area
EEC	European Economic Community
ECU	European Currency Unit
EDP	Excessive Deficit Procedure
EFC	Economic and Financial Committee
EMI	European Monetary Institute
EMS	European Monetary System
EMU	European Monetary Union
EP	European Parliament
ESA95	European System of National and Regional Accounts
EU	European Union
FAWP	Financial Accounts Working Party
GDP	Gross Domestic Product
MDD	ESA95 Manual on government deficit and debt
MOF	Ministry of Finance
NAWP	National Accounts Working Party
NCB	National Central Bank
NSI	National Statistical Institute
OECD	Organisation of Economic Co-operation and Development
PAYG	Pay as you go system
PPM	Swedish Premium Pension System
PPP	Public-Private-Partnership
SGP	Stability and Growth Pact
SNA93	System of National Accounts (UN)
SPC	Statistical Programme Committee
SPV	Special Purpose Vehicle

Table of contents

Figures

Annexes

1. Introduction

This first chapter includes the background to the study, the purpose, delimitation, the sources and methods and finally the structure.

1.1 Background of the study

In 1992 the Maastricht Treaty came into force and only four years later, the Stability and Growth Pact was born. From a statistical point of view, the early years of the implementation of the Stability and Growth Pact (SGP) did not raise any special issues, except the so-called France Telecom case in 1997, which effectively allowed France to join the euro-zone. Nevertheless, in the following years, many countries started to face budgetary problems and had to take action in order to avoid breaching the 3% deficit limit. In some cases they genuinely achieved doing that, but in some cases they did not, and crossed the limit. However, some countries saw at the same time the benefit of avoiding unpopular decisions to comply with the Maastricht criteria, and to resort to dubious accounting practices instead, hence the birth of the term "creative accounting" which started to be used in this respect.

As a consequence of the budgetary pressure in the Member States, due in most cases to an increasing slowdown of their economies, partial compliance with statistical rules became more attractive and individual interpretations by Member States of ESA95, often with the precious help of Investment Banks, became a challenge for Eurostat. As a consequence, Eurostat's role, previously limited to aggregation of data and provision of figures for EU15 and the euro-zone, had to evolve quickly, and procedures for the setting up of excessive deficit procedure (EDP) task forces, CMFB consultations etc. were established. Every year since then, the number of contentious methodological cases has increased.

This also resulted of course in an enhanced interest, from the press and policy makers, in the statistical implications of the SGP. When Portugal, Germany and France all breached the 3% criteria, press coverage increased enormously and today Eurostat is constantly solicited by the press to provide comments, explain its positions and decisions and inform about its future activities in the context of its SGP (EDP) work. There are exceptions of course, and these are mainly Scandinavian countries (Denmark and Sweden in particular), where the interest for EMU related affairs (and the EU in general) is still low.

Although in 2003, Germany and France were in a position of excessive deficit for the second year in a row, the Council decided not to continue the procedure that would have perhaps led to imposed sanctions. This decision had substantial consequences, and as a result the SGP was declared at the time as dead, or at least in need of major revision in order to survive. After long discussions and negotiations, the SGP was finally revised. Shortly after, Regulation 3605/93, being the basis for implementation of the EDP from the statistical point of view, was also amended.

Interpretation of national account rules is often not a case of deciding between black and white, and different shades of gray are sometimes admitted. Rules are often in the form of general principles and practical concrete cases are not always described. Moreover, there are also developments not foreseen at the time in which the basic rules were devised (in the domain of new financial instruments for instance) which lead to difficult decisions to be taken by Member States or Eurostat. Also for this reason, the number of methodological decisions taken by Eurostat has greatly increased. Statistical decisions in the domain of national accounts might be regarded as quite uninspiring, but in fact most of them have often, if set in the context of the SGP, economic and political implications, and this contributes to the interest of the issues treated.

1.2 Purpose

The purpose of this study could be described as two-fold. The first objective is to give a complete picture of the framework surrounding the Stability and Growth Pact, and in particular to the statistical framework. Most likely nothing on this subject was published before in such a level of detail, and it is my hope that this will be a useful companion to complement other more politically or economically oriented publications on the Stability and Growth pact.

The second objective, which actually constitutes the core of the thesis, is to analyse in detail the statistical implications of the Stability and Growth Pact both from the perspective of the European Commission (Eurostat) and of Member States. From the point of view of Eurostat, great importance is attached to the process leading to its methodological decisions and to the respect of ESA95 rules. From the point of view of Member States on the contrary, ESA95 rules were considered in a certain number of cases as a means to deliver certain results.

Finally, the revision of the SGP and its complementing legislation have been appropriately treated in the last chapter with the objective to describe the main changes in this respect, and the effect of these changes.

1.3 Delimitation

As described in the previous paragraph, this study can be divided into two parts. In order to provide as complete a background as possible on the issue, the introduction encompasses a wide range of aspects including detailed descriptions of the work of DG ECFIN in the context of its bi-annual spring and autumn forecasts, the updated stability programmes and the excessive deficit procedure (EDP). Similarly, the background to EMU and the origin of the Maastricht criteria, share the same goals. These issues are undoubtedly important, but they have already been treated in much academic literature, and as a consequence it was decided not to devote an excessive amount of space to them in the more analytical parts of the study.

On the other side, the country and methodological cases have been sparsely treated in international literature until now, and therefore more time and space have been devoted to this part. This includes detailed information on the EDP notification tables and the methodological framework of ESA95, but in particular it includes the implementation of the rules. In this context, all main decisions taken by Eurostat in recent years, as well as the developments in some Member States have been covered. Member States have been chosen based on the importance of their cases and access to public material. No new Member State (i.e. any of the ten Member States joining in May 2004) was included at this stage, even if the number of interesting cases, being the objects of discussions between Eurostat and Member States, are increasing steadily.

1.4 Sources and methods

This thesis draws from a wide range of sources. The main source is the legal framework surrounding EMU and the Stability and Growth Pact, including the European System of

National and Regional Accounts (ESA95). As a complement to the legal acts, including also the Treaties and its Protocol, other official documents have been used, mainly originating from Commission decisions or communications. All these documents are public and have been included in foot notes and/or the references. The documents can be found on the Commission or Council web sites.

For chapter 6 on “the most important decisions taken by Eurostat”, the Eurostat decisions as published in the press releases and in the ESA95 manual on government deficit and debt have been used as a basis, complemented with interviews with some Commission officials participating in the task-forces, and some further information found either in the press or in economic and statistical literature.

Concerning the chapter on creative accounting and the case studies, public Commission material, from several years back, as well as other official sources, have been used as a background to the analysis. In a couple of cases, these reports have been in languages other than English, as in the Italian and Portuguese case studies, and have been partly translated by native speakers. Nevertheless the report of Eurostat on the Greek accounts has been published by Eurostat in English. In addition, articles from the press have been used widely in this chapter as well as reports and books. As in the chapter on “the most important decisions taken by Eurostat”, some complementary interviews have been made, in order to complement or confirm the information and figures presented.

The analysis in the last chapter is based on the amended legal acts, Commission documents, academic papers and press articles.

1.5 Structure

This thesis starts with an introduction to the background to EMU, the Maastricht Treaty and the SGP. The complete legal framework, as well as the origin of the deficit and debt thresholds, are covered here. It has to be said in this context, that when the first chapters of this thesis were written in 2005, the SGP and Regulation 3605/93, being the basis for implementing the work on EDP, had still not been revised. Therefore the last chapter was written simply to complement and update the rest of the thesis.

The thesis then continues with two chapters describing the role and work of DG ECFIN and Eurostat in the context of the SGP. This section includes a detailed presentation and analysis of the work in the preventive as well as the corrective arm of the SGP and in particular on the preparation of spring and autumn forecasts, the assessment of the stability and convergence programmes and the excessive deficit procedure. Furthermore, the procedures and content of the reporting of data by Member States, being the basis for the excessive deficit procedure, are also adequately covered. In this context, the statistical framework, ESA95, is explored in detail, and emphasis is put on the most contentious areas in the context of the excessive deficit procedure.

The second part includes an analysis of the implementation of the statistical framework. This encompasses the involvement of Eurostat in the interpretation of the framework, as well as in the process of methodological development. The background to, and results of, the most important decisions taken by Eurostat in recent years are covered and include decisions on securitization operations, Public-Private-Partnerships, EU grants, capital injections, transfer of pensions funds to government and classification of pension funds. Furthermore, in parallel, the Member States' implementation of the framework is also included, often being in itself the reason for new decisions to be taken. Apart from a general chapter on creative accounting, a range of important case studies concerning Portugal, Italy, France, Germany and Sweden have been included in this part. Greece has been covered in a special chapter, due to the extent of revisions undertaken in government accounts during recent years.

Finally, the background to, and results of the revision of the SGP, a process starting seriously in 2003 and ending in 2005, have been described and analysed.

2. The Stability and Growth Pact (SGP) – a step towards fiscal stability

The goal of this chapter is to give a short background to EMU, as well as to present the legal framework underpinning EMU and the SGP. It will additionally briefly explain the procedures for modifying the EU legislation in this respect and provide an historical overview of the selection of the deficit and debt thresholds, as specified in the *Protocol on the excessive deficit*.

2.1 Background to EMU

"And thou shalt lend unto many nations, but thou shalt not borrow (Deuteronomy 15:6)"

The first thoughts concerning an economic and monetary union can be traced back to the very beginning of the European Communities (EC) and to the provision of the Rome Treaty from 1957, establishing the European Economic Community (EEC). It was specified in the Treaty that *"The Member States have to co-ordinate their economic policies closely with the institutions of the Community (article 7) and to the extent necessary to obtain the objectives of the Rome Treaty. Some of the main objectives, such as the creation of the common market and the increasing convergence of the economic policies of the Member States (article 2) made it necessary to foresee (article 3) the abolition of the obstacles which existed to the free movement of goods, persons, services and capital between the Member States"*.

The first concrete plans to create an economic and monetary union were established in 1969 by the Heads of State and Government of the EC in Den Haag. They were included in a Commission report called "*Plan by stages towards EMU*". During the following years several working groups were established as a follow-up to the report and the need for coordination of economic policies was specifically addressed. In 1977, the President of the Commission, Roy Jenkins, made an important speech on the need for a greater monetary stability within the internal market and this can be seen as one of the main forces in the drive towards the creation of the European Currency Unit (ECU) and the European Monetary System (EMS) in March 1979.

Between 1980 and 1988 the ECU was at the forefront of internal debates in the Commission. Jacques Delors, the President of the Commission and the chair of an expert group, mandated by the Member States to examine the possibilities of creating an economic and monetary union, prepared a report on "Economic and Monetary Union" in April 1989, which became the blueprint for the Maastricht Treaty and for the implementation of the EMU during the following 10 years, a period which culminated with the introduction of the euro in 1999 (and the introduction of the euro banknotes and coins later in 2002). The EMU was also the subject of one of the two Intergovernmental Conferences (IGCs) which concluded their deliberations in Maastricht in December 1991. The decisive step towards achieving a closer economic integration of Europe was embodied in the Maastricht Treaty and it provided for EMU to be achieved in three successive stages:

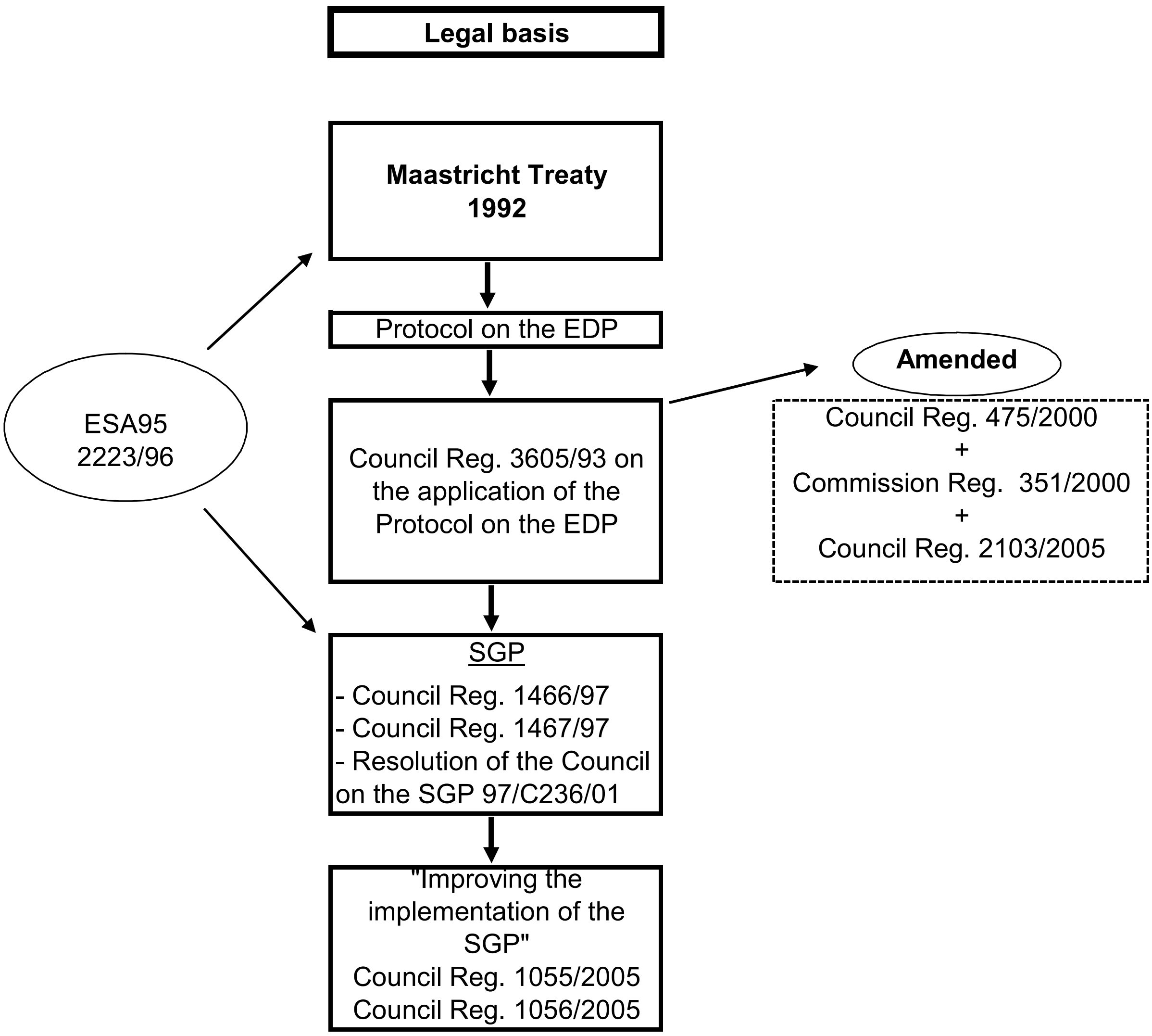
The first stage (1 July 1990 to 31 December 1993) included the free movement of capital between Member States, a closer coordination of economic policies and closer cooperation between central banks;

The second stage (1 January 1994 to 31 December 1998) involved the convergence of economic and monetary policies of the Member States (to ensure stability of prices and sound public finances) and the creation of the European Monetary Institute (EMI) and, subsequently in 1998, of the European Central Bank (ECB);

The third stage (from 1 January 1999) saw the irrevocable fixing of exchange rates and the introduction of the single currency on the foreign-exchange markets and for electronic payments, followed by the introduction of euro notes and coins from 1 January 2002. It was at this stage that it was explicitly specified that Member States shall avoid excessive deficits.

There is little doubt that EMU represents an important historical development. For the first time in history, a large number of sovereign countries have voluntarily decided to adopt a common currency and relinquish monetary authority while retaining independent fiscal policies. It is in this context, that the need for fiscal rules, complementing EMU, has become a particularly important issue due to the adoption of a common currency. What follows will describe the features and provisions of the first and second step of EMU and in particular it will analyse the Maastricht Treaty and the creation and main procedures of the SGP.

2.2 The legal framework of EMU



2.2.1 The Maastricht Treaty and its relevant legislation

The Maastricht Treaty in 1992 devoted a substantial part of its text to economic and monetary policy and detailed the different stages to be followed in the context of the creation of EMU. Already in the objectives of the Treaty, it is stated that (Article 2): "*The Community shall have as its task, by establishing a common market and an economic and monetary union and by implementing the community policies or activities referred to in articles 3 and 3a, to promote throughout the Community a harmonious and balanced development of economic activities, sustainable and non-inflationary growth respecting the environment, a high degree of convergence of economic performance, a high level of employment and of social protection, the raising of the standard of living and quality of life, and economic and social cohesion and solidarity among Member States*"

The Treaty includes references to the so-called "convergence criteria" guiding the Community in taking decisions on the passage to the third stage of the economic union (Article 104c). The convergence criteria (including the one concerning budgetary stability) are specified in detail in the "*Protocol on the convergence criteria referred to in article 104c of the Treaty*". These criteria refer to price stability (inflation), budgetary position, exchange rate fluctuations and interest rates. The budgetary position refers explicitly to government deficit and debt, specifying the reference values (3 and 60 % of GDP respectively) to be achieved. These will be described in detail later on in the chapter. For the other three convergence criteria the Treaty reads as follows:

Article 1: "The criterion on **price stability**…shall mean that a Member State has a price performance that is sustainable and an average rate of inflation, observed over a period of one year before the examination, that does not exceed by more than 1½ percentage points that of, at most, the three best performing Member States in terms of price stability"

Article 3: "The criterion on **participation in the Exchange Rate Mechanism** of the European Monetary System … shall mean that a Member State has respected the normal fluctuation margins provided for by the Exchange Rate Mechanism of the European Monetary System without severe tensions for at least the last two years before the examination. In particular, the Member State shall not have devalued its currency's bilateral central rate against any other Member State's currency on its own initiative for the same period".

Article 4: "The criterion on the convergence of **interest rates** … shall mean that, observed over a period of one year before the examination, a Member State has had an average nominal long-term interest rate that does not exceed by more than 2 percentage points that of, at most, the three best performing Member States in terms of price stability"

Articles 102 a, 103, and 104c of the Treaty constitute the first chapter on Economic Policy. Article 104c is of particular importance for EDP related work. The first part of the article reads "*Member States shall avoid excessive deficits*". This statement is followed by detailing the role of the Commission: "*The Commission shall monitor the budgetary situation in the Member States and the stock of government debt in the Member States. In particular it shall examine compliance with budgetary discipline on the following:*

a) whether the ratio of the planned or actual government deficit to gross domestic product exceeds a reference value unless

-either the ratio has declined substantially and continuously and reached a level that comes close to the reference value

-or, alternatively, the excess over the reference value is only exceptional and temporary and the ratio remains close to the reference value;

b) whether the ratio of government debt to gross domestic product exceeds a reference value, unless the ratio is sufficiently diminishing and approaching the reference value at a satisfactory pace."

The reference values are not specified in the Treaty itself, but are detailed in the *Protocol on the excessive deficit procedure* annexed to it. Article 104c of the Treaty not only refers to the reference values but also specifies the procedures to be followed by the Commission in the case of an excessive deficit of a Member State. This includes the preparation of a report for the Council, the requirement to make the information public, the possibility of undertaking more drastic measures against a "faulty" Member State such as requesting a non-interest bearing deposit, the possibility to impose fines, etc. However, no specific details are provided (for instance in terms of timing, size of deposits or fines etc). These rules were instead detailed at a later stage in Council Regulation 3605/93 and in the context of the SGP and of its supportive legislation (see chapter 3).

The protocol on the excessive deficit procedure is the document where the widely known reference values of 3 and 60% were detailed for the first time. The protocol develops the provisions stated in article 104c of the Maastricht Treaty and it has to be considered as the real cornerstone for the statistical implications of the EDP. Apart from the reference values, it refers to the definition of general government and to the European system of integrated economic accounts[1] (ESA79) which are treated in detail in chapter 5, as well as to the reporting procedures, which are treated in chapter 4. Furthermore, the definition of deficit, debt and investment under the EDP and the fact that the statistical data to be used in the application of the Protocol are to be provided by the Commission (i.e. Eurostat) are also mentioned.

PROTOCOL on the excessive deficit procedure

THE HIGH CONTRACTING PARTIES,

DESIRING to lay down the details of the excessive deficit procedure referred to in Article 104c of the Treaty establishing the European Community,
HAVE AGREED upon the following provisions, which shall be annexed to the Treaty establishing the European Community:

Article 1

The reference values referred to in Article 104c(2) of this Treaty are:
- 3% for the ratio of the planned or actual government deficit to gross domestic product at market prices;
- 60% for the ratio of government debt to gross domestic product at market prices.

Article 2

In Article 104c of this Treaty and in this Protocol:
- government means general government, that is central government, regional or local government and social security funds, to the exclusion of commercial operations, as defined in the European System of Integrated Economic Accounts;

[1] At the time of the Protocol the reference was made to ESA79. ESA95 was gradually introduced and only fully replacing ESA79 in this context in year 2000.

- *deficit means net borrowing as defined in the European System of Integrated Economic Accounts;*
- *investment means gross fixed capital formation as defined in the European System of Integrated Economic Accounts;*
- *debt means total gross debt at nominal value outstanding at the end of the year and consolidated between and within the sectors of general government as defined in the first indent.*

Article 3

In order to ensure the effectiveness of the excessive deficit procedure, the governments of the Member States shall be responsible under this procedure for the deficits of general government as defined in the first indent of Article 2. The Member States shall ensure that national procedures in the budgetary area enable them to meet their obligations in this area deriving from this Treaty. The Member States shall report their planned and actual deficits and the levels of their debt promptly and regularly to the Commission.

Article 4

The statistical data to be used for the application of this Protocol shall be provided by the Commission.

As a further step, in November 1993 the Council adopted "*Regulation 3605/93 on the application of the protocol on the excessive deficit procedure annexed to the Treaty establishing the European Community*". This Regulation lays down in detail the implementing modalities of article 2 of the *Protocol on the excessive deficit procedure* for the reporting requirements in terms of definition, rules and coverage of reporting and it has constituted the basis for EDP data reporting until the revision in 2005.

At the time of the signature of the Maastricht Treaty, it became evident that the monitoring of compliance with the fiscal provisions depended also on the Council's (and in particular the ECOFIN Council's) access to transparent, reliable and updated budgetary and economic data, which should be consistent with the harmonizing standards of the European System of National and Regional Accounts (ESA95). In order to carry out the necessary surveillance, determine whether sanctions should be imposed, decide on access or denial to EMU Membership, access to this information was crucial. The Treaty and its supporting legislation delegated to the Commission the responsibility for assessing compliance with ESA95 and gathering, analysing, and evaluating the data provided by Member States as part of the ongoing monitoring and surveillance process (the harmonised system of national accounts, ESA95, is further developed under chapter 5).

Regulation 3605/93 has been amended three times. The first two times, through Council Regulation 475/2000 of 28 February 2000 and Commission Regulation No 351/2002 of 25 February 2002), were mainly due to changes in the National Accounts coding. However, at the end of December 2005 an amended text (*Council Regulation 2103/2005 as regards the quality of statistical data in the context of the excessive deficit procedure*), which introduced major modifications, was adopted after a long debate between the Commission and the Member States. This constituted an important development, whose implications are described in the last chapter of the study.

Regulation 3605/93 includes some fundamental principles of the definitions of General government, of government deficit/surplus, of investment and of the composition of the debt. Furthermore it specifies the meaning of planned and actual government deficit and debt figures. Finally, the rules and coverage for reporting are also defined in detail. The content of the Regulation will be further developed in chapters 3 and 4.

2.2.2 The Stability and Growth pact (SGP) and the Resolution of the European Council

Political agreement on the SGP was reached at the Dublin European Council of December 1996. It could be seen as the EU's answer to repeated concerns about the establishment and continuation of budgetary discipline in the EU Member States, under EMU. By making fiscal discipline a more permanent feature of EMU, the Maastricht Treaty provisions on fiscal discipline were strengthened.

The SGP is comprised of two Council Regulations and a Resolution of the European Council. The first Regulation 1466/97- "*on the strengthening of surveillance of budgetary positions and the surveillance and coordination of economic policies*" deals with the preventive dimension of the SGP and has article 99 of the Treaty as its legal base. This Regulation entered into force on 1 July 1998. The second Regulation 1467/97 "*on speeding up and clarifying the implementation of the excessive deficit procedure*" deals with the dissuasive part of the SGP and its legal basis is Article 104 of the Treaty. This Regulation entered into force on 1 January 1999 (at the same time as the introduction of the euro) thus making the SGP fully applicable. The main provisions of these two Regulations will be detailed later in this thesis. Finally, the *Resolution of the European Council on the Stability and Growth Pact,* provided political guidance to the parties who will implement the SGP and sets a range of guidelines concerning the roles of the Member States, the Commission and the Council.

Apart from the legal provisions included in the above-mentioned Regulations, the *Code of Conduct on the content and format of stability and convergence programmes* incorporates the essential elements of Council Regulation 1466/97 into guidelines to assist Member States in the drawing up of their programmes. Finally, it is important to mention that, just as in the case of the Council Regulation 3605/93, there have also been recent changes to the two SGP Regulations[1], which will be described in the last chapter of this thesis.

2.2.3 The legal implications of the SGP –procedures for changing the Treaty and other Community legislation

In Community law, treaties belong to so-called primary law whereas Regulations, Directives and Decisions are defined as secondary law. A Regulation is compulsory for all Member States and is normally detailing a part of a Treaty, but it must never be in contradiction with dispositions included in a Treaty.

The procedures for changing a Treaty are stated in article 48 of the Treaty of the European Union (consolidated version from 24.12 2002). "*The government of any Member State or the Commission may submit to the Council proposals for the amendment of the Treaties on which the Union is founded. If the Council, after consulting the European Parliament and, where appropriate, the Commission, delivers an opinion in favour of calling a conference of representatives of the governments of the Member States, the conference shall be convened by the President of the Council for the purpose of determining by common accord the amendments to be made to those Treaties. The European Central Bank shall also be consulted in the case of institutional changes in the monetary area. The amendments shall enter into force after being ratified by all the Member States in accordance with their respective constitutional requirements*".

[1] Amended by Council Regulations 1055/2005 and 1056/2005

The procedure for changing a Treaty is cumbersome and it is known from experience (see, as an example, the events surrounding the approval of the European Constitution) that even after final agreement of the Council on the text of a new Treaty, unanimity is needed for its entering into force and all Member States must therefore ratify it. This can be done through the national parliament or via a referendum.

For Secondary legislation, and in particular for Regulations, there are well established procedures for revisions. There is no need to go into detail here, but some elements should nevertheless be mentioned in the light of the revision of the SGP, which occurred during spring 2005 and of the revision of Regulation 3605/93.

The Regulations underlying the SGP have been object of the so called "co-decision procedure" which means that Community legislation has to be adopted by both the European Parliament (EP) and the Council. The co-decision procedure is divided into three parts: the first reading, the second reading and the third reading (conciliation procedure). In short, the first reading begins with a communication from the Commission. The EP either approves or proposes amendments to it. The Council thereafter either adopts the Commission proposal and/or the EP amendments. As a next step the Council adopts a common position and transmits it to the EP. In the second reading the EP acknowledges in a plenary session the common position of the Council and approves, rejects or proposes amendments to the common position of the Council. The Council then either approves the new version of the legislation including the introduced EP amendments (and therefore the Act is adopted), or alternatively does not approve all amendments and a Conciliation committee is then convened. The Conciliation committee (third reading), by a qualified majority of the members of the Council and by a majority of the representatives of the EP in the Committee, approves a joint text which is either adopted, or rejected in cases where no joint text can be proposed by the Committee (the act is not adopted).

2.3 The deficit and debt thresholds of 3 and 60 percent

The following part intends to provide a short background to the reasons why the EDP thresholds previously mentioned were finally selected. The aim would be to briefly describe the (political) reasons behind the choice, rather than analysing these thresholds from an economic point of view.

2.3.1 The origin of the deficit threshold

The inclusion of deficit and debt targets in the Maastricht Treaty reflected the widespread concern that EMU could be undermined by governments conducting irresponsible fiscal policies. Germany, in particular, influenced by its own history of hyperinflation in the 1920s-1930s, expressed reservations about admitting nations into EMU with a history of incurring large and chronic deficits financed by way of devalued currencies and high levels of debt. Savage, 2005 writes: " In the so called Delors Report from 1989, the former French Finance Minister Jaques Delors declared: *the large and persistent budget deficits in certain countries has remained a source of tension and has put disproportionate burden on monetary policy…access to large capital markets may…facilitate the financing of economic imbalances. As a result the report urged that "binding rules…consisting of effective upper limits on budget deficits of individual countries" be established as uncoordinated and divergent national budgetary policies would undermine monetary stability and generate imbalances in the real and financial sectors of the Community.* The Maastricht Treaty adopted many of the

Delors report's recommendations and incorporated its own famous budget constraints as urged by the Germans, Dutch, Danes and British "

The key discussions over what constituted proper reference values for deficit and debt occurred in the European Community's Monetary Committee. Representatives from Germany and Holland both firmly supported the idea that deficits in the current account or operating budget should be prohibited. This proposal was rejected by other countries, with arguments stressing the difficulty of separating capital and investment expenditure and debt from the operating budget. Furthermore such limitations were considered by some to cripple anti-cyclical policies during recessions. France and Italy defended the use of high-employment or cyclically adjusted budgets, but this idea was also rejected because of measurement problems. Multi-year budget targets were ruled out due to their dependence on fiscal estimates rather than actual revenue, expenditure and debt figures. Consequently, annual budget deficits and debt levels as measured by ratios to GDP became the reference value for fiscal convergence (Savage, 2005).

The origin of the two values and especially of the 3 percent deficit figure, is worth mentioning. The 3 percent deficit reference originated in France, where it was adopted by the Mitterand government in 1982 following the recommendation of the Finance Minister Jaques Delors to impose fiscal rigor. Delors said in an interview in 2001 (Savage, 2005) that *"3 percent was a realistic target for the adjustment of the French economy; At three percent if you make a distinction between ordinary spending and investment spending, you could consider that in an European country the part of the budget devoted to the preparation of the future is at least three percent, more than if you include all the spending on education and so*".

The criteria, procedures and sanctions to avoid excessive deficits played a major role in French negotiating objectives. The French Finance Ministry saw the need to establish a new basis of credibility for EMU in the financial markets. Hence it introduced the concept of three percent budget-deficit criterion in the negotiations. Mitterand was prepared to concede on this issue using two arguments coming from the French Ministry: that the president had actually endorsed the three percent figure in 1982 and that tough criteria would be a signal for French seriousness and determination to the Germans (Savage 2005). After some discussions and general agreement, the 3% threshold was finally endorsed.

2.3.2 The origin of the debt threshold

The background to the choice of the debt target is different (Savage, 2005). The 60 percent criteria was the result of the discussion of a group of Finance Ministers in charge of preparing the Maastricht Treaty. The debt reference value was selected because it was the approximate average of the combined EU government's gross debt, which for the 15 Member States stood at 57 percent of GDP. The Monetary Committee focused on gross debt level because for several EU members there existed no reliable measure of net debt[1]. The three percent figure also coincided with the economic formula that determines what the deficit level must be in order to stabilize the debt level at 60 percent of GDP, based upon the EU's assumed growth rate of GDP. Nevertheless, some governments still objected to precise deficit targets and

[1] It should be noted that the Maastricht debt deviates from the debt according to ESA95. Maastricht debt means total debt at nominal value outstanding at the end of the year and consolidated between and within sectors. Maastricht debt excludes financial derivatives, other accounts payable, shares and other equity and insurance technical reserves which are part of ESA95 debt.

argued for greater fiscal flexibility, particularly arguing that looking at a single year's deficit and debt levels ignored broader economic and fiscal conditions. As a compromise the 3 and 60 percent targets initially became "reference values" rather than exact ceilings.

3. The role of the European Commission (DG ECFIN) in the implementation of the Stability and Growth Pact

This chapter will describe the role of DG ECFIN in the implementation of the SGP, and in particular, in the preparation of the spring and autumn forecasts and in the assessment of the Stability and Convergence Programmes submitted by Member States. The rules to be implemented in the case of excessive deficits in Member States, as well as an assessment of the current situation in Member States, will also be described.

3.1 The role of DG ECFIN

One of the main tasks of the Commission is to be the Guardian of the Treaties (together with its other main responsibilities of initiating legislative and policy proposals to the European Council and Parliament, managing the EU budget, carrying out EU policies and creating and implementing legislation). The Directorates-General (DGs), which are most involved in the SGP are DG ECFIN and Eurostat. Their respective roles and tasks in the context of EDP will be described in the two following chapters.

In its mission statement[1], DG ECFIN indicates in the introduction that "*DG ECFIN's main role consists in providing high-level analysis and policy advice to the Commission and its services on economic and financial questions. ECFIN actions find their origin in the Title VII of the Treaty - Economic and Monetary Policy -, which assigns considerable institutional responsibilities to the Commission on economic policy coordination, economic surveillance and policy assessment. This is notably the origin of the Broad Economic Policy Guidelines, the assessment of the Stability and Convergence Programmes submitted by the Member States, the preparation of the Convergence Reports*".

When analysing the different legal texts referring to the role of the European Commission, article 104 of the EC Treaty states that "*The Commission shall monitor the development of the budgetary situation and of the stock of government debt in the Member States with a view to identifying gross errors*". The Protocol on the Excessive Deficit Procedure annexed to the Treaty establishes *inter alia* that "*the Member States shall report their planned and actual deficit and debt levels promptly and regularly to the Commission. Furthermore, the statistical data used for this application shall be provided by the Commission*".

The Resolution of the European Council on the Stability and Growth pact dates 17 June 1997 lays down the respective roles of the Member States, the Commission and the Council in this respect. As far as the Commission is concerned, it is specified in the first paragraph that: "*The Commission will exercise its right of initiative under the Treaty in a manner that facilitates the strict, timely and effective functioning of the Stability and Growth Pact*".

As a complement to Council Regulation 3605/93 and its successive amendments, and to the ESA95 Regulation 2223/96, the ECOFIN Council endorsed a *Code of best practice (23 February 2003) for the compilation, transmission and publication of data for the purpose of the EDP*, in order to clarify the obligations and procedures to be followed at the level of the Member States and of the Commission. The Code states that "*the Commission's role as statistical authority in the context of the EDP is taken on by Eurostat, on behalf of the Commission. However, the Commission does not directly compile government data in the Member States but depends on data compiled and reported by the national authorities*".

---

[1] DG ECFIN website http://europa.eu.int/comm/economy_finance

3.2 The preparation of spring and autumn forecasts

Twice a year (in spring and autumn)[1] the European Commission produces short-term macro-economic projections for the 25 EU Member States. The focus on these forecasts is mainly on the euro area and on the Member States of the EU, but the report deals also with the Candidate countries, Japan and the US. The forecasts concern a comprehensive set of macroeconomic variables and they are most relevant for short-term economic policy analysis, where the objective is to take timely corrective action if needed. The forecast horizon is two years.

The European Commission (i.e. the college of Commissioners) does not formally adopt the forecasts but is informed of the outcome by the Commissioner in charge of economic and financial affairs (Mr Almunia at present). After having informed his colleagues, the Commissioner officially releases the forecasts. These reports are published on paper and on the DG ECFIN web site (downloadable free of charge). In the context of the publication of the forecasts, a press conference is organized.

It is interesting to note that DG ECFIN basis its forecasts on the information received from the Member States and on its own analysis. In this context, in case of operations with doubtful accounting consequences, DG ECFIN's strategy is to accept the position presented by the Member State, even if Eurostat voiced open doubts on the accounting implications of such operations, whilst a final decision by Eurostat on the issue still needed to be taken. This has often lead to the forecasts of DG ECFIN being more favourable to the country than the eventual outcome, as well as being more favourable compared to those prepared by major research institutes or bodies. One extreme example[2] is the autumn forecast for Portugal in 2004, projecting a deficit of 3.7% of GDP in 2005. In the meantime the government in Portugal changed. The new government asked the governor of the Bank of Portugal to make a thorough review of the budgetary and fiscal situation, and as a consequence the new forecast issued by DG ECFIN one year later was a deficit of 6.2% of GDP for 2005. The reasons behind this incorrect projection were overestimation of tax revenue, higher expenditure for social security, contribution to public corporations, public staff costs, health, pensions, EU contributions and capital increases (see the case study of Portugal for more information).

3.3 The preparation of convergence and stability programmes by Member States

For the purpose of the multilateral surveillance foreseen by article 99 of the Treaty, Member States prepare stability or convergence programmes as part of the Stability and Growth Pact (SGP) under EMU (specifically, in conformity with Council Regulation 1466/97 as mentioned earlier). These programmes constitute the core of the preventive arm of the SGP.

Public documents are drawn up following the guidelines set in *the Code of conduct on the content and format of the stability and convergence programmes*, and the programmes are submitted to the Commission and Council. Their aim is to strengthen and clarify Treaty provisions on multilateral economic surveillance and budgetary discipline during the third stage of EMU. Programmes are updated annually and sent at the same time as, or shortly after, the adoption of the national budget proposals (normally around December). In this way the programmes can include the main elements and targets of the forthcoming budget as well

[1] From 2006 DG ECFIN will make four forecasts per year for major countries
[2] The s.k. Constancio report (Relatorio da Comissao para a analise da situacao orçamental) from May 2005

as the medium-term objectives. To ensure transparency and accountability a common framework for the programmes has been designed according to Regulation 1466/97 and the *1998 Code of Conduct*.

Member States which have adopted the single currency prepare stability programmes, while those which have not, prepare convergence programmes.

Stability and convergence programmes must present the following information:

- a medium-term objective for a budgetary position of close to balance or in surplus, the adjustment path and the expected path of the general government debt ratio
- the main assumptions about expected economic developments (growth, employment, inflation and other important economic variables)
- a description of budgetary and other economic policy measures being taken and/or proposed to achieve the objectives of the programme
- an analysis of how changes in the main economic assumptions would affect the budgetary and debt position

In addition, convergence programmes must present:

- the medium-term monetary policy objectives and the relationship of those objectives with price and exchange rate stability.

The information provided for the budgetary position must be based on the ESA95 framework and cover the general government sector and it must include, as well as the current and preceding year, at least the following three years.

3.3.1 Examination and monitoring of the programmes by the Commission

In accordance with the SGP, the Council examined for the first time the original 1999 programmes. Since then, the Council examines, in most cases, the annual programme updates at the beginning of each year. This examination is based on assessments by the Commission and the Economic and Financial Committee and includes:

- whether the medium-term budget objective in the programme provides for a safety margin to ensure the avoidance of an excessive deficit;
- whether the economic assumptions on which the programme is based are realistic;
- whether the measures being taken and/or proposed are sufficient to achieve the medium-term budgetary objective (and, for convergence programmes, to achieve sustained convergence);
- whether the content of the programme facilitates the closer co-ordination of economic policies;
- whether the economic policies of the Member State concerned are consistent with the broad economic policy guidelines;

On a recommendation from the Commission, and after consulting the Economic and Financial Committee, the Council delivers an opinion on each programme, and can invite the Member State concerned to take additional measures to contain its deficit and debt. The Council monitors implementation of programmes and, to prevent an excessive deficit, can recommend to the Member State concerned to take adjustment measures. If subsequent monitoring suggests worsening budgetary position, the Council can recommend Member States to take prompt corrective measures.

The Stability programmes are of major importance. Since the last revision of the SGP in 2005, they can even be used for the process of starting an excessive deficit procedure. This constitutes a new development, as previously the EDP procedure could only be started based on actual notified data. This is explained in more detail in the last chapter on the revised SGP.

The Commission's convergence reports examine in detail whether the Member States satisfy the necessary conditions for the adoption of the single currency, namely

- the convergence criteria
- the legal requirements

At least once every two years, or at the request of a Member State by derogation, the Commission shall report to the Council on the progress made in this respect.

3.3.2 The EMU status of Member States – assessment in April 2006

At present, thirteen Member States do not participate in the euro area – the Czech Republic, Denmark, Estonia, Cyprus, Latvia, Lithuania, Hungary, Malta, Poland, Slovenia, Slovakia, Sweden and the United Kingdom. Sweden was assessed in 1998 as not fulfilling the necessary conditions for the adoption of the single currency and is, therefore, a Member State with a derogation to be re-examined regularly. The ten countries that joined the European Union on 1 May 2004 are Member States with a derogation, and their stability programmes were examined for the first time in 2004.

Denmark and the United Kingdom have negotiated opt-out arrangements and will therefore not be the subject of an assessment until they request to be assessed for adopting the single currency.

The SGP applies to all EU countries, but it stops short of imposing sanctions on non-euro-members. It can be expected however that peer pressure and concern about being declared in excessive deficit also exerts discipline on the latter group.

The queue of new countries wanting to join the EMU is already long and the time table currently looks as follows: Slovenia in 2007, Estonia, Lithuania, Cyprus, Latvia and Malta possibly in 2008 if they comply with all convergence criteria (see chapter one for details). For the remaining countries, the time table is still quite open. Slovakia may join in 2009 and the Czech Republic and Hungary in 2010. For Poland and Sweden there are no foreseen dates.

3.4 The recognition of the existence of an excessive deficit

Regulation 1467/97 of 7 July 1997 on speeding up and clarifying the implementation of the excessive deficit procedure provides clarifications on how to implement the rules as stated in Article 104 of the Treaty, and in addition sets precise deadlines for the different steps of the excessive deficit procedure.

To recall, according to Article 104 (and to the Protocol on the Excessive Deficit Procedure) a government deficit over 3% is not excessive if "*the excess over 3% is only exceptional and* *temporary and the (government deficit) ratio remains close to the reference value*". However, no precise definitions of these concepts are provided by the Treaty. While the SGP Regulation clarifies the concept of exceptional and temporary, it is silent on the notion of "close to the reference value". The issue of exceptional and temporary circumstances is relevant for the assessment whether a deficit is excessive or not: if the excess over 3% is considered exceptional (and the "temporary" and "close to" conditions are also satisfied) then there is no excessive deficit and the process stops there.

The SGP Regulation considers that a deficit over 3% can be considered exceptional if (i) "*it results from an unusual event outside the control of the Member State*" (for example a natural disaster) or (ii) *if it results from a severe economic downturn.* A severe economic downturn is defined as an annual fall of real GDP of at least 2 %. This has to be taken into account when the Commission prepares its report on the EDP. According to the SGP Regulation, the Commission will also in this case have to prepare a report even if the process stops there. In the case of an economic downturn of less than 2% of GDP, the Member State may present arguments on the abruptness of the economic downturn and thereby avoid an excessive deficit. The Council may then decide that based on the Commission report and arguments from Member States, there is no excessive deficit. The first report prepared by the Commission always goes to the EFC, which will provide an opinion on which the Council will then base its decisions. In the case where the opinion of the EFC differs from the Commission opinion, the Commission has to present in writing to the Council its reasons for its position. If the Council still does not agree with the Commission, the Council will most likely decide that an excessive deficit does exist. This has already happened in a number of cases. Normally, the Council will then give to the Member State a deadline for correcting its deficit. If this deadline is also not respected, the Member State will incur sanctions. However, this provision of the Treaty has never been activated.

3.4.1 The excessive deficit – deadlines, sanctions and amounts

Countries report data by 1 March (1 April from 2006) and 1 September (1 October from 2006)[1]. From this date up to the Council decision on the existence of an excessive deficit, no more than three months can elapse. To give a practical example; in the case of data reported in March n+1 for year n, by 1 June n+1 the Council must have decided on an excessive deficit procedure and made a recommendation to the Member *State "to bring the situation to an end within a given time period".* This recommendation under Article 104(7) gives four months for the Member State concerned to take effective action to correct its deficit. In this example it means by end of September of year n+1. If the Council considers that no effective action has been taken, a notice is given to the Member State within one month, that is, before the end of October in this example. If the Member State fails to comply with the notice received from the Council, within two months, sanctions will be imposed. This means that in this example sanctions would be imposed before the end of the year n+1. These deadlines are supposed to be a worst-case scenario in which the Member State does not take effective action in response to the Council recommendations/notice. If the Council decides that effective action was taken, the process stops. However if the action taken by the Member State is subsequently not being implemented or being inadequate, the procedure would begin again and move immediately to the step following the one at which it had stopped. It should be noted, as described in chapter 9, the time-schedule not only for the reporting dates, but also for the different steps in the excessive deficit procedure have been changed.

[1] Council Regulation 2103/2005 amending Regulation 3605/93

If the data show that the excessive deficit has not been corrected the procedure goes immediately to the next step, which is the last step of the dissuasive part of the Stability and Growth Pact.

If the Council decides to apply sanctions, a non-interest-bearing deposit shall be required from the Member State concerned. The deposit will remain until one of the following cases occurs: If after two years since the payment of the deposit, the excessive deficit is not corrected, then the deposit will be transferred into a fine. The second case is if, before the two years have elapsed, the Council considers that the excessive deficit has been corrected. In this case the deposit can be returned to the Member State. Indeed once the interest-bearing deposit has been made, the Council assesses, every year, whether the Member State concerned has taken effective action to correct the excessive deficit.

The amount of the first deposit shall comprise a fixed component equal to 0.2 % of GDP, and a variable component equal to one tenth of the difference between the deficit as a percentage of GDP in the preceding year and the reference value of 3 % of GDP. Each following year, until the decision on the existence of an excessive deficit is abrogated, the Council shall assess whether the participating Member State concerned has taken effective action in response to the Council notice. In this annual assessment, the Council might decide to intensify the sanctions. If an additional deposit is decided, it shall be equal to one tenth of the difference between the deficit as a percentage of GDP in the preceding year and the reference value of 3 % of GDP. The total single deposit may not exceed an upper limit of 0.5 % of GDP.

It should be noted that according to the SGP Regulation, the amount of sanctions can only be calculated from non-compliance with the deficit ratio criterion. In the case of non-compliance with the debt criteria there are no mandatory sanctions.

DG ECFIN publishes on its web site all ongoing excessive deficit procedures under article 104 of the Treaty. Portugal and Germany were the first countries in 2002 to be declared in an excessive deficit, followed by France in 2003. In 2004 the number of countries considerably increased, due to the accession of new EU Member States. Most of these countries were however already taken out of the excessive deficit procedure by the end of 2004. In April 2006, there were ongoing EDP procedures for the Czech Republic, Germany, Greece, France, Italy, Cyprus, Hungary, Malta, the Netherland, Poland, Portugal, Slovakia and the UK. When looking at the individual Member States at the DG ECFIN web site, there is very detailed information available, including all reports issued by the Commission.

Figure 1: Excessive Deficit procedures (DG ECFIN web site April 2006)

Country	**Date of the Commission report (Article 104§3)**	**Last update**
Year 2006		
Germany	19 November 2002	14 March 2006
Italy	7 June 2005	22 February 2006

United Kingdom	21 September 2005	24 January 2006
Year 2005		
Hungary	12 May 2004	11 November 2005
United Kingdom	21 September 2005	21 September 2005
Portugal	22 June 2005	12 September 2005
Netherlands	28 April 2004	18 May 2005
Greece	19 May 2004	6 April 2005
Year 2004		
Greece	19 May 2004	22 December 2004
Hungary	12 May 2004	22 December 2004
Czech Republic	12 May 2004	22 December 2004
Cyprus	12 May 2004	22 December 2004
Malta	12 May 2004	22 December 2004
Poland	12 May 2004	22 December 2004
Slovakia	12 May 2004	22 December 2004
The Netherlands	28 April 2004	22 December 2004
France	2 April 2003	14 December 2004
Germany	19 November 2002	14 December 2004
Greece	19 May 2004	5 July 2004
Czech Republic	12 May 2004	5 July 2004
Cyprus	12 May 2004	5 July 2004
Hungary	12 May 2004	5 July 2004
Malta	12 May 2004	5 July 2004
Poland	12 May 2004	5 July 2004
Slovakia	12 May 2004	5 July 2004
The Netherlands	28 April 2004	2 June 2004
United Kingdom	28 April 2004	
Year 2003		
France	2 April 2003	25 November 2003
Year 2002		
Germany	19 November 2002	25 November 2003
Portugal	24 September 2002	28 April 2004

4. The role of Eurostat in the implementation of the SGP and the provision of data by Member States

At first, when the rules of the SGP were established, Eurostat did not have a specific role. Considerations of a statistical nature did not figure prominently in the writing of the Maastricht Treaty or in the *Protocol on the excessive deficit procedure* to the Treaty. Furthermore, Eurostat's influence was not relevant in the development and approval of Regulation 3605/93, whose creation was lead by DG ECFIN. However, with time, more weight was given to statistics in the surveillance process of the SGP and Eurostat gained importance and took on new responsibilities in this respect.

Commission decision EC 97/28 provides that "*Eurostat is in charge of developing, setting the standards, determining the methodologies, and interpreting the European Community statistics*". It was further stated in Council Regulation 322/97 that *"Eurostat could invoke any number of EU rules to defend the principles of impartiality, objectivity, scientific independence and transparency in protecting the autonomy of its ruling"*.

In this chapter the role of Eurostat in the SGP will be analysed. The first part of the chapter will be devoted to a detailed description of the data reported by Member States in the context of the EDP notifications, as well as the additional government finance information to be provided to Eurostat. The Code of Best Practice on the compilation and reporting of data in the context of EDP will be described, as well as the so-called EDP missions and the process of "validation" and publication of data.

4.1 The provision of data by Member States

The legal basis for the provision of data to Eurostat is *Regulation 3605/93 on the application of the Protocol on the excessive deficit procedure annexed to the Treaty to the European Community*. The Regulation deals with all aspects of the EDP notifications, such as definitions, reporting rules and coverage. This Regulation has been complemented, for the purpose of EDP issues, by "*The Code of Best Practice on the compilation and reporting of data in the context of EDP",* described later in this chapter. In December 2005, Regulation 3605/93 was amended by Regulation 2103/05. The content of the revised regulation as well as a presentation of the main changes impacting EDP work, will be fully covered in chapter 9.

Each year countries must report to the Commission their planned and actual government deficits and levels of government debt. Data shall be reported twice a year, by 1 of March year n (changed to 1 April with the new regulation) and by 1 September year n (changed to 1 October with the new regulation). Data shall be reported for year n, year n-1, n-2, n-3 and n-4. The figures for the current year (year n) are defined as the planned deficit, while the deficit figures for years n-1 n-2, n-3 and n-4 are considered actual government deficits. These figures shall be provided for all sub-sectors of general government (central government, state government (only applicable for a minority of countries with "federal" structure, which are at present Austria, Belgium, Germany and Spain), local government and the social security sub-sector).

Along with the deficit, countries shall also report debt figures for the years n-1, n-2, n-3 and n-4, all considered actual government debt.

Countries shall also report the figures explaining the transition between the public accounts deficit (working balance defined nationally) and the national account deficit (net lending/net borrowing in ESA95), included in tables 2A-2D of the notification.

Finally, the figures which explain the transition between the government deficit and the change in government debt must also be provided. These are shown in tables 3A to 3E. The EDP tables are explained in detail below.

EDP Table 1
Table 1 provides a summary view showing *net lending / net borrowing* for general government and for its sub-sectors, general government debt by instrument, interest paid by general government (reported both with and without interest payments on swaps and forward rate agreements), gross fixed capital formation of general government, as well as the GDP.

EDP Tables 2
Tables 2 (2A, 2B, 2C and 2D) provide the link between the so-called working balances (i.e. the public deficit as voted nationally by the Parliament) and *net lending / net borrowing* in ESA95 for each sub-sector. The latter corresponds to the government deficit for EDP purposes. The working balances often correspond to the traditional cash budget deficit as nationally defined. Working balances need to be adjusted by operations that are nationally considered off-budget, but that are considered in national accounts as part of government operations. Working balances also need to be adjusted for operations that have an impact on the working balance but which are considered as financial transactions in national accounts without an impact on the ESA deficit (e.g. loans granted by government), Conversely, figures are also adjusted by operations that do not impact the working balances but are considered as expenditure in national accounts with an impact on the ESA deficit (e.g. many cases of capital injections).

EDP Tables 3
Tables 3 (3A, 3B, 3C, 3D, 3E) provide the link between *net lending / net borrowing* and the change in "Maastricht" debt. Whereas the change in debt over one period should largely reflect the deficit of the period, there are also other components which make the two figures diverge. As an example, for a set government deficit (i.e. an excess of expenditure over revenue), net acquisitions of financial assets (which do not increase the deficit) lead to higher borrowing needs and therefore result in a higher increase in debt.

The change in government debt reflects:

- the net *lending / net borrowing* (ESA deficit)
- net acquisitions of financial assets (i.e., acquisitions minus disposals) such as currency and deposits , loans granted, equity purchased, or other securities (e.g. bills and bonds)
- net incurrence of liabilities not in the government debt (mainly other payables)
- revaluations
- so called “other changes in volume”, arising mainly from reclassifications
- statistical discrepancies

These tables are compiled for general government and for its sub-sectors. Data are to be reported consolidated, that is, transactions or other flows occurring between units within the sub-sector (Tables 3B to 3E,) or within the sector (Table 3A), are not to be reported in the tables.

EDP Table 4
Table 4 shows supplementary information as concerns the stock of trade credits payable by government, debt arising from public corporations and Gross National Income.

Initially Member States were only requested to send the tables for general government (4 tables) but since September 2003 countries were asked to notify 11 tables on a voluntary basis and since March 2004 on a compulsory basis. With some exceptions, all Member States complete the full set of tables apart sometimes from table 4 which is regarded as less important than the other tables. The latest set of reporting tables from the April 2006 notification for Sweden are annexed (Annex1). All reporting tables can be found on the Eurostat web site.

4.1.1 Additional information on government finance statistics to be provided by Member States

Apart from the notification tables, countries are requested to supply additional information supporting the data provided in the notification tables. Eurostat has developed a "questionnaire" (*Questionnaire related to the EDP notification tables*) including further details on specific areas to assist in data assessment. This questionnaire has been extended and developed recently, with the objective of having as complete information as possible from Member States (and additionally being able to cross-check information and tables provided). The questionnaire's focus is on especially complicated or delicate methodological issues which have appeared in the past. To mention some examples, there are questions on the treatment of debt cancellations and debt assumptions, the recording of EU grants, the recording of capital injections, the recording of taxes and social contributions.

Ad-hoc questionnaires are also sent out throughout the year, and in many cases they are used in the assessment of EDP data. Countries have also been requested to complete two so called EDP inventories; one on description of sources and methods in the context of the transmission of the EDP tables and one constituting an update on data sources.
The questionnaires and inventories have been specifically described in the amended Council Regulation 3605/93.

4.1.2 The ESA95 transmission programme

As earlier mentioned, the provision of EDP data is fully based on the System of National Accounts (Council Regulation 2223/96). Annexed to the Regulation is the ESA95 transmission programme. The transmission programme includes no less than 28 different transmission tables of annual and quarterly data. Some of these tables are of great importance when assessing the EDP data. The most important table is table 2 on government revenue and expenditure. This table is transmitted by 1 April and by 1 October, that is, at the same time as the EDP tables as requested in the amended Regulation 3605/93. The table includes some common items with EDP table 1, namely EDP B.9 (net lending/net borrowing or the deficit), D.41 (interest) and P.51 (gross fixed capital formation). Apart from the treatment of SWAPS, the figures for net lending/net borrowing in ESA table 2 and in the EDP notification should be exactly the same.

Other annual government finance statistics tables delivered to Eurostat under the ESA95 transmission programme are tables 6 and 7 on financial accounts, table 9 on taxes and social contributions by receiving sub-sector and table 11 on government expenditure by function.

Furthermore Eurostat receives quarterly data in tables 25 (public finance statistics), 27 (financial accounts of general government) and 28 (quarterly debt). In principle, all tables should be consistent except for timing differences (different transmission deadlines).

In the press release on deficit and debt, published by Eurostat around 3 weeks after the notification, figures on government revenue and expenditure are also included.

4.2 The Code of Best Practice on the compilation and reporting of data in the context of EDP

The *Code of Best Practice on the compilation and reporting of data in the context of EDP* (CBP) was published as a complement to Regulation 3605/93 and the annexed *Protocol on the EDP*. The CBP aims at clarifying and streamlining procedures both at Member State and Commission levels when compiling and reporting government accounts, in particular in the case of data for government deficit and debt. The CBP has been the basis for some of the procedures described in this chapter, and in particular for the details on the reporting tables and reporting deadlines. It furthermore indicates the policy to be followed for revisions of data: "*Member States shall inform the Commission, as soon as they become available, of revisions of the actual accounts and of major revisions of the planned data. Major revisions should be properly documented including a breakdown of the revisions. In any case, revisions have to be reported and properly documented if the reference values as specified in the relevant Treaty Protocol are being surpassed*".

Apart from the specification of reporting data, deadlines and revision policy, the CBP also includes a part on the issue of the securing of the quality of the actual budgetary data. This includes a reference to the statistical inventory described under 3.4.1.2 , references to how to resolve methodological issues and references to the monitoring of data described in this chapter. Finally, the last chapter of the CBP concerns the publishing of data and this is also described in this chapter.

It should be said that the Code of Best practise has lost most part of its relevance since the entering into force of the Council Regulation 2103/2005 (amending Regulation 3605/93) which incorporated most of the relevant elements. The content and importance of Regulation 2103/2005 will be examined further in the chapter 9.

4.3 The EDP missions and their scope

According to the CBP, Member States shall be visited by Eurostat at least every two years by so called EDP follow-up missions. In practise, however, in the case of new Member States, EDP missions should be undertaken more often, especially to those countries which are supposed to join the euro-zone soon. Moreover, Eurostat also undertakes ad-hoc missions, especially to countries having a deficit close to 3%, or if there are special (contentious) cases under discussion. The missions are usually limited in time, their duration typically being between one and two days. Apart from the Eurostat delegation, DG ECFIN and the ECB also take part in the missions as observers. As far as the organisation of the missions is concerned, the following procedures are established: A letter to the Director General of the NSI of the country to be visited, including a draft agenda and a list of documents to be sent to Eurostat before the mission, is sent a couple of weeks in advance. Eurostat prepares in the meanwhile a detailed briefing note including a summary analysis of the reported EDP tables, a follow-up of

Eurostat decisions taken during past years, specific outstanding issues since the latest notification, etc. The agenda also focus on special issues where Eurostat knows by experience that there would be a risk that countries would not have followed the rules properly or where extra monitoring is needed. The EDP missions are of fundamental importance in identifying potential accounting problems or mis-recordings of operations. It is also an opportunity for Member States to discuss issues in detail and to ask methodological questions, as Eurostat has also an important role to play in providing consistent advice to Member States. Upon the return from EDP missions, Eurostat prepares draft conclusions and minutes that are sent to countries for agreement (rather than approval). These mission minutes are later published on Circa, which is a common, but restricted, electronic discussion forum between the Commission services and officials at the Statistical Offices, Central Banks and Ministries of Finance in the Member States. In the past, the mission minutes have not been made public but with the new Regulation 2103/2005 there is now a legal obligation to publish the main findings, making them available to everyone.

4.4 The assessment and publication of data – procedures and possible courses of action

Eurostat is the Commission service responsible for assessing the data notified by the Member States according to the tables described. According to the CBP*,* Eurostat shall assess and publish data for each Member State within two weeks of the reporting deadline. This deadline was however extended due to the fact that the number of notifications increased from 15 to 25 after the enlargement in 2004, and in the amended Regulation 3605/93, the time was finally set to three weeks. The period between the actual reporting and the issuing of the press release by Eurostat are intensive days with continuous contacts with Member States, ad-hoc EDP missions to the Member States, etc.

The purpose and nature of Eurostat's work in the process of analysis of the EDP notifications, have changed in recent years. While, until 2002, Eurostat focused its activity on the compilation and aggregation of data presented by Member States in order to obtain EU and euro-area aggregated figures, in recent years Eurostat has assumed the role of deciding whether the figures provided by Member States are in agreement with ESA95 rules and whether the data presented in the notification can ultimately be validated or not.

In case of doubts concerning the reported data by Member States, Eurostat can express a reservation on the quality of the figures provided (earlier this was named "non-validation of data"). The Code of Best Practice on the compilation and reporting of data in the context of EDP reads: "*Any reservation expressed when publishing the actual data, including if necessary and possible amendments by Eurostat and a reference to the objected figures, shall be communicated no later than two working days before this publication, to the Member State concerned and to the EFC President. When the issue is subsequently resolved, the withdrawal of the reservation is also published*". The reservation normally takes the form of publishing a footnote in the press release. In the case of the press release published in September 2005, three reservations were included and in April 2006 there were two reservations. In the case of Greece, Eurostat has published footnotes and reservations for several years.

5. The interpretation of the European System of National and Regional Accounts (ESA95)

In order to be able to fulfil the task of analysing compliance with the fiscal provisions in the Treaty and its subsequent legislation, the need for harmonised standards of accounting was identified and the System of National Accounts (SNA93) and the European System of National and Regional Accounts (ESA95) were chosen as the appropriate framework. This chapter describes the main features of SNA93 and ESA95, as well as the ESA95 Manual on government deficit and debt, written and published by Eurostat. It further details the main issues as already identified in the Treaty of the European Communities, the Protocol to the Treaty and the Regulation 3605/93. A special emphasis is put on the definition of the general government sector and government transactions.

5.1. SNA93 and ESA95

The System of National Accounts (SNA93) is the world-wide National Accounts framework. The first version came out in 1953 under the chairmanship of the UN and the second version was released in 1968. The current version of 1993 was developed by the United Nations, the EU, the IMF and the OECD under a joint effort.

ESA95 is the adaptation to European conditions of the norms included in SNA93, and in fact they are almost the same. The SNA93 is currently being revised, a process which usually takes several years before coming to completion. To ensure the European perspective and point of view, Eurostat has also taken the initiative to convene a European-based task-force, which has focussed its attention on selected areas. This task-force has provided a formalised input in the form of a common European position to the SNA review. The work on the revision of the SNA is expected to be completed in 2007 with published SNA in 2008. This then will be followed by a subsequent revision of ESA95 that should result in a new regulation, being the basis for EDP work and future data provisions by Member States in the context of the SGP. This work is expected to be finished by 2010 (at the earliest).

ESA95 is a comprehensive publication comprising over 400 pages. Being a Council Regulation[1], it is translated into all languages, though the translation of the languages of the new Member States has not yet been completed. It must nevertheless be said that ESA95 is the complete National Accounts framework and therefore not all part of it are relevant for EDP purposes.

5.2 The ESA95 manual on government deficit and debt

The first version of the manual on government deficit and debt was published in the year 2000 by Eurostat. It was the result of a collective work of reflection and conceptual and textual elaboration by a group of experts representing EU Member States, the Commission (Eurostat and DG ECFIN) and the ECB. The manual should be seen as a complement to and an interpretation of ESA95 for EDP purposes. It aims to clarify accounting rules in the context of calculation of government deficit and debt. Although ESA95 is the legal framework serving as basis for the EDP, experience showed that the rules were not always comprehensive enough for this purpose, and countries have in the past taken advantage of the incompleteness of the ESA95 Regulation by interpreting the rules in different ways (most of the time in their

[1] Council Regulation 2223/96

own favour). The first version of the manual has been complemented with new or updated chapters over the years to create a consistent framework. The most relevant new chapters, which are finalised based on a rather complicated decision making process (see later on in this chapter), are described below. It should be noted that Eurostat does not have the right to modify the actual wording of the chapters, even for minor modifications, without following the formalised procedure of organising taskforces and consulting the Committee on Monetary, Financial and Balance of Payments statistics (CMFB).

The manual consisted initially of 5 chapters containing issues identified as not clear or complete enough in ESA95 for debt and deficit purposes, and which therefore needed to be clarified in the manual. The second version of the manual came out in 2002 and the chapters are as follows:

Part I. Delimitation of the general government sector
I.1. Criteria for the classification of units inside the general government sector
I.2. Specific units

Part II. Relations between the government and public enterprises
II.1. Overview of principles
II.2. Sale of assets (privatisation)
II.3. Capital injections
II.4. Government and public enterprise debt
II.5. Government and the financial sector

Part III. Implementation of the accrual principle
III.1. Recording of taxes and social contributions
III.2. Changes in the due for payment dates for taxes, subsidies, compensation of employees, social contributions and benefits
III.3. Recording of interest
III.4. Cases of court decisions with retroactive effect

Part IV. Leases, licences and concessions
IV.1. Overview.
IV.2. Allocation of mobile phone licences
IV.3. Sale and leaseback
IV.4. Public infrastructure financed and exploited by the corporation sector

Part V. Addendum on government debt
V.1. The calculation of general government debt
V.2. Debt in foreign currency (currency swaps on debt instruments)
V.3. Repurchase agreements

The listing of the chapters above should already provide an idea of the most contentious and debated areas during recent years.

Compared to the first version of the manual, some chapters were subsequently changed, the main difference being a completely new part on leases, licences and concessions, and on capital injections. As already mentioned, there have been several important decisions taken during recent years and the main ones are described later on in chapter 6. The manual and all chapters are available on Eurostat's web site free of charge. Eurostat intends to publish a revised paper version of the Manual during the course of 2006. This consolidated version will include the latest decisions and chapters on EU grants (2005), Classification of funded pension schemes and the impact on government finance (2004), Payment to government by public corporations in the context of the transfer to government of their unfunded pensions obligations (2004), Long-term contracts between government units and non-government partners (PPPs (2004)), Capital injections (2003) and securitization operations undertaken by government (2003). There are currently also ongoing taskforces on Military expenditure, Government Guarantees and Securitization Operations (development in 2005), which will ultimately lead to new chapters in the manual.

5.2.1 The implementation of the accruals principle – the recording of taxes and social contributions

One of the most important Regulations amending ESA95 concerns accrual recording (ESA95 paragraph 1.57 on the accrual principle) of taxes and social contributions[1], or more precisely, how to ensure that taxes and social contributions unlikely to be collected are not included in government revenue, and therefore have no impact on government net lending/net borrowing. The Regulation has been included under part III.2 in the MDD. Article 3 of the Regulation says:

Treatment of taxes and social contributions in the accounts
Taxes and social contributions recorded in the accounts may be derived from two sources: amounts evidenced by assessments and declarations or cash receipts.
(a) If assessments and declarations are used, the amounts shall be adjusted by a coefficient reflecting assessed and declared amounts never collected. As an alternative treatment, a capital transfer to the relevant sectors could be recorded equal to the same adjustment. The coefficients shall be estimated on the basis of past experience and current expectations in respect of assessed and declared amounts never collected. They shall be specific to different types of taxes and social contributions. The determination of these coefficients shall be country-specific, the method being cleared with the Commission (Eurostat) beforehand.
(b) If cash receipts are used, they shall be time-adjusted so that the cash is attributed when the activity took place to generate the tax liability (or when the amount of tax was determined, in the case of some income taxes). This adjustment may be based on the average time difference between the activity (or the determination of the amount of tax) and cash tax receipt.

As will be shown in the analysis relating to individual countries, this Regulation has often been abused by Member States. Even if Member States are requested to send a description of the methods used for the different taxes and social contributions this has not always been the case and it has partly been difficult to make sure that the rules are fully respected and that the recorded amounts correspond to the actual amounts collected. One explanation is that the coefficients are based on long-term analysis and it takes several years to obtain meaningful coefficients. Apart from coherence between the cash and accrual amounts, another important aspect is the time of recording; countries should not be allowed to record the payments in an instrumental way (in order to improve the deficit figures in one year for example) but only in the year when the activity took place.

5.2.2 The decision procedures concerning the classification of units

[1] Regulation No 2516/2000 modifying the common principles of the European system of national and regional accounts in the Community (ESA) 95 as concerns taxes and social contributions.

The issue on the delimitation of the general government sector is covered in the first chapter in the manual on deficit and debt and it deserves special attention due to its profound implications for the accounts of Member States. The MDD reads:

The definition of the general government sector:
"*The sector general government (S.13) includes all institutional units which are other non market producers whose output is intended for individual and collective consumption, and mainly financed by compulsory payments made by units belonging to other sectors, and/or all institutional units principally engaged in the redistribution of national income and wealth"*

When starting to analyse the classification of a unit in the correct sector, a sequence of questions should be established as indicated in the MDD.

1. Is the entity an institutional unit?
Sectorization decisions must be taken at the level of institutional units, defined in the system as units having autonomy of decision and a complete set of accounts. Producers that are not institutional units must be classified in the institutional sector to which the unit which controls them belongs. Therefore, public producers not recognised as independent legal entities are to be included in the general government sector except if they can be recognised as quasi-corporations (i.e. market entities keeping a complete set of accounts and whose economic and financial behaviour is similar to that of corporations).

2. Is the institutional unit private (i.e. not controlled by the general government) or public (i.e controlled by the general government)?
Control, defined as the ability to determine general policy, is an essential criterion for sectorization. Private producers are found in all sectors, except the sector general government. In contrast, public producers are found either in the corporations sector (if they are market) or in the general government sector (if they are non-market). The sectorization of non-profit institutions (NPIs) constitutes a particular case: to be considered as public, a NPI must be both controlled and mainly financed by the general government.

3. Is the public institutional unit market or non-market?
When the principal function of the public institutional unit is the redistribution of national income and wealth, this unit is to be classified in the general government sector. However, when the principal function of the public institutional unit is financial intermediation, the unit is to be classified outside the general government sector, in the financial corporations sector.

As specified above, in order to decide the classification of the unit in the correct sector, it is necessary to verify if this unit is *market or non-market*: in other words, the MDD defines this as whether more than 50% of production costs are covered by sales or not.

Eurostat regularly discusses with Member States the classification of institutional units, and this issue is very often the subject of discussion during EDP missions, primarily but not exclusively in the new Member States. Often, in order to decide whether a public unit is market or non-market, the Statistical Office is asked to analyse the profit and loss account and the balance sheets of the unit, and to check whether the revenue of the corporation represents "sales" according to ESA95 terminology.

It is also important to underline that since 2004 Member States have sent to Eurostat two different questionnaires, the so-called "EDP-inventory" and the "Second Step of EDP inventory of Source and Methods", which were originally devised by Eurostat. In this context Member States are also asked to provide details on the delimitation of general government and annex a list of units included in each of the sub-sectors of general government.

5.3 Disagreements between Eurostat and Member States

Eurostat is, and has been, in permanent discussions and dialogue with Member States about issues concerning the classification of units and recording of transactions at a national level as well as issues of common interest for all Member States. Apart from e-mail or letter exchanges, numerous EDP missions undertaken in the Member States, meetings of the Financial Accounts Working Party (FAWP), special bilateral meetings at the request of Eurostat or the Member State(s) concerned are also regularly organized. It is relatively common for a Member State to ask for advice from Eurostat concerning a classification issue or about an operation undertaken by government. This can be the case of securitisation operations undertaken by government, a planned major infrastructure project (so-called Public-Private Partnerships) etc. Sometimes it is Eurostat who takes the initiative in organising a bilateral meeting to discuss and clarify some specific issues. In several cases, however, the opinion of Eurostat has diverged from the Member State's initial views. When this situation occurs, there are formalised rules about how this should be handled.

5.4 The establishment of taskforces to examine contentious cases

The Code of Best Practice of 2004 states the following, under the section on securing the quality of actual budgetary data, for resolving methodological issues:
"*Where there are doubts on the correct accounting treatment of a specific government measure, without prejudice to the authority exercised by Eurostat on behalf of the Commission, Member States are strongly advised to at the earliest stage organise consultations at national level between the Ministry of Finance, the NSI and where applicable the Central Bank. In cases where the doubts prevail the NSI shall formally ask Eurostat to rule on the matter*".

"*Eurostat shall liaise with other Commission departments, and if necessary with the ECB, and give prompt advice about the recording of the government transaction in question in the ESA95 accounts. Eurostat can also take decisions on its own initiative. In cases which are not covered adequately by ESA95 or are particularly complex or of general interest, Eurostat shall consult the CMFB before taking a decision*".

The possibility of creating a taskforce to prepare a CMFB consultation is not included in the Code of Best Practice, but this has always been, in practise, the first step which must be accomplished before proceeding with a CMFB consultation. It is of course a way to make Member States co-responsible for the proposals, which will be finally submitted to the CMFB. Member States participate in these task-forces to varying degrees depending on their expertise. Both Eurostat and single Member States have the right to ask for a CMFB consultation.

5.5 The CMFB and its role

The CMFB was established by a Council Decision in 1991 to assist the European Commission in drawing up and implementing work programmes concerning monetary, financial and balance of payments statistics, and by offering opinions on these areas of statistics as well as with other areas of economic statistics and in particular national accounts. The creation of the CMFB was undertaken partly under the initiative of Eurostat, to ensure that the National Statistical Institutes (NSIs) and the National Central Banks (NCBs) cooperated in the development of the statistical databases and methodologies that might be needed by EMU in the areas of monetary, financial and balance of payments statistics. In the area of national accounts, it was also important to associate Member States in the taking of decisions by Eurostat on issues of important statistical and budgetary relevance in the context of the SGP.

The original Council Decision has afterwards been amended to reflect changes since 1991. The Council Decision of February 1991 establishing a Committee on monetary, financial and balance of payments statistics (91/115/EEC) can be considered a sort of a CMFB statute. In 1996, it was amended by a further Decision (96/174/EC), taking into account the transition, in 1994, to the second stage of EMU. The most important changes were an extension of the advisory tasks of the CMFB and the admission of a representative of the European Monetary Institute, the predecessor of the ECB, as a member of the committee. During the years after its creation, the CMFB together with its two working parties, the National Accounts Working Party (NAWP) and the Financial Accounts Working Party (FAWP) became the locus of formal decision making and discussion for the EDP. The current version of the rules of procedure dates from June 2004. The CMFB is chaired by an elected representative from one of the Member States who chairs both the CMFB and its executive body. A new chair is nominated every second year. The Member States are represented by the NSIs and NCBs.

The Executive Body meets every second month in different European countries, with plenary sessions of the CMFB end-January and end-June each year.

The CMFB is an independent committee with advisory functions; it has no legislative powers. Decisions are taken on a majority-rule basis. Until a few months ago, Eurostat has never gone against the advice from the CMFB in any of the consultations carried out (this happened for the first time in the context of the decision on Military equipment expenditure in March 2006, but only for a smaller part of the consultation). The Opinion of the CMFB is always published with the decision in the Eurostat press releases.

6. The main decisions taken by Eurostat and the consequences

The following chapter discusses the main methodological decisions taken by Eurostat since the publication of the latest version of the Manual on government deficit and debt (MDD) in 2002. These decisions will be referred to in the country chapters. This chapter not only presents and describes the decisions taken, but analyses in detail the main developments surrounding the decisions. All methodological decisions of Eurostat have resulted in new chapters being added to the MDD as described in the previous chapter (except for the chapters on EU grants and Military expenditure, which have not yet been published).

6.1 Securitisation operations undertaken by government

Fact box:

Securitisation operations occur when a unit, named the originator, transfers the ownership rights over financial or non-financial assets, or the right to receive future flows from assets, to another unit named the securitisation unit, which pays the originator a certain amount for such a right. Securitisation units set up specifically for securitisation operations are called Special Purpose Vehicles (SPVs)

<u>The past</u>

In 2001 it became evident that some Member State governments, Italy and Greece in particular, were securitizing assets in order to obtain revenues in the current year to artificially improve their government accounts.

In the case of Italy, this referred to assets already existing in the balance sheet of government such as unpaid social contributions or real estate assets. In the case of Greece, on the contrary, government had been securitizing future revenues, such as income from lottery or from EU Grants, therefore explicitly renouncing to future government income coming from such sources of income in the following years.

The accounting treatment of securitization operations did not originally feature explicitly in national accounts. It was for this reason, and also in order to avoid the risk of a multiplication of securitization related operations, which would positively and artificially improve the net borrowing/net lending of Member States, that Eurostat decided to convene a taskforce on the issue, which led to the adoption of new rules in this respect.

The task-force met twice and proposed specific rules which were the subject of a positive opinion by the CMFB members and finally adopted by Eurostat on 3 March 2002. As an indication of the importance of such rules in the financial community, the decision of Eurostat and the rules were reported on the first page of the "Financial Times" on the following day.

<u>The present rules of Eurostat</u>

Eurostat's rules effectively managed to put an end to the planned securitization operations of future revenues in Greece as they stated that securitization of future flows not attached to pre-existing assets in the balance sheet of government, were always to be treated as government borrowing. Moreover, the task-force established the principle that in the context of each single securitization operation, if the revenue received by government was to be treated as a non-financial transaction, therefore improving government deficit/surplus, the risks and benefits of the operations had to be borne by the purchasing unit, i.e. in most cases by the owners and bondholders of so called Special Purpose Vehicle (SPV), created for the specific purpose of purchasing securitized assets from government operations. This implied that no guarantees could be provided by government to the SPV relating to any possible shortcomings of the SPV in reimbursing investors through the sale of the assets purchased from government (bonds are usually issued by the SPV in order to raise the capital necessary for the acquisition of the assets from government). Furthermore, it implied also that the initial sale price which government received from the SPV could not be less than 85% of the real market price (government would possibly get back the remaining 15% of the market price as well as any other “excess value” which the SPV would make in the operation, in the form of Deferred Purchase Payments (DPP) after reimbursement of the debt of the SPV). In both cases the underlying principle was that if the initial sale price was less than 85% of the market price, or a guarantee was provided by government, the purchaser of the asset would not take sufficient risks in the operation, and therefore this would be an indication that according to ESA95 rules, no real sale had occurred and government had to be considered as being still the owner of the asset in national account terms. If such was the case, the revenue obtained by government in the operation, previously considered as government income, would be reclassified as government borrowing and that the debt raised by the SPV would be considered as government debt.

<u>The future</u>

The rules of Eurostat, which were considered at the time as adequate, and which effectively stopped some questionable securitization operations by government, may not be applicable to the case of securitization of delinquent tax claims. Portugal undertook this kind of operation in 2003, and Belgium in 2005 (it is interesting to note, incidentally, that in all operations the arranger and the entity which set up the SPV was always the same investment bank which seems to be touring around Europe to propose similar operations to Member States). Eurostat therefore decided to convene a second task-force on securitization operations in 2005.

In this context, three sorts of issues are now being discussed. The first relates to the securitization “per se” of financial claims, and whether this kind of operation should always be considered as government borrowing (due to its intrinsic nature of financial operations) or be subject to strict rules.

The second concerns the existence of Deferred Purchase Payments in the operation and whether the fact that in some cases the whole DPP, or a constant part of it, would eventually be transferred to government, would mean that it is not the purchasing unit, but government, that will benefit from any rewards of the operation (the allocation of benefits was in fact somehow overlooked in the first set of rules in 2002, as a decisive factor for the classification of the operation).

The third case relates to the fact that in some securitization operations involving delinquent tax claims, a massive substitution of assets took place after the initial sale, and this raised the issue of if and how this should be allowed, and if this has led to the non-respect “a posteriori” of the 85% rule.

Finally, the task-force is also discussing whether the provision of indirect government guarantees to the purchasing unit, after the sale, could be the cause of reclassification of the SPV inside the government sector.

The task-force is expected to establish new rules in the second half of 2006.

In any case, as this kind of operations has been extremely profitable for the investment banks arranging it, it is expected that even after the new rules will come out, some loop holes will be found and new types of securitization operations conceived by banks. For this reason, the present Eurostat task-force will perhaps not be the last one to be organized on this issue.

6.2 Private-Public-Partnerships (PPP)

Fact box

PPP is a generic term describing the relationships formed between the private sector and public bodies, with the aim of introducing private sector resources and/or expertise in order to help provide and deliver public sector assets and services. Typical features of PPPs are that they are usually long term projects, the assets are used to directly deliver a public service traditionally made available by government (such as health, education and transport), the partner is "private" or a public market producer, government is the main purchaser of the services that derive from the PPP asset and the private partner provides a majority of or the full financing. The classical PPP project is a major infrastructure project like the construction of a new road.

Introduction

The term PPP has been in use since the 1990s and PPPs have existed for several years, the UK having the largest set of programmes. Other frequent users of PPPs have been Italy, Ireland, Portugal and Spain. Part of its growing success is determined by the fact that national governments, due to the need to restrain expenditures, increasingly find themselves with limited financial resources to increase capital expenditure and improve public services and infrastructure.

In 2001, the Commission published a White Paper ("a time to decide"), proposing a programme of more than 60 measures and an action plan to provide improvements in the quality and efficiency of transport in Europe. By 2003 little progress had been made and the investment need had in the meanwhile even increased. It was then realized that alternative ways of financing public infrastructure projects had to be found. This is why in December 2003 the European Council adopted the European Growth Initiative, which promoted the use of PPPs to increase and improve the amount of public infrastructure. As part of the costs in these projects are born by the private partner, a number of countries, encouraged by the initiative, planned some major projects, and as there existed no complete accounting rules for PPPs, Eurostat was faced with the issue of how to classify these costs and subsequent debt. A CMFB task-force was convened in order to analyse the issue, and in February 2004 Eurostat published the rules on PPPs by issuing a press release[1]. A new chapter based on the decision was subsequently added to the MDD and published the same year.[2] Finally, in March 2005,

[1] Eurostat press release " Treatment of Public-Private-Partnerships No 18/2004 11February"
[2]Long-term contracts between government units and non-government partners (Public-Private-Partnerships)

the European Council stressed once more the importance of infrastructure investment to boost economic growth, and called on the EU and the Member States to continue explore ways of encouraging PPP projects.[1]

<u>The issue and Eurostat's decision</u>

Government contracts with non-government units can take various forms, which normally do not raise difficulties as regards their treatment in national accounts. However, clear guidance is required on the treatment in national accounts of arrangements often referred to as "Public-Private-Partnerships" (PPPs). In many of these partnerships government agrees to buy services from a non-government unit over a long period of time, resulting from the use of specific "dedicated assets", such that the non-government unit builds a specifically-designed asset to supply the service. The services bought by government might be to meet its own needs or to satisfy third party users (as seen notably for health and education services, and for the use of some transport infrastructures). At the end of the contract, government acquires the assets, either for free or payment.

The key issue is the classification of the assets involved in the partnership contract – either as government assets (thereby influencing government deficit and debt) or as the partner's assets. This is a similar issue to distinguishing between operating leases and finance leases, which is explained in annex II of ESA95.

As a result of the methodological approach followed, in national accounts, the assets involved in a Public-Private-Partnership can be considered as non-government assets only if there is strong evidence that the partner is bearing most of the risk attached to the assets.

In this context, there was agreement among European statistical experts that the risk assessment should focus on the following three main categories of risk:

- construction risk: covering events like late delivery, respect of specifications and additional costs.
- availability risk: covering volume and quality of output.
- demand risk: covering variability of demand.

A PPP's assets should be classified off-balance sheet for government if both of the following conditions are met: The partner bears the construction risks and at least one of either availability or demand risk. If these conditions are met, then the treatment of the contract is similar to the treatment of an operating lease in ESA95; it would be classified as the purchase of services by government over the contract period. If the conditions are not met, then the assets are to be classified in the balance sheet for government. This will mean that the initial capital expenditure relating to the assets will be recorded as gross-fixed capital formation of government, impacting negatively government deficit/surplus. At the same time a loan would be imputed to government from the partner, increasing government debt. The treatment is in this case similar to the treatment of a financial lease in ESA95 requiring the recording of government capital expenditure and borrowing. In borderline cases it is appropriate to consider other criteria, and notably what happens to the asset at the end of its life, as well as the existence of any guarantees to support the partner's borrowing.

[1] European Council, Brussels, 22-23 March 2005, Presidency Conclusions

As can be seen from above, the central issue in determining the classification of the project is which party bears the risk of the operation. This can normally be determined through a project risk analysis and thorough examination of the contract established between the two parties. There is certainly scope for subjectivity here, and many Member States have decided to ask for Eurostat's ex-ante assistance in determining how the proposed PPP operation would impact government accounts before the actual contract is signed.

It is interesting to note that Eurostat's ruling has been seen as stimulating private funding for public construction projects throughout the EU, while providing significantly greater opportunities for government to remain in compliance with the rules of the SGP. However, the IMF has recently raised serious objections concerning the relative ease of building infrastructure off-balance sheet for governments in the context of Eurostat's rules, and it is possible that these rules will be reviewed once more in the future.

6.3 EU grants - the treatment of transfers from the EU budget to the Member States

Factbox

EU grants are transfers from the EU to the Member State for the financing of common policies. These transfers can take the form of agricultural subsidies, regional aid etc. The grants can go directly to the final beneficiary or via government.

<u>Background</u>

Every year, there are very significant transfers from the European Commission to Member States, especially in the field of agricultural subsidies and structural funds. Some time ago, Eurostat realised that practices for recording these flows, in terms of treatment, amounts, and timing, were quite heterogeneous among Member States, and decided to intervene by establishing clear rules in order to avoid artificial effects on deficit and debt of Member States and ensure full comparability of data. Eurostat convened a taskforce in 2004 and in February 2005 the rules for how to treat transfers from the EU budget to Member States were published[1].

The destination of these flows varies. In some cases, the final beneficiary is government, while in other cases these flows only transit through government accounts for practical reasons, while the final beneficiary is a unit outside government (for instance, farmers). In this last case, these flows should be neutral for government non-financial accounts, and not constitute revenue for government at the moment in which they are received by government, or expenditure at the moment in which they are paid to the final beneficiaries by government, especially if these two operations are carried out in different years. Moreover, in the case of multi-year programmes, the Commission makes significant initial payments to the Member States, not linked to any particular project, to provide some cash flow for the early expenditures of government, and this has to be recorded not as revenue for government, but as a financial advance, without any effect on deficit/surplus. These programmes were of particular importance for the ten new Member States, which received, in the framework of their accession, a considerable amount of financial advances, constituting up to 16% of the total amount to be disbursed in the context of their participation in the multi-year programme period. There was therefore a need to clarify these issues urgently in order to avoid a

[1] Eurostat news release 22/2005 15 February 2005

misinterpretation of the rules in this respect, having possible serious consequences for the comparability of data between Member States.

The decision of Eurostat

Below follows a summary of the decision concerning the main cases. A chapter for the MDD is being drafted and will be published in 2006. After the unfortunate experience with Greece, and following the establishment of the new rules, the recording of EU grants is always one of the issues featuring on the agenda of EDP missions.

1. Case when the final beneficiary of a transfer from the EU budget is not a government unit
It might happen that the government of the beneficiary advances payments to the final beneficiary, which is entitled to receive the transfer from the EU. This is mainly the case for agricultural policy but it also concerns some payments from structural funds (notably the Social Fund and Cohesion Fund). In this case, government must be considered as acting "on behalf" of the EU. The transfer between government and the final beneficiary must be recorded as an expenditure of the EU budget and as revenue of the final beneficiary, and the general government deficit/surplus will not be impacted.

As a counterpart to the cash transferred, a financial transaction will be recorded for a liability of the EU to general government. This liability will be removed once the payment of the EU to government is made. In this context, the transaction between government and the EU will have no impact on government deficit/surplus.

If government pays to the final beneficiaries in advance more than the EU will finally reimburse, two cases can be distinguished:

– If the over-payment by government is definitively acquired by the final beneficiary, this amount will not be considered as EU expenditure but as government expenditure at the time of the payment by government. This would be the case, for instance, where government is allowed to complement the aid from the EU and where the over-payment is not considered as a distortion of competition.

– If the over-payment by government is not definitively acquired by the final beneficiary, the amount in excess is deducted from the EU expenditure in the year where the payment was recorded. In this case, the amounts in excess may be deducted from future payments from the European Commission (and the final beneficiaries will receive less in the future) or may be returned to the European Commission.

2. Case when the final beneficiary of a transfer from the EU budget is a government unit
This would be the case when the aim would be to cover a current expenditure carried out by a government unit (for instance for social assistance, training, education) or when the aim would be to increase the stock of fixed assets held by government (generally in the context of a co-financing procedure, the EU supporting an investment effort by government but not substituting it). This would mainly be the case for Regional Development and Social Funds, where government units would be managing the project under an agreement with the EU Commission.

In this context, after having made the expenditure, government would send the relevant documents in order to be reimbursed by the EU. The general policy of the European

Commission is to pay what is effectively declared, as EU payments are based on government "certification" at national level. As a result, in order to better reflect economic reality, the time of recording of the transfer (when government revenue would be impacted) shall be the time when the government unit, which is the final beneficiary, makes the expenditure, which should be in practice at the moment when government sends the documents to the European Commission. Therefore, there is no temporary impact on government deficit.

3. A specific case: prepayments by the EU Commission at inception of a multi-year programme

At the inception of a multi-year programme, the Commission pays to Member States 7% or 16% (depending of the programme) of the total amount foreseen for the programme. These prepayments are implemented in the framework of Community Support Programmes (Cohesion and Structural Funds). The initial payments by the EU Budget to the government of a Member State, at the inception of a multi-year programme, are to be treated as financial advances recorded as such until the accumulated payments (including the initial payment) by the EU budget have reached 95% of the total amount. This is because the Commission keeps 5% of the total amount agreed for the multi-year programme.

If at the end of the period the total government expenditure do not reach 95% of the total agreed amount for the period, the part of the advance in excess (not justified by effective government expenditure) is reimbursed to the European Commission, with only an impact on government financial accounts.

To conclude, the rules on the recording of EU grants had previously not been fully clear to all Member States, or had been clear but had been deliberately flouted. The decision of Eurostat, which specifies in summary "*EU transfers should have no impact on government deficit/surplus regardless of the timing differences between the moment of a government pre-financing and the moment of effective reimbursement by the EU",* the establishing of clear rules in the MDD, as well as an increased attention by Eurostat on this issue during its regular EDP follow-up missions, should hopefully minimise the problems encountered in the past with the interpretation and correct application of the rules concerning the recording of EU grants.

6.4 Capital injections by government units into public corporations

Fact box – capital injections

The notion of "capital injection" is not defined in the SNA93 or in the ESA95. The term is used for many types of payments from government to a public corporation, which in national accounts might have to be classified under quite different headings such as capital transfers (having a negative impact on the deficit) or as financial transactions (having no impact on the deficit). For example, it includes transactions that might be described in public accounts as investment grants, capital grants, loans, equity injections, acquisition of share capital or public dividend capital. Such injections are most often made in cash, but can also be made in kind.

Background

It was observed over many years that in some circumstances, Member States' governments provided cash to public corporations which was requested for different reasons. In some cases such payments were identified as transfers or subsidies with the effect of increasing the government deficit. Such transactions were normally carried out for government policy purposes.

However, in some cases, governments claimed that as a counterpart of this funding, it had acquired a financial asset. Generally, this asset took the form of shares (an increase in the equity capital of the corporations). This happened almost systematically in the past in the cases of Greece and Portugal, where both governments found it convenient to use this way of raising cash for public enterprises (usually in the transport sector, which had been incurring heavy losses).

Eurostat has in the past examined transactions of this kind in many Member States. In several cases, Eurostat has decided that, under national accounts rules, there was no evidence that government effectively received a financial asset of some value, notably when there were strong doubts about the real market value of such a claim. As a consequence, some of the capital injections previously classified as financial transactions were reclassified by Eurostat as capital transfers.

Eurostat established a first set of rules, included in the current MDD from 2002 (Second edition, chapter II.3). However, experience showed, already shortly after the rules were made known, that some Member States encountered practical difficulties in applying the existing rules or that in some cases the rules were systematically misinterpreted (as we will see in the chapters on Portugal and Greece). There was therefore a clear need to provide further guidelines on this issue, with the aim of clarifying doubtful rules and to cover a greater number of concrete cases without any change in the spirit of the existing rules. Eurostat convened a CMFB taskforce and on 21 August 2003 the updated Eurostat decision on the recording of capital injections by government was published[1], endorsed by a large majority of the CMFB members. A new chapter in the MDD was subsequently also published.

It has to be said that the conclusions of the work of the task force was shared by almost all participants as the room for controversial issues was quite limited (and the work of the task force was not directly linked to a specific national case which could have had negative consequences on the impartiality of one or more of the task force members).

The Eurostat decision

If government injects capital into an existing corporation that has accumulated net losses and where government is acting alone (other shareholders do not participate in the injection whether this is possible or not), as a general rule, the capital injection is in this case treated as a non-financial transaction for its full amount, having a negative effect on the deficit.

However, there are two exceptions to be considered:

- When at the same time the capital injection exceeds the amount of accumulated losses and it may be shown that the part in excess is exclusively used for investment in

[1] Eurostat news release, 98/2003, Capital injections by government units into public corporations

already profitable operational areas of the corporation activity, the capital injection is treated as a non-financial transaction up to the level of the accumulated losses and as a financial transaction beyond this amount;

- When a "fundamental restructuring" of the corporation has been designed and decided in order to restore profitability, the capital injection is treated as a financial transaction for its full amount if there is a large consensus on the high likelihood that the corporation will become profitable in the near future due to the restructuring. But if there is some uncertainty as to the future effects of the restructuring, the capital injection is treated as a non-financial transaction up to the level of the accumulated losses and as a financial transaction beyond this amount.

Eurostat also identified some further possible cases where clarifications were needed: the case where a capital injection would also be undertaken by private shareholders, the case with corporations which had not been making any losses and the case of a new public corporation.

The first possible case relates to a public corporation bearing losses but with the substantial participation of private shareholders (including newcomers) in the capital injection. Provided some conditions relating to the private investors are fulfilled (notably concerning rights and risks similar to those incurred by government), the capital injection by government is treated as a financial transaction for its full amount.

The second case involves a public corporation that has accumulated no losses in recent fiscal years. The capital injection is then recorded as a financial transaction in "shares and other equity" (or possibly as a loan) for its full amount, except in the event of a change in the conditions of the corporation's activity imposed by government which could raise strong doubts about the future profitability of the corporation. In this case, the capital injection should be treated as a non-financial transaction for its full amount.

The last case involves a new public corporation, set up at the time of the injection, or an existing public corporation starting a completely new activity or acquiring new kinds of productive assets, where it is obvious that government does not intend to use this corporation for public policy purposes. If various analytical elements may show that, after a normal period of losses (as usually observed for similar investments) the corporation should be structurally profitable, the capital injection is treated as a financial transaction for its full amount. If this is not the case, the capital injection is treated as a non-financial transaction for its full amount.

Consequences of the decision

The press release for the Eurostat decision stressed that it is important that government authorities consult Eurostat on borderline cases before making a final classification decision. This has already happened in a number of cases and the issue of capital injections is also always discussed during EDP missions. Additionally, Eurostat pays great attention to capital injections in the EDP notifications by asking for detailed additional figures concerning capital injections undertaken by government and their accounting treatment. However, this is still a difficult borderline case, particularly for new bodies.

6.5 Payment to government by public corporations in the context of the transfer to government of their unfunded pensions obligations

Fact box

Corporations, including public corporations, may set up specific pension schemes for their own staff which they manage directly. Governments may decide to take over these funded or unfunded obligations of corporations and as a counterpart to the undertaking of future liabilities of government, the corporation pays a lump sum to the government. In the case of funded pensions schemes, government may, instead of a lump-sum, receive the financial assets accumulated in the scheme.

The issue of the recording of lump-sum payments to government by public corporations in the context of the transfer to government of their pension obligations was already in the limelight in 1996 in the context of the so called France Telecom case, which is described in the case study on France. Eurostat decided at that time that the transfer of payments from public corporations in the context of the transfer of their pension obligations was a non-financial transaction, having a positive effect on the government balance (deficit). However, this decision and the related CMFB consultation were controversial and were permanently figuring in the background of Eurostat's work.

After this single case, the interest on the issue subsided for many years, until 2003 when it was revived jointly by Belgium, Portugal and (yet again) France, as in that year all these countries were facing budgetary problems.

In this context, the Belgian government required Belgacom (a state-owned telecommunications company) to undertake the same operation as carried out 6 years before by France Telecom, by suppressing their existing employer's pension schemes, and transferring the pension obligations to government in the general social security scheme in exchange for a lump-sum, which was assumed to cover the burden of the pensions to be paid by government in the future.

The same kind of operation had simultaneously been planned by the Portuguese government to be undertaken with its state-owned telecommunications and postal corporation, the CTI. Anecdotic evidence suggests in fact that it was the Belgian ambassador to Portugal who suggested to its government to undertake the same operation, after having read in the newspaper what the Portuguese authorities were up to. France then decided to follow suit one year later, repeating the operation already undertaken in 1997 with France Telecom, this time with EDF and GDF (Electricité de France and Gas de France).

Worried by these developments, Eurostat decided to establish a further task-force on the issue and a CMFB consultation was swiftly organized.

Unlike France in 1997, Belgium was not close to the 3% deficit figure, but the Belgian government had imposed, for a number of years a policy of zero deficit and prided itself to be able to reach this visible political objective every single year. Thanks to this specific operation once more in 2003, it did. The combined pressure of Belgium, France and Portugal and some political intervention gave result at the end. A small majority of NSIs and NCBs, 14 against 11, confirmed the same accounting treatment of the old France Telecom case.

The press release from 21 October reads:

"Eurostat has decided that the payments received by a government from a corporation in the context of a transfer of obligations under unfunded schemes that the corporation operates for its own employees should be recorded as government revenue and should therefore have a positive impact on government surplus or deficit (EDPB9). As a consequence, the payments connected to the transfer to government of pension obligations have the same impact on government deficit in the cases of both funded and unfunded schemes organised by a corporation…In both cases, funded and unfunded, the counterpart of the cash received by government is an unrequited transaction, classified as a capital transfer (codified D99 in ESA95) and the pension obligations taken over by government are not recorded in the form of an ESA95 liability. According to the accrual principle, the capital transfer should be recorded at the time the pension obligations are effectively transferred and not at the time of the payment(s)…In the future, the improvement in government surplus or deficit due to this capital transfer will be offset by the payment of benefits that government has to pay and that will be recorded as government expenditure and thus will have a negative impact on government surplus or deficit in the coming years. Therefore, the Eurostat decision ensures that, in all cases, the transfer of pension obligations is neutral (or very close to neutrality) over time".

Once more, some Member States had devised a one-off operation in order to obtain a short-run improvement of the fiscal situation, leaving the burden of the payments to be made to future generations and future governments. Short-term political gains had thus been favored against an increase of the government deficit for many years to come. From a national accounts point of view, this trade-off actually works because ESA95 does not record government obligations for unfunded pension schemes as assets of households nor as liabilities of government, due to the fact that it is impossible to exactly calculate the amounts which will have to be paid by government. It constitutes therefore only a contingent liability in national accounts (independently, this issue is discussed at present in the context of the revision of SNA93, with many countries suggesting to include such liabilities explicitly in the balance sheet of government while other countries, especially EU ones, favour a solution based on the taking account of such liabilities not in the main set of accounts but only as a memorandum item). The press release further reads:

"It may happen that an employer's pension scheme is cancelled and the pension obligations are transferred to the government, either into the general social security scheme or as part of the scheme that government organises for its own employees. Such transfers have been observed in several Member States in the case of public corporations where government, as owner of the public corporations, decided to take over the pension obligations and relieve the corporations of these future obligations. Different arrangements can be envisaged to that effect. But the common point is that government receives a "lump sum" that is assumed, on the basis of some hypothesis, to cover the future burden of the pensions for government". The lump sum is assumed to cover the future burden of the pensions that will be paid by government"

Nevertheless, the issue may still not be fully closed as a foot note to the relevant ESA95 chapter reads: "*However in the case where government receives financial assets for a market value less than the common actuarial value of the pension obligations already to ESA95 as S.136, the difference should be recorded as a capital transfer to the corporation that therefore would potentially offset the capital transfer from the corporation to government. In cases therefore in which the amounts to be transferred to government in exchange of the assumption* *of pension liabilities by government would not be close to the actuarial estimate of the present value of future pensions costs, the difference between the two amounts could be recorded as a capital transfer".*

6.6 Classification of Pension Funds

Fact box - Definition of the most common pension schemes:

Unfunded pension schemes - PAYG Defined-contribution (DC) unfunded pension schemes Defined benefit (DB) unfunded pension schemes
Funded pensions schemes
Employers pensions schemes (including government as an employer)
Private pension schemes (voluntary)

Introduction

The European population is getting older and countries are slowly realizing that forceful actions must be taken in order to ensure the payment of pensions in the future. Sweden was one of the first countries to reform its pension system in the mid-1990s, and since then some countries have followed with models inspired by the Swedish system.

In national accounts, the payments of pensions have traditionally been the responsibility of the social security sub-sector. In this context, social contributions by employees and employers have been classified as government revenue, while social benefits paid by government to retired workers have been considered as government expenditure.

However, as countries have reformed the systems and created more complicated models with a mixture of the traditional unfunded Pay As You Go (PAYG) system and funded schemes, this has raised new classification issues. It has to be underlined that in some cases the amounts involved are substantial, having a considerable fiscal (as well as political) importance.

When a new system is established, it typically includes workers below a certain age. As the workers are generally young at the beginning, if such a system would be classified inside government, the social contributions paid by workers and employers would count as government revenue while in practice no government benefits would be paid out. It is only in the long run that such temporary dis-equilibrium will be offset by the payments of social benefits. Nevertheless, the political reward in the short and long term can be substantial.

When Sweden reformed its pensions system, it decided to consult Eurostat already in 1996 and the features of the system were discussed in technical meetings. Even if the Swedish system consisted of several parts it was looked at as "a package" at that time. The idea was to reform the old defined-benefit PAYG system (ATP) into a defined contribution system. That is, the payments of the pensions would not depend mainly on some preconditions attached to the benefits to be received after retirement, but principally on the amount of social contributions paid in by employers and employees (and also on their funds' performance on the market). This part was also completed with a compulsory minor part for the premium pension (PPM). Contributions from pensionable income were set at 16% for the PAYG system and 2.5% to the premium pension. In 1997 Eurostat took a decision to classify both pillars of the system within general government, a decision that has been reconsidered after the work of the task-force on pensions schemes and after the CMFB provided its opinion on the issue.

After Sweden, more countries decided to reform their pension schemes along the same lines and Eurostat was faced with several countries presenting similar models. The main actor in this area was Poland, which introduced a defined contribution funded scheme in addition to their PAYG scheme. The Poles received technical assistance from Sweden in creating their own system and insisted that their system was similar to the Swedish system and therefore its classification should follow the Eurostat decision from 1997. In economic terms the Polish funded scheme was larger than the Swedish one, contributing for instance in 2004 to 2% of the deficit. The Polish authorities decided however, in order to be on the safe side, to consult Eurostat in 2001 and at this stage it became clear that the rules in ESA95 had to be interpreted to meet the recent changes in several Member States. At the end of 2002 it was decided to organize a CMFB task-force. The task-force led by Eurostat met three times in 2003. It can be mentioned that it was the longest task-force ever chaired by Eurostat. Seven Member States (Denmark, France, Sweden, Finland, Italy, the Netherlands and Germany) and two Acceding countries (Poland and Latvia) along with the Commission services, the ECB, the IMF and the OECD participated in the task-force. The importance which the Polish authorities attached to this task-force was demonstrated by the fact that the Polish representative was the Polish Minister of Social affairs himself, Mr Pater. The task-force started with a comprehensive questionnaire on the pensions systems in Europe. At the end of its work the back-ground document prepared by the task-force was circulated and approved by the FAWP and finally sent to the CMFB for consultation.

What did Eurostat decide?

As described earlier, the predominant pension scheme in Europe is the PAYG system, which is an unfunded system and part of social security. The rules concerning the classification of this type of pension system are clearly stated in ESA95 where paragraph 4.87 and 4.88 describe the conditions for a system to belong to the social security sub-sector. The rules for fully private pension schemes, classified outside general government, which exist in most countries, are also clear and specified in ESA95. The social security PAYG scheme is often referred to as the first pillar system, whereas the latter is referred to as the third pillar system.

However, the task-force's main concern was the classification of certain funded pensions schemes, belonging to the so called second pillar. Or to express it differently, should we consider according to the rules in ESA95 that the contributions paid each month to the PPM in Sweden should be considered as government revenue or should these payments be considered as made to a private saving scheme (and vice-versa for pensions paid)?

After several meetings, the task-force came to the following conclusions (decision of 2 March 2004) concerning the classification of defined-contribution funded pensions schemes:

A funded scheme is an arrangement where assets are accumulated with the objective of ensuring all, or a major part of payments of the future pension benefits from these assets. A first category of funded schemes are defined-benefit funded schemes where a unit bears a financial risk as it takes a commitment to pay a promised level of pensions determined on the basis of a linked number of criteria (such as age, number of years worked, last salary etc) irrespective of the value of the accumulated assets.

In a defined-contribution funded scheme, the pensions are directly linked to the assets performance on an individual basis. The risk is borne by households (just as in the case of the PPM; most Swedes have seen the value of their future pensions decreasing substantially during the years when the stock market was mainly bearing losses without any compensation from government). Government does not finance the scheme and it does not decide/control the amount of pensions to be paid. In other words, government is not the “sponsor” of the scheme although government intervenes in some circumstances in order to provide a guarantee relating to minimum pension levels or provide substitution payments linked to periods of inactivity due to unemployment, maternity etc.

Among pension schemes that may be managed by government, a defined-contribution funded scheme cannot be treated as a social security scheme. By “managed” it is meant where government is involved either as a manager of the flows of contributions and pension benefits, or as a guarantor for the risk of defaulting payments of pensions. The decision does not cover the schemes organized by employers for their own staff (including specific schemes for civil servants organized by government).

The task-force further decided that in a mixed scheme where a government unit simultaneously manages two kinds of schemes, one funded and one unfunded, as far as the flows of contributions and benefits are concerned, two separate units should be distinguished in national accounts. Finally, it was ruled that the existence of a guarantee provided by government to a scheme not classified as a social security scheme is not a sufficient condition for reclassifying the beneficiary scheme as a social security scheme. However in a few cases the government guarantee could cause a reclassification of the scheme, and principally in the case where there is a recurrent call for guarantees during several fiscal years and the government support cannot be considered as temporary. Also, if government ensures a payment of more than 50% of the actuarial value of the pensions to be paid from its own resources, the private scheme could be reclassified. The same situation occurs if government guarantees a minimum return on assets, which would have some market significance.

<u>What happened after the Eurostat decision?</u>

The Eurostat decision (endorsed by the CMFB) was taken just after the deadline for the March 2004 notification, which means that the effects of the decision were only to be included in the September 2004 notification. In theory the decision forced several Member States to reclassify their defined contribution funded schemes from inside to outside general government with negative effects on the fiscal balances (and with the effect of making the EMU entry more difficult for new Member States). The political price for this is of course high and therefore an intensive dialogue started with some Member States. In spite of the decision, both Poland and Hungary visited Eurostat with beefed-up delegations in order to present their systems (with the objective of showing that the systems did not fall under the new Eurostat ruling). In the Polish case, the mission was headed by the same Minister of Social affairs which had been a member of the pension task-force. Sweden also came to Eurostat to discuss the issue with a Ministry of Finance/Statistics Sweden delegation.

Thus, as described in detail in the chapter on Sweden, there was a strong political resistance to accept the Eurostat decision in some countries and as a consequence of this, a very special derogation was given to all Member States during a transitional period (until March 2007). Four countries decided to use this possibility; Sweden, Denmark, Hungary and Poland (In 2006 also Slovakia joined making it five countries). Lithuania and Latvia, both having defined contribution funded schemes did however classify their schemes, outside government according to the Eurostat decision.

The issue about pensions is still a sensitive topic and will remain so as long as the demographic situation in Europe continues to look threatening. In the SNA review currently taking place (see chapter 5 for reference), the pension "chapter" is by far the most important one. We will also see in the last chapter that pensions have received a special status in the revision of the Stability and Growth Pact. The guidelines for the implementation of the revised Stability and Growth pact say the following under part B: The excessive deficit procedure 1) Preparation of a Commission Report under article 104(3) in case of non-compliance with the deficit criterion:

"The Commission will give due consideration to the implementation of pension reforms introducing a multi-pillar system that includes a fully funded pillar, if these reforms have a direct negative impact on the general government deficit…in particular the Commission Report will examine the net cost of the reform to the publicly managed pillar. The net cost of the reform is measured as its direct impact on the general government deficit…Consideration to the net cost of the reform will be given for the initial five years after a Member State has introduced a fully funded system, or five years after 2004 for Member States that have already introduced such a system. Furthermore, it will also be regressive…The net cost of the reform is measured as its direct impact on the general government deficit".

Sometimes statistics influence politics but in the case of pensions the situation has been the reverse.

7. Fiscal Gimmickry and beyond

This chapter constitutes, together with the previous chapter on Eurostat's main decisions and its consequences, the central part of the thesis. It discusses and analysis how Member States have followed ESA95 rules in the past, including cases where figures have been deliberately altered in order to get some benefits in the context of the SGP. It furthermore looks at the statistical implications of these cases.

The chapter starts with a general discussion on creative accounting, followed by the identification of so called one-off operations. Thereafter follow case studies on Portugal, Italy, France, Germany and Sweden. The Greek case has however, due to its importance and consequences, been devoted a chapter by itself.

7.1 A definition of creative accounting

There is no "recognized" definition of what constitutes creative accounting. This is however a term often used in the context of the SGP. But what does it means exactly? And how has it been used in the context of the budgetary reporting of Member States? Typing "creative accounting" on a search engine on the internet, the first item found literally reads:

Creative accounting is an euphemism referring to accounting practices that deviate from standard accounting practices. They are characterized by excessive complication and the use of novel ways of characterizing income, assets or liabilities. This results in financial reports that are not at all dull, but have all the complication of a novel by James Joyce, hence the appellation "creative." Sometimes the words "innovative" or "aggressive" are used (Wikipedia encyclopedia)

This definition however refers mainly to accounting practices in the private sector, and it is not fully appropriate in a national accounts perspective. Turning our attention to public accounting, some of the following references can be found:

"Accounting conventions in practice usually leave room for judgement. Hence when fiscal rules threaten to bite, or are biting, governments may be tempted to take advantage of the implied degrees of freedom…The concept of creative accounting comes closer to what would usually be thought of as gimmicks. It refers to more or less unorthodox treatment of operations involving the general government… It may even be that the Eurostat ruling itself would endorse creative accounting" (Koen and von den Noord 2004)

"A measure implying an improvement in the fiscal balances is considered to be creative accounting if it does not imply an improvement in the intertemporal budgetary position"…"Creative accounting is used in the economic literature as meaning measures with temporary effect or one-off measures" (Milesi-Ferretti 2001)

Creative accounting can be seen as stretching existing rules to a maximum without breaking them. Creative accounting does not mean outright cheating or falsification of figures. In the context of creative accounting, other terms used are window-dressing, fiscal massaging and fiscal gimmickry. Even if one-off measures have sometimes been included under the terminology of creative accounting, this does not mean that all of them would qualify as such.

If we analyse semantically the word, we can conclude that creative accounting should imply creativity. To look for such creativity, investment banks have often been engaged by the Member States and the offer on the market has increased during the last years, especially with the increasing number of securitisation operations. It is clear that the tighter the fiscal rules, the greater the scope of creative accounting (and the higher the price for providing good advice on how to breach them without enduring the consequences).

7.2 When and how it has been applied

Creative accounting has been used by many Member States but only the most "prominent" cases will be presented in this chapter as case studies. Portugal was the first in terms of timing, but was later followed by several Member States as Italy, Germany and France (the list is by no means complete). Nevertheless, some clear differentiations have to be made between Greece and Portugal on one side, and the other countries on the other side. In the case of Greece and Portugal it has become clear that a deliberate attempt was made to conceal the reality by providing false information and reporting incorrect figures, while in other cases, although primary data were not changed, the rules were stretched and/or interpreted incorrectly.

7.3 One-off measures at the disposal of Member States

"One-off measures refer to government decisions of a non-recurrent nature. They affect general government net lending or borrowing, in a given year or for a few years, but not permanently, at least to a first approximation" (Koen and von den Noord, 2004).

As already mentioned in the introduction, one-off measures may sometimes constitute a part of a creative accounting strategy, although this is not always the case. This paragraph includes some concrete examples to illustrate the phenomenon of one-off measures and it is meant to complement and systematise the one-off operations as described in the country chapters.

In 2004[1] the Commission services made an analysis of one-off and temporary measures and established a tentative list of measures. The lists included deficit-reducing and deficit-increasing measures that could be taken into account in the context of budgetary surveillance. The list was drawn up by taking operations, already carried out by governments in the past, into account, and was as follows:

Deficit-reducing measures:

- Tax amnesties implying a one-off tax payment
- Sales of non-financial assets (real-estate, publicly owned licences and concessions)
- Securitisation operations
- Temporary legislative changes in the timing of outlays or revenue
- Exceptional revenues from State owned companies
- Exceptional revenues linked to the transfer of pension obligations
- Changes in revenues and expenditure consecutive to Court or other authorities rulings

Deficit-increasing measures:

[1] Commission Report Public Finances in the EMU-2004

- Short-term emergency costs associated with major natural catastrophes or other exceptional events
- Temporary legislative changes in the timing of outlays or changes in revenues
- Court ruling or Commission decisions leading to changes in revenues or expenditures.

The European Commission further grouped one-off measures which had been implemented in the 15 old Member States in four main groups. The figures covered the years 2000 to 2004 as estimated by DG ECFIN. Only measures having an effect of a minimum 0.1% of GDP were included.

<u>1. Sales of real assets</u>
They occurred in at least three countries: Portugal in 2002 and 2004, Italy for four years in a row (2001–2004), and Denmark in 2000. In Portugal and in Italy they constituted an important part of their budgetary strategy. In Portugal, the deficit had been reduced in 2004 by 0.7 % of GDP, after a contribution of 0.3 % of GDP in 2002. In Italy, sales of real assets counted, amongst others, for 0.9 percentage points of GDP in 2002 and for 0.3 % of GDP in 2004.

<u>2. Sales of licences</u>
These refer largely to UMTS licences sold mainly in 2000 and 2001 by the majority of Member States. They had a relevant impact on the budgetary position of governments, in particular in Germany (2.5 % of GDP in 2000), the UK (2.4 % of GDP in 2000) and Italy (1.2 % of GDP in 2000).

<u>3. Unusual events</u>.
They occurred in Greece and Austria (environmental damage) and the UK, where the 'foot and mouth disease' cost around 0.3 % of GDP in 2001. Also the cost for the Iraq War could possibly be classified as an unusual event for the UK, which accounted for about 0.1 % of GDP in 2003 and 2004.

<u>4. Tax amnesties and tax settlements</u>.
Such schemes were identified at least in Greece (2004), Ireland (2000–02), Italy (2002–04) and Portugal (2002). They led to additional revenues of about 1 % of GDP in Portugal, allowing it to bring the deficit-to-GDP ratio below 3 % for that year. In Italy, it amounted to around 1.5 % of GDP in 2003 and to around 0.5% in 2004. It is questionable to what extent these schemes have a more lasting impact. On the one hand, tax revenues may increase as a result of larger tax bases emerging after the amnesties. On the other hand, it may also be that they lead to lower future tax revenues if expectations are created for future tax amnesties, and taxpayers then decide to avoid paying taxes on a regular basis while waiting for the next amnesty.

Figure 2 summarises the main categories of one-off measures recorded during the last five years in EU countries (2000-2004), including measures having an effect of minimum 0.1% of GDP.

Main categories of one-off measures recorded during the last five years in EU countries

(% of GDP)

	Sale of licences	Sales of real assets	Tax amnesties/ settlements	Unusual events	Others
BE	0.2 (2001)		0.3 (2004)		1.2 (2003) 0.5 (2004)
DK	0.2 (2001)	0.1 (2004)			
DE	2.5 (2000)		0.2 (2004)	– 0.1 (2003) – 0.2 (2004)	– 0.1 (2001) 0.3 (2003)
EL	0.4 (2001)			– 0.3 (2002) – 0.3 (2003) – 0.3 (2004)	
ES	0.1 (2000)		0.3 (2003)		0.1 (2003)
FR	0.1 (2001)				0.1 (2003)
IE	0.2 (2002)		0.2 (2000) 0.2 (2001) 0.2 (2002)		– 0.2 (2001) – 0.3 (2002) 0.1 (2003) – 0.6 (2004)
IT	1.2 (2000)	0.2 (2001) 0.9 (2002) 0.2 (2003) 0.5 (2004)	0.1 (2002) 1.5 (2003) 0.5 (2004)		0.4 (2001) 0.5 (2002) 0.5 (2003) 0.1 (2004)
LU	2.0 (2001)	0.3 (2004)			– 1.5 (2002) – 1.0 (2003) – 0.5 (2004)
NL	0.7 (2000)				– 0.3 (2001)
AT	0.4 (2000)			– 0.2 (2003)	
PT	0.3 (2000)	0.3 (2002) 0.7 (2004)	1.0 (2002)		0.2 (2002) 2.0 (2003)
FI					0.6 (2004)
SE					0.5 (2000)
UK	2.4 (2000)			– 0.3 (2001) – 0.1 (2003)	

Source: Commission services.

As concerns the first two groups, sales of real assets and sales of licences are fully covered by national accounts rules and are among the most uncontroversial of one-off measures. The sale of a real (non-financial) asset is a non-financial transaction, having a positive impact on the deficit (i.e decreasing the deficit). Several countries have used these one-off possibilities, for example by selling land or buildings through various means. Concerning the sale of licences, several countries sold the spectrum for UMTS licences obtaining non negligible revenue in the context of this one-off operation.

The most important one-off operations, which can be highly controversial in the context of applying national account rules, and which have deserved close attention of Eurostat, are securitisation operations, described in the previous chapter (6.4). Another important one-off operation is the transfer of pension obligations to government in exchange of a lump sum, also described in the previous chapter (6.5). As is described in the last chapter 9 on the revised

SGP, one-off measures have been given increased scrutiny by ECFIN when assessing stability and convergence programmes and deciding on the existence of EDP in the revised SGP[1].

It has to be said that, in general, one-off operations are only a subset of the much broader ensemble of non-cyclical temporary measures. One-off measures have only temporary influence and are non-recurrent. It is expected that the ability to raise one-off revenues, which has so far in some countries largely been used as a substitute for lasting structural fiscal adjustment, will nevertheless become increasingly difficult as available options are exhausted (Standard and Poor's 2004).

7.4 Case study: Portugal – the first country above 3%

In March 2002 Eurostat decided for the first time not to validate the data for Portugal, Greece and Austria. This was unprecedented. In the case of Portugal, the decision not to certify the Portuguese data was taken due to the non-respect of rules on capital injections and of rules on the recording of taxes and social contributions.

In the case of capital injections, the Portuguese statistical authorities had, over many years, continued to treat as financial operations, capital injections undertaken by government in companies (especially transport companies) which were unprofitable, which had accumulated substantial debt during a number of years and for which, in some extreme cases, the net worth of the company was close to zero and sometimes even negative. In such circumstances the injections should not have been considered acquisition of equities (financial transactions) but capital transfers, impacting on the deficit. (See MDD II.3 and the chapter 6.4 on capital injections).

In the case of the recording of taxes and social contributions, the problem originated from the non–respect of Regulation 2516/2000 on the recording of taxes and social contributions, in the sense that taxes and social contributions recorded, were assessed on the basis on what was formally due to be paid by taxpayers and companies and were not adjusted by a coefficient, which indicated the likelihood that such taxes would never be paid (later on to solve this problem the Portuguese statistical authorities adopted a method based on time-adjusted cash receipts). In the aftermath of the Eurostat decision not to validate the Portuguese data, the new Portuguese government decided to create a "Commission" for the analysis of public accounts. The Portuguese Commission was chaired by the Bank of Portugal and included also representatives from the National Statistical Institute (INE) and the Ministry of Finance.

The Portuguese Commission undertook work in April 2002 and presented its results in June 2002 in a Report[2]. At the end of its work the government deficit in Portugal for the year 2001 had increased from the previously reported value of 2.2% of GDP to 4.1% of GDP. This figure also marginally increased in the course of the following years and it is now (October 2005) set, due to further revisions at 4.4 % of GDP. Portugal was therefore in 2002 the first country not to comply with the requirements in the Protocol of the Excessive Deficit Procedure attached to the Maastricht Treaty, indicating that the deficit must stay below 3% of GDP. Moreover Portugal was the first EU Member State to admit that its government had willingly and on purpose communicated to the European Commission incorrect data on the level of its government deficit. It was however not going to be the last.

[1] Council Regulation 1055/2005
[2] Relatorio da Comissao para a analise das contas publicas 2002

The work of the Portuguese Commission for the analysis of public accounts indicated that the level of government deficit in 2001 had been underestimated due to at least seven different factors, some of them related to the non-respect of ESA95 rules as far as the recording of transactions were concerned, and some to the under-recording of government expenditure at the level of central government, local government and social security funds. The Commission also included in its report five recommendations in order to correct the data and provide methodological solutions so that such issues be treated according to ESA95 rules in the future. What follows is a summary of its conclusions in this respect[1]. In addition, the Commission published several reports on the revision of the Portuguese data.

Figure 3: Deficit revisions in Portugal (in % of GDP) in 2001

	Deficit reported in March 2002	**Major revisions of deficit between March and September notifications due to:**	**Deficit reported in September 2002**
	-2.2		**-4.1**
• Capital injections • Tax arrears • Spending relative to previous years but not yet made • Change in recording of EU grants • Revision in State Expenses • Revision in accounts of health services and other services • Revision of local accounts		• -0.2 • -0.6 • -0.3 • +0.1 • -0.2 • -0.4 • -0.3	
TOTAL		**-1.9**	

Source: European Commission

Capital injections

The Portuguese Commission concluded that ESA95 rules on the recording of capital injections (see Eurostat's decision in chapter 6.4) had not been followed by the Portuguese authorities. Capital injections in public transport enterprises, which were basically systematically used to cover accumulated debt, had been recorded for years as acquisition of equities without an impact on government deficit. Once correctly reclassified as capital transfers, the government deficit deteriorated by 284 mn euro, equal to 0.23% of GDP.

Recording of taxes and social contributions

It was found that regulation 2516/2000 had not been correctly applied and that the amount of taxes and social contributions recorded as government revenue had not been corrected by a coefficient, indicating the likelihood that some of the amounts would never be paid (due to tax evasion, bankruptcy etc). The amount of government revenue recorded had included amounts never to be collected and was therefore adjusted by 756.5 mn euro, equal to 0.6% of GDP.

[1] Relatorio da Comissao para a analise das contas publicas 2002

Non-respect of accruals principle
The Portuguese Commission indicated that there were 326.1 m euro (equal to 0.3% of GDP) related to expenditure in year 2001 (or even in previous years) that had not been paid, and which originally had been allocated to the budget in 2002. Such amounts were then reclassified and recorded as government expenditures for the year 2001, following the accruals principle which states that the time of recording of revenue and expenditure should be the moment in which the activity takes place.

Budget revision
An accumulated amount of 833 mn euro (equal to 0.7% of GDP) increased government deficit in 2001 due to reclassification of government revenue and expenditure at the level of central government, local government , social security and other government bodies.

7.5 Case study Italy: the Italian miracle

If in the case of Greece, as to be presented in the following chapter, the statistical authorities deliberately played with figures and hid the true state of the Greek government finances, in Italy the government decided to test the capacity of Eurostat by extending to its maximum extent the meaning and concept of borderline cases. Investment banks were called to provide advice, rules were stretched to accommodate particular operations and publicly owned companies were created ex-novo to be used as instruments for government operations. The strategy worked for a while and it was only in 2005 that Eurostat was fully able to demonstrate that the Italian "miracle" (if compared to France and Germany) to keep a government deficit below 3% in the presence of low growth of the economy, was based on a good deal of inventive operations and interpretations of the accounting rules. What follows is a description of what this consisted of[1]:

Concessionari d'imposta

In 2003 and 2004, government asked banks exercising the function of tax collectors (consessionari d'imposta), to advance to government payments to be collected only in the future, for an amount of 2.7 bn euro in 2003 and 1.5 bn euro in 2004. The amounts were supposed to be paid back by government to the banks at the moment in which the banks ceased their activity as tax collectors. As such, given the fact that at some stage such amounts would have been reimbursed, they should have been considered as financial advances without impacting the deficit, but the Italian authorities decided to consider them instead as government revenue. Eurostat decided on the contrary to reclassify the operations as a financial transaction after the examination of the balance sheets of the banks acting as tax collectors, that showed that such amounts did not have the nature of a tax but one of a deposit or a guarantee which would one day be reimbursed by government. The previous recording by the Italians had reduced government deficit by 0.2% in 2003 and by 0.1% in 2004.

EU Payments

In Italy, EU funds provided to final beneficiaries other than government transit through an account opened at the Treasury and inflows and outflows should not enter government accounts (they should be transparent, in national account terms) as they are financial operations for government.

[1] ISTAT 2005, Conti Economici Nazionale anni 2001-2004 and Revisioni delle stime dell'indebitamenti netto delle amministrazioni pubbliche per gli anni 2002-2004eu

In 2004 Eurostat discovered that, between 2000 and 2003, the difference between inflows and outflows in this account had been equal to 13 bn euro, as outflows had been much higher than inflows. At the end of a thorough investigation it was discovered that some of the amounts transiting in this account, previously considered as relating to EU payments, included in reality amounts which should have been considered as government expenditures in the first place, such as current transfers to non-financial corporations, payments of salaries, acquisition of services, purchases of goods etc. After a long investigation, and when a clearer picture of the issue could be obtained, it was clear that the deficit had been artificially reduced through this recording by 0.2% in 2001 and by 0.1% in each of 2002, 2003 and 2004.

Railways

Over a number of years, the Italian authorities claimed that the Italian railways, which received every year a non-negligible amount of capital injections from government, were profitable, and as such the capital injections received should be considered as financial transactions without impact on the deficit. When Eurostat was finally able to check carefully the profit and loss accounts and balance sheets of the railway company, the reality which emerged was quite different. Far from being profitable, revenues covered only 70% of costs. Once this became clear, the capital injections were reclassified as capital transfers and government deficit increased by 0.3% per year between 2001 and 2004.

ISPA

ISPA is a state-owned company which was used by government to finance the construction, amongst others, of a high-speed railway link (TAV) between Turin, Milan, Rome and Naples. ISPA would provide to the railways the necessary resources for the construction of the high-speed railway link by issuing notes and raising loans. The debt of the railway towards ISPA was not considered initially as government debt. However, it later became clear that the railways, even under the most optimistic hypothesis, would never have been able to repay the debt through profits derived from the sale of tickets once the TAV become operational, and that most of the debt would have to be reimbursed in any case by government, which had a contractual obligation to do so. The whole debt raised by ISPA for this purpose was then rerouted to government and considered as government debt. Today, due to this, ISPA has stopped raising debt on the market for construction of the new railway lines.

Moreover ISPA has very recently lost its autonomous status and has been fully integrated in the "Cassa Depositi e Prestiti". Evidently, ISPA was created as an attempt to try to put off balance sheet some of the debt which otherwise the government would have been obliged to raise in order to finance the construction of the new high-speed railways in Italy.

Other issues

Eurostat intervened and requested clarifications on other issues, such as the amount of the statistical discrepancies in government accounts, inconsistencies between data on cash and accrual bases (mainly due to an accumulation of other accounts payable, mostly in the health sector), tax and real estate amnesties, sale and leaseback operations, securitisation operations, the role of Cassa Depositi e Prestiti, the recording of taxes and social contributions and capital injections. Some of these items have now been clarified and resulted, in a number of cases, in a further reclassification and increase of government debt and deficit, while in some other cases the situation is not yet fully clear. So has all the creative accounting undertaken by Italy in recent years been in vain? Not really. Although it has now become clear that between 2001 and 2004 Italy had crossed the 3% limit during every single year except in 2002, Italy was able for a number of years to escape the opening of an excessive deficit procedure and the risk of further punishment by not applying the rules correctly on a number of issues.

7.6 Case study France -a permanent close shave

Among the eleven countries which originally joined the euro-zone, France was the one which, at the moment of assessing whether the Maastricht parameters were respected[1], showed the highest government deficit, being exactly equal to 3.01 percent. Moreover, this less glorious performance had been achieved only through a specific operation – hitherto named the France Telecom case - which had allowed France to benefit from a lump sum transferred from France Telecom (a public telecommunication corporation) to the French government, in exchange for the fact that the government would have to pay from that moment onwards the payment of pensions of all existing workers of France Telecom through social security. After some discussions, and a CMFB consultation, it was decided by Eurostat that the payment from France Telecom could indeed be considered as a non-financial operation, reducing the French deficit. The decision was motivated by the fact that government obligations for unfunded pension schemes are treated in national accounts only as contingent liabilities (due to the fact that the final amount to be paid for such obligations is not fully certain).

The ruling was however far from being uncontroversial. Savage 2005, writes: "*Eurostat presented at least four analyses of the case to the FAWP and the NAWP and after very tense discussions neither of the two working groups reached consensus on how to classify, and Eurostat was left with seeking approval for its ruling with the CMFB…this was the first consultation of this kind and it was not very structured. Several CMFB members reacted, claiming they had not been properly informed in advance, and that they were not given enough time for consultation (the dead-line was "fore-shortened" and additionally there was a holiday in between). Furthermore, only two options, instead of the initial four, were given in the consultation. The dissatisfaction with the process even made some people express the suspicion that the decision was a French conspiracy with a French Commissioner, a French Director-General and a French company*".

The noise originating from this case created the framework for establishing very strict rules for CMFB consultations in the future. Nevertheless, when 6 year later the case was reopened and presented in more general terms, the second CMFB consultation organized on the same subject gave the same result; the CMFB members voted for considering the transfer of a lump sum to government as a non-financial transaction. The full methodological reasoning behind the case is found in the chapter 6.5 on the Eurostat decision on payments to government by public corporation in the context of the transfer to government of their unfunded pension obligation.

It is interesting to notice that in 2005 France resorted once again to this accounting rule and managed to stay under the 3% limit only through a similar operation carried out this time with Electricité de France - EDF (another public corporation, within the electricity sector) and GDF (Gas de France). Moreover, other operations of the same sort are foreseen for 2006. The French and international press expressed doubts and displeasure on the fact that the French

[1] Only later on were deficit figures revised upwards for various reasons for Greece, Spain and Portugal.

government decided to resort once more with gusto to this measure. The Times online, 2005 writes "*French Minister accused of trickery over budget*" referring to the Finance Minister Thierry Breton's presentation of a series of planned one-off operations relating to the taking over of the pension liabilities of the French Post Office, the Bank of France and the Paris Chamber Of Commerce in exchange for a series of lump-sum payments to government. Similar articles were written in all main French newspapers, in the context of EDF in 2005 as well as for the planned actions for 2006.

Nevertheless, the operation with EDF would not have been sufficient to comply with the 3% rule in 2005, if it wasn't for the fact that in addition government obliged all companies with a turnover of more than 1 bio € per year to pay an exceptional payment (tax) at the end of December 2005, based on the estimated profits of the same year. It is particularly interesting to notice in this context that the law obliging corporations to do so was published on 31 December. Additionally, as the recording of taxes in France follows the cash principle and not the accrual principle, even if the corporation would have paid the tax only a few days after the law came into force, this would not have been sufficient for the purpose of reducing the deficit in 2005. For this reason, it seems that the Minister of Finance wrote personally to the presidents of the corporations affected by this manoeuvre, telling them to anticipate the effects of the coming law and to pay the exceptional advance before the end of the year (although they were not yet obliged to do so, as at that time the law had not yet been published)[1]. This operation had its intended effect, and government received a total amount of 2.3 billion euro, equal to 0.15% of GDP, which allowed it to respect the Maastricht criteria in 2005. This issue was also covered by all main French newspapers in January 2006.

The outcome of this operation raises one question: Did France always have its way through a mixture of exceptional operations carried out at the 25th hour, contentious accounting rules, CMFB consultations and a sheer dose of good luck?

Not always, in fact. In 2003 Eurostat decided to change the deficit data notified by France (a suspicious 3.02% of GDP) through the reclassification of the capital injections which France had done in 2002, and in all previous years since 1999 for that matter, into RFF (Reseau Ferré de France). This constituted a kind of last minute ambush which the French authorities did not expect. As the capital injections had been undertaken by government for many years, it was thought that the practice of considering them as financial transactions could have continued for a long time unchallenged. Nevertheless, Eurostat pointed out that RFF had consistently shown losses in the past for every single year of its activity. In practice, every year government would inject some capital which would be completely eaten up by the losses of the corporation during the following year, bringing the capital of the company down to around zero, so that government would be forced to recapitalize the capital of the company again from scratch the following year. It was, in other words, a typical case of subsidies to keep the corporation afloat, which were earmarked as capital injections. No private investor was participating in the recapitalization of the company, and government was injecting capital in a corporation which had no prospect of being profitable in the short or medium term (See chapter 6.4 on capital injections).

Eurostat pointed out that in similar cases in other countries, such as Greece and Portugal, a reclassification of comparable capital injections had already taken place. As a consequence,

[1] Le Canard en chaine, 2006

the deficit of France was raised from 3.0 to 3.1 % of GDP[1]. Independently this was also the first time that Eurostat actually modified the data notified by a Member State, so France also had the less glorious honour of becoming the first country in the EU which became the victim of such a practice[2].

7.7 Case study: Germany – in permanent excessive deficit

Germany was declared in excessive deficit in 2003 for the first time and expects to remain over 3% at least until 2006 (first estimates of 2005 are 3.3%). It has been struggling hard to get under 3%, but it has failed so far. We will now look at problems relating to the administrative structure as well as at some interesting accounting cases in 2005.

Germany is a federal country. In statistical terms this means that at the regional level, the Länder have maintained a broad responsibility for the reporting of figures in the context of the EDP. As a matter of example, when it comes to verifying if Eurostat's ruling on this or that issue is being implemented at the level of the Länder, the German Federal Statistical Office (D-Statis) can only rely on the goodwill of the Länder which are not obliged to provide full details on this or that transaction involving government.

Capital injections in local government constitute one such case. In September 2005, Eurostat included Germany among the countries in which it was impossible to determine whether the Eurostat rules on capital injections were fully implemented, due to the lack of details on what was happening at the regional level.

In 2003, for instance, the regional government of Berlin injected capital in Bankgesellschaft Berlin, a government owned bank which was virtually bankrupt. The operation was originally considered by the German statistical authorities as a financial transaction (cash versus equity) without impact on the deficit. It was only due to the insistence of Eurostat, which happened to be informed of the operation via the press, that this operation was later considered as a capital transfer by government, increasing the deficit by 0.1% of GDP.

Capital injections at the level of local and regional government are not, however, the only operations which have recently attracted the attention of Eurostat. Two additional operations in 2005 gave rise to an exchange of letters between Eurostat and the German authorities. These refer to the securitization of contingent claims of the Postal Employers Pension Fund (BPS-PT) and to the sales of shares by government to the "Kreditanstalt für Wideraufbau" (KFW). Both operations were reported frequently in the German (and international) press.

As far as the latter is concerned, Eurostat ruled that the income obtained by the German government through the sale of shares to the KFW must be considered as government borrowing. Eurostat discovered that if KFW was bearing losses on the operation (at the time

---

[1] Eurostat press release 30/2003
The French government deficit series from 1999 to 2002 has been revised upwards by Eurostat to include the capital injection by the French state to Réseau ferré de France (RFF). This is the result of recent decisions taken by Eurostat on similar transactions in other EU Member States. The revision amounts to 1.362 bn euro for 2002 (0.09% of GDP), 1.067 bn euro in 2001 (0.07% of GDP), 1.067 bn euro in 2000 (0.08% of GDP) and 1.906 bn euro in 1999 (0.14% of GDP). The capital injection is considered as government expenditure in line with ESA 95 rules (Regulation 2223/96). As a consequence, the government deficit for 2002 has been revised from 3.0% of GDP (as notified by the French authorities) to 3.1% of GDP.

[2] Eurostat decided also in April 2006 to change the data of the French notification. See Eurostat press release 48/2006.

in which it was reselling the shares to the final investor), a compensation would be paid by government. Conversely, any profit obtained by KFW in the operation had also to be transferred to government. In short, all risks and rewards in the operation were not undertaken by KFW, but by government. It was also discovered that any disposal of shares by KFW had to be approved by government which was a clear indication that after the "sale" of shares by government to KFW ("transfer" would, no doubt, constitute a better terminology here), government was still maintaining control of the shares.

The case ended up in a revision (a marginal increase) of the figures of government debt in the September 2005 notification. Nowadays, in all transactions involving disposal of shares by government through KFW, it is considered that a financial operation involving sales of shares occurres only at the moment in which the shares are sold by KFW to the public, and not at the moment of transfer of shares from government to KFW.

As far as the securitization operation, involving sales of contribution claims of the German Postal Employers Pension Fund (BPS-PT), is concerned, Eurostat ruled that, first of all, the fund had recently been misclassified in the financial corporations sector as in this particular case the BPS-PT was managing an unfunded defined benefit pension scheme controlled and mainly financed by government. Government was in fact providing considerably more than 50% of the payment contributions towards its former civil servants that were employed in the "Post", and by doing so, it had to be considered as the real "sponsor" of the scheme as well as the entity which took most of the financial risk of the payment of the benefits. BPS-PT had therefore to be reclassified as a government unit. Notwithstanding the problem of classification of the pension fund included in the transaction, Eurostat also ruled that the borrowing of BPS-PT in the context of the securitization operation had to be considered as government borrowing, as government had taken the commitment to repay the debt of BPS-PT, and this had therefore to be assimilated to a guarantee provided by government.

In short, the BPS-PT had securitised future government payments and was able to securitise them only through a government guarantee in a situation in which it was clear that in any case government would have had to pay the reimbursement of the great majority of the debt issued by the BPS-PT.

The German government had initially hoped that this securitization operation would have determined the fact, that for a number of years, it would not have had to provide a non-negligible amount of contributions to the BPS-PT pension fund in order to pay the pensions of its former civil servants, reducing therefore government expenditure in such years and decreasing government deficit. It did not turn out that way.

7.8 Case study Sweden - are there any skeletons in the cupboard?

Sweden, being a Scandinavian country, has benefited until now from the general reputation of northern European countries of seriousness, precision and reliability of their statistics. In many circumstances this is deserved. However, when it comes to the application of some "uncomfortable" national accounts rules, the picture looks different. What will be discussed in this chapter is the "pension affair" or the refusal of the Swedish authorities to accept a decision taken by Eurostat in 2004.

The pension affair

In chapter 6.6 concerning pensions, the background and circumstances surrounding the "decision on classification of funded pension schemes in the case of government responsibility or guarantee" are described. The role of Sweden is also mentioned, even if only briefly. To recall, after several meetings in a task-force created for this specific purpose, long discussions in the appropriate Working Party (the FAWP) and a vote held by the CMFB, Eurostat took a decision on the classification of funded pension schemes on 2 March 2004. This decision had an impact on the fiscal balance in a number of countries having funded pension schemes, Sweden being one of them.

The issue had previously come in the spotlight due to the recent reform of the Polish pension system. The Poles, wanting to be on the safe side, had asked to Eurostat to provide an opinion on the classification of their newly-created scheme. The answer of Eurostat was not, as they had foreseen, very encouraging for their fiscal balance, and this gave rise to the decision to create a task-force to look into the issue. However, it immediately became clear that an eventual Eurostat decision would have had profound implications for the fiscal balance in a number of countries; Sweden, Denmark, Poland, Hungary and Slovakia being the most prominent ones.

Sweden participated in the task-force that met three times in 2003 and the Swedish delegate never raised any fundamental reservations on the issue. It was only at the end that it was "discovered" at a political level in Sweden, that the decision could have negative effect on the Swedish fiscal balance. As the Swedish Prime Minister on several occasions had expressed the importance of running a healthy surplus in the budget, the pension reclassification was not welcomed at all, as the surplus in 2003 would turn into a deficit (change from a surplus of 0.2% to a deficit of 0.7% of GDP) and the surplus almost disappear (change from 1.6% of GDP to 0.6% of GDP) in 2004 with the reclassification of the funded pension scheme outside government. Given the fact that its Scandinavian neighbours, Denmark and Finland in primis, were running a fiscal surplus, the Swedish political authorities decided to interfere in a strictly statistical technical decision.

On 26 January 2004 the Swedish Ministry of Finance presented a note by the State Secretary to the chairman of the EFC. The note had the title "Adverse effects on pension-reforms of possible change of Eurostat interpretation of ESA-95". The content of the note ("promemoria") was to draw the attention to the ongoing task-force and to the effects of the decision on the deficit and debt figures, and to raise attention on the possible negative consequences of the decision in the context of ongoing pension reforms in Europe. The note ended by saying: "The work of Eurostat to clarify accounting issues in an independent and professional way is invaluable. However one must also assure that accounting practices and rules encourage sound and sustainable public finances. After all, this is perhaps the most important aspect of public sector accounting system".

The Commission authorities were put under pressure by the Swedes and the pension issue was discussed not only during EFC meetings but also in bilateral meetings at different levels. Nevertheless, Eurostat decided to go along with the work of the task-force and the opinion of the CMFB, and decided, on 2 March 2004, which was incidentally just after the deadline for the March 2004 notification, that second-pillar pension systems should be classified outside government, but that the decision was however not to be immediately applied .

Contrary to what usually happens in the case of Eurostat's decisions, this time the issue found an echo in the Swedish press, which stressed the possible negative consequences for Sweden of this decision[1]. However, it was also said that Mr. Ringholm (the Finance Minister at that time) was still confident of including the Premium Pension in the state budget.

The exact wording of the Eurostat press release from 2 March was as follows*: "This is a framework decision taken in the context of the principles for the classification of certain types of pension schemes. Within this framework decision, individual cases in Member States will be analysed bilaterally during the following weeks".*

Understandably, the Swedish authorities were not at all happy with the outcome of the story. An offensive strategy was devised. Letters started to be sent at different levels. Meetings with the Commission authorities were requested. Delegations started to visit Eurostat. Material describing the Swedish pension system started to be sent to-and-fro. At the end of several months of uncertainty, Eurostat decided that the Swedish pension system had to be classified outside government. Nevertheless, due to the fact that (or so it was claimed) this decision had put Sweden into a difficult position, the offer was launched to discuss with the Swedish authorities a transitional period for implementation of Eurostat's decision. In other words, a decision of Eurostat was, for the first time ever, not to be immediately applied, but only after a certain number of years.

At the end of further discussions, this period was set in March 2007 (safely after the next general elections in Sweden of September 2006). Of course, the same possibility was also given to the other Member States in the same situation as the Swedes. Denmark, which had always declared its readiness to accept Eurostat's decision, decided that under no circumstances should this result in the fact that Sweden would show a relatively higher surplus than Denmark, due to the fact that the Danish authorities accepted Eurostat's decision while the Swedish ones did not, and decided to take advantage of the transitional period for implementation as well.

The pension classification still comes up in the debate every now and then. In January 2006, the news paper Expressen had a debate with the Finance Minister P. Nuder on the budget balance. Expressen claimed that the figures from the MoF were too optimistic as they did not take the Eurostat decision into account. P. Nuder replied that Eurostat decided already in 1997 that the Swedish pension system should be included inside general government, but Eurostat had now changed their mind and say that the PPM should be classified outside government from 2007. Expressen replied, saying that the decision was actually taken in 2004 and known long before…[2]

At the end of the story, it is worth pointing out that due to considerations of a political nature, triggered by one Member State which was not ready to accept that a fiscal surplus was in reality a fiscal deficit (or a smaller surplus), in spite of a decision taken at a technical level, based on ESA95 rules, (which constitute, as we know, a Council Regulation), the accounts of some Member States will be, until March 2007, artificially improved by amounts between 1 and 2% of GDP. Moreover, technically speaking, it is also a matter of concern that the Commission finds itself now in a position of irregularity, as a Council Regulation is at present not being applied, with a derogation provided by the Commission to a number of Member States.

---

[1] Dagens Industri 2004, Dagens Nyheter 2004

[2] Expressen 2006

As described at the end of the Pensions chapter, pensions were given a special role in the revised SGP. Member States have been given a number of years during which the impact of pension reform will be counted (but with decreasing effects) in the context of verifying whether they have been complying with the obligations taken in the context of the SGP. It is ironic to think, in this respect, that the vehement opposition of one Member State which is not even part of the euro-zone will perhaps have an effect on when other Member States might be allowed to join the euro-zone based on the respect of the Maastricht criteria.

8. A Greek tragedy

This chapter is entirely devoted to Greece and to its implementation of national accounts rules. As “the Greek case” constituted a turning-point, or crisis, in the history of the SGP, it is highly relevant for the discussion of the reform of the statistical components of the SGP. The chapter analyses what happened, how it could happen and whether it could happen again in Greece or in any other Member State.

8.1 The sequence of events

On 1 December 2004, Eurostat published a report on the revision of the Greek government deficit and debt figures[1]. The report contained a detailed list of all accounting devices which had been used by the Greek statistical authorities since 1997 onwards, first in order to join the euro-zone, and then to continue to record deficit and debt figures substantially lower than if ESA95 accounting rules had been correctly applied. The report constituted the confirmation of what had been long suspected, namely that the Greek statistical authorities had for a long time hidden the real figures in order to continue to satisfy the European Commission and the ECB on one side, and in order to avoid taking unpopular economic measures and decisions on the other side.

However, the report of Eurostat did not come as a complete surprise. On several occasions, Eurostat had raised its finger on a number of accounting irregularities committed by the Greek authorities in past years, and had explicitly stated so in its bi-annual press releases on government deficit and debt in the form of footnotes. This has led to several revised EDP notifications from the Greek authorities. However, as it turned out, this was apparently only the top of the iceberg. In March 2002, for instance, Eurostat noted a number of “doubts” as far as the recording of convertible bonds and privatisation certificates were concerned. In September 2002[2], such doubts were maintained and Eurostat declared itself not able to certify the figures presented by the Greek authorities. Finally, in November 2002 it became also clear that rules on the recording of capital injections had not been respected. In March 2004, Eurostat detected irregularities in the recording of VAT tax revenues, in the recording of EU grants and on the respect of rules concerning payments from a financial corporation to government. Later on in the same year, new irregularities were discovered (the process of investigation had been in the meantime favoured by a change of government in Greece) in the recording of military expenditures, on the recording of interest, and again on the recording of capital injections. At the same time, the debt figures were also revised due to the discovery of an incorrect consolidation inside general government of social security assets and of the previous non-inclusion of the debt of some mutual funds inside social security.

The picture does not seem however to be complete yet. It is to be underlined that even in 2005[3], Eurostat expressed a reservation on the Greek accounts due to the existence of an unexplained “black hole” concerning other accounts receivable and payable, the recording of EU grants and the statistical discrepancy. In April 2006 Eurostat was not able once more to validate the Greek figures, this time due to problems of a systemic and structural nature.

---

[1] Report by Eurostat on the revision of the Greek government deficit and debt figures
[2] Eurostat press release no 116/2002 30 September 2002
[3] Eurostat press release no 120/2005 of 26 September 2005

8.2 How could it happen?

Ex-post, most of the blame was given to the Greek Statistical office, which was pointed out as the main executor of this accounting scam. However, this would not have been possible without the involvement of the general accounting office. The Greek Central Bank also did not ring an alarm bell at the right moment, although later on it claimed that it had in fact indicated in its reports that the figures provided by government were not to be fully trusted.

As far as the services of the Commission were concerned, they were never able to obtain from the Greek statistical authorities the basic figures and the transition tables used to compile the EDP notifications, which would have raised suspicion or showed the extent of the misreporting of deficit and debt figures, and had therefore to rely on their own intuition and on informal information received from different sides.

8.3 The extent of the scam

The following figure shows the extent of the revision of the Greek figures from March to September 2004, split between the main components of the revision.

Figure 4: Main components of the revision of Greek data between the figures reported in March 2004 and September 2004

Revisions GREECE March 2004 / September 2004

	2000	**2001**	**2002**	**2003**
DEFICIT	% GDP	% GDP	% GDP	% of GDP
March 2004	***-2.0***	***-1.4***	***-1.4***	***-1.7***
Tax revenue				0.9
Payments from the EU				0.3
Reclassification of payments from the Postal Bank				0.2
Military expenditure	1.9	1.2	1.7	0.7
Surplus of Social Security Funds	0.0	1.0	0.4	0.6
Under recording of interest	0.3	0.1	0.1	0.1
September2004	***-4.1***	***-3.7***	***-3.7***	***-4.6***
DEBT				
March 2004	***106.1***	***106.6***	***104.6***	***102.6***
Capitalised Interest	4.5	4.2	3.9	3.4
Consolidating Assets of Social Security	3.2	3.8	3.8	3.7
	0.1	0.1	0.2	0.1
September 2004	***114.0***	***114.7***	***112.5***	***109.9***

Source: Eurostat

However, the table does not include the revisions of data already undertaken in 2002 following the discovery by Eurostat of irregularities in the presentation of deficit and debt data to the Commission.

What follows is a description of the main accounting devices used by the Greek statistical authorities in recent past.

Expenditure on military equipment

According to accounting rules, military expenditures are to be recorded at the time in which they enter the process of production, as they are considered as intermediate consumption (ESA95 § 3.70). Most countries however, not being able to determine whether this is the case (mostly due to confidentiality reasons), use a cash system of recording, treating the amounts spent by government for the purchase of military material as government expenditure at the moment in which they are paid (so-called cash method). However, even those countries which applied fully the ESA95 rule, interpreted the fact of "*entering the process of production*" as the moment in which the goods were crossing the border of the country concerned and became available for use. The Greek authorities, on the contrary, decided to adopt a very strict view of the concept of "*entering the process of production*", refusing to record the expenditures undertaken for the purchase of goods (say, airplanes) until the moment in which the good was perfectly fit for use, the spare parts consigned and even only when the pilots had finished their training period. In such ways, substantial amounts of military expenditures had accumulated without ever being recorded.

Recording of taxes

Taxes and social contributions unlikely to be collected must not be recorded as government revenue, according to Council Regulation 2516/2000 as described in chapter 5.2.1. The deficit-reducing impact on government accounts should be equal only to amounts effectively received. To recall, two ways can be applied in order to comply with this Regulation: either cash receipts are to be used (preferably time-adjusted so that the cash is attributed to the period in which the tax was determined or the activity that generated a tax liability was undertaken) or, if assessment and declarations are to be used, the amounts shall be adjusted by a coefficient reflecting assessed and declared amounts never collected. The determination of the coefficients, which has to be tax and country specific, is basically left to the country, which will determine it according to past experience and current expectations. In this context, it seems that for a number of years the Greek authorities applied coefficients unrealistically low (even lower than the ones recorded in Scandinavian countries), with the result of inflating the amounts recorded as government revenue in this respect. Once this became fully clear, Eurostat summoned the Greek authorities to change the method and to record taxes and social contributions using the time-adjusted cash method.

Social security

From 1996 to 2004, the figures presented by the Greek authorities showed an important surplus of the social security sector (a part of general government). This was partly due, it later appeared, to an overestimation of revenues and an underestimation of expenditures, itself depending on the fact that an unreliable and old survey was used to compile such figures. Due to the insistence of Eurostat, the Greek authorities were finally forced to undertake a new survey which provided more detailed, reliable and timely figures. As a consequence, it later appeared that the social security surplus had been overestimated between 2001 and 2003 by a cumulative amount of 2.8 bn €.

Debt assumptions and cancellations

ESA95 (§4.165) specifies that the counterpart transaction of a debt assumption or debt cancellation is a capital transfer, with a direct impact on government deficit (if the debt cancellation is undertaken by government towards an entity outside the general government sector). The only exception relates to debt assumptions carried out in the context of an ongoing process of privatisation, or in the context of a liquidation of the entity, which can then be treated as financial transactions. These rules are quite straightforward and are normally applied without great difficulty by most Member States. In the case of Greece, however, it later turned out that debt assumptions and debt cancellations were never recorded as non-financial transactions, and that the exception relating to privatisation was applied in an extensive way to cover even cases when the privatisation was only announced, following a simple declaration of intents by government, and in many cases never carried out.

Capitalised interest

According to ESA95 (§4.50) interest is to be recorded on an accrual basis, that is, it has to be recorded continuously over time by the creditor on the amount of principal outstanding, whether or not it is actually paid or added to the principal outstanding. This did not happen for quite a long time in Greece, and capitalised interest was not recorded as a government expenditure in all cases in which it was not paid by government at the end of each year but simply accumulated to the capital (during the so-called "grace-period"). Following the discovery of the issue in 2004, the deficit of the Greek government increased by sizeable amounts between 1995 and 2000, for amounts varying between 108 and 1964 mio € per year.

Capital injections

The recording of capital injections has given rise to a number of problems in several EU countries (see Chapter 6.4 on Eurostat's decision on capital injections for reference). Greece was one of them and it was also the country in which the non-application of rules gave rise to the highest correction in government accounts. To recall, the basic principle to be followed is that capital injections undertaken by government can be recorded as financial transactions without impact on the deficit only in cases where the government can be deemed as acting as a normal shareholder, expecting dividends in the future, and is not acting for public policy purposes by providing funds to a public corporation without expecting some kind of property income in exchange, etc.

In the case of Greece, very sizeable capital injections were undertaken by government between 1997 and 2004, and they were systematically recorded below the line (that is, not included in the calculation of the deficit). In most cases, they referred to capital injections in loss-making corporations involved in the domain of transport (such as railways, the underground, or a company building motorways) which had accumulated sizeable debt in the past. As such, even if government got some (unquoted) shares of a nominal value equal to the amount of cash received, they should be recorded as government expenditure, but this was not the case until 2003, following the decision of Eurostat on the issue.

Convertible bonds

According to ESA95 (§5.62) convertible bonds are part of government debt, as long as they have not been converted. The Greek authorities took, on the contrary, the opposite view. They judged that as it was not sure whether they would have been one day converted into shares or not, they did not have to be included in government debt until the moment in which they could be absolutely sure that such was going to be the case. Such moments turned out to be either when they were converted into shares (and therefore would not be anymore part of government debt), or when the principal had to be reimbursed and the bond would be redeemed (no effect on the debt either). At that stage, the repayment of the principal would possibly be done through the emission of more share-convertible bonds, which again would not figure as included in government debt. The intervention of Eurostat in 2002 ended this original interpretation of national accounts undertaken by the Greek authorities.

Classification of DEKA

In 1997 the Greek government created a state-owned holding known as DEKA, moving into it enterprises to be privatised. Conveniently, DEKA used the revenues obtained through privatisation of companies to inject capital in other companies, and to pay dividends to government. Eurostat begged to differ, and at the end of seven years of tense correspondence on the issue, DEKA was finally reclassified inside government, as it appeared that most of the transactions conducted were undertaken on behalf of government anyway. Some of the amounts originally classified as share capital increases (financial transactions) were then reclassified as capital transfers, increasing the deficit.

Structural funds (EU grants)

EU grants, in case where the government would not be the final beneficiary, must not transit through the non-financial accounts of government (see part 6.3 on EU grants in the previous chapter). In addition, many projects are co-financed both by the EU and national governments. The part co-financed by government should of course be treated as government expenditure. The Greek authorities had devised an original system of recording of such expenditures. Not only were such amounts transiting in the non-financial accounts of government, but they were recorded as government revenue when received, and as financial transactions at the moment in which they left the accounts of government in the form of share-capital increases to state owned corporations.

8.4 Could it possibly happen again?

The Greek case was probably exceptional as far as the size and number of irregularities was concerned, and in terms of the time needed to discover and clarify all the outstanding issues. However, Greece was until now by no means the only country which reverted to fiscal massaging in order to paint a more beautiful picture of the state of its public finances.

Although not everything has been clarified yet, there is no doubt that the new authorities responsible for Greek statistics have done much to clarify the situation, acknowledge accounting irregularities, correct mistakes and introduce new instruments and surveys which will allow the Greek authorities to provide to Eurostat in the future with reliable, updated and timely public finance statistics. The remaining outstanding issues in fact, still originate from the past and are still a consequence of the misrepresentation of reality that was forwarded to the EU until (2004).

Having being caught once as the chief villain of the tale, and having greatly suffered in terms of reputation, it is unlikely that the Greek statistical authorities will ever want to put themselves in a situation in which there will be widespread suspicion that the quality of their data is far from being optimal and that accounting rules are not being respected. The new Regulation 2103/2005, amending Regulation 3605/93, has increased the demands for transparency and might also be a dissuasive element for Member States for stretching the rules and providing incorrect data.

However, as the recent experiences demonstrate, the attention of Eurostat is needed more than ever in checking the respect of national accounts rules by Member States. As, moreover, new innovative financial operations are constantly devised and presented to Member States by investment banks or other private-sector entities, it is to be assumed that the work of Eurostat in this respect will have to continue for a long time.

The Greek experience, nevertheless, was by no means completely negative, and it allowed the Commission and Member States to understand that in a system where so much (the respect of the Stability and Growth Pact and possible sanctions) depends on so little (one single figure being under the 3% threshold), the inducements for starting to tamper with this figure by unorthodox means are substantial. As such, surveillance is needed and it will be up to Eurostat to answer in an appropriate way to this challenge in the future.

9. The revision of the Stability and Growth Pact

"The Pact is dead, long live the Pact"

This chapter deals with the background and main implications of the revised Stability and Growth Pact. It will describe the proposals put forward, and analyse the decisions taken by the Commission in March 2005, resulting, among other things, in two new Council Regulations underpinning the Pact. Additionally, the consequences for the Commission's work will also be discussed. The revised *Regulation 3605/93 on the application of the Protocol on the Excessive Deficit Procedure* is also described in detail. Finally some considerations about the future of the Pact have been included.

9.1 The background to the discussions and initial proposals

The Greek case was probably the final proof in confirming that the SGP had outlived its role in its present shape, and that the legal framework of the SGP and the excessive deficit procedure was in need of a thorough review. The SGP has however been the subject of controversy ever since its inception and has been lively debated over the years. It has been criticised by academics and opinion makers and various proposals for change have been put forward at different stages. Even the dismantling of the Pact has been considered in the past.

The debate about the SGP intensified in 2002 when Portugal was the first Member State to breach the 3% rule and was declared in excessive deficit, and it took off seriously after the ECOFIN Council meeting in November 2003, when excessive deficits in France and Germany were noted, but no sanctions were imposed. To many people, these events were seen as the death-knell for the SGP.

The intensive debate about the SGP that followed after November 2003, with the increasing number of countries breaching the SGP and the Greek case, finally resulted in a Council report "Improving the implementation of the SGP", endorsed by ECOFIN on 22 March 2005. The main actors in this work were the Commissioner for Economic and Monetary affairs, Mr Almunia and Mr Juncker, the Luxembourg Prime Minister and EU Council President during the first half of 2005. After a long debate, the political agreement and fast decision on the SGP was quite surprising as the Financial Times title showed on 22 March "*Juncker achieves "small miracle" as deal rewritten*". Few people had found Juncker's statement about an agreement in March 2005 a realistic scenario when expressed two months earlier (at the time when Luxembourg took over the EU presidency). Actually, even on 8 March, the ECOFIN meeting failed to reach an agreement on the SGP in particular concerning on the specification of "other relevant factors" and the treatment of the second-pillar pension reforms, and therefore Juncker convened an extraordinary meeting on 20 March.

There was at the time a general European (political) unity on the agreement. Most countries did acknowledge the need for fiscal discipline but at the same time more flexibility was also sought. The revised Pact comprised these two elements.

However, not everyone was pleased with the results and important actors such as the ECB expressed sincere concerns about the outcome. The Financial Times wrote: *"Sound fiscal* *policies and monetary policy geared to price stability are fundamental for the success of EMU…by ECB standards this is quite threatening*[1]. In general, the press was quite pessimistic about the outcome, but on the other hand the press has always been quite pessimistic about the functioning of the SGP in general. During the days after the agreement was reached, the headlines were numerous and some quotes from the newspapers were quite explicit in this respect; "The stability pact is no longer worthy of its name" (Berliner Zeitung), "Mehr Luft für Defizitsünder" (Der Standard, Austria), "The Party is over" (CEPS), "Europe has lost its economic policy anchor" (Süddeutsche Zeitung), "A much needed relaxation of the Stability Pact" (Politiken Denmark) etc…

On 20 April 2005 the Commission proposed to amend the two Council Regulations underpinning the Pact, 1466/97 and 1467/97 (see chapter for 2 for an analysis and description of the Regulations), and on 27 June Council Regulations 1055/2005 and 1056/2005 were adopted, representing the new legal basis for the revised SGP.

Apart from the two regulations underpinning the revised pact, the EFC published an update of the document “Opinion of the EFC on the content and format of the Stability and Convergence programmes”, originally written in 2001. This document constitutes an important complement to the SGP Regulations.

As mentioned in the introduction, an agreement on the revised SGP was only reached after a long debate. Many proposals were launched, with or without too much conviction by Member States. There were broadly three camps. The first comprised those who favored a strict interpretation of the 3% ceiling. The second group wanted to propose some flexibility if the excess spending was intended for reforms, having a beneficial impact on the medium and long-term finances of the country. The third group wanted to exclude certain kind of expenditures; Italy proposed to exclude expenditure for infrastructure, France proposed to exclude military expenditure, Germany expenditure for “reunification” and so on.

Euractiv editorial 2005 reports: “The Germans introduced laxity in the debate and the German Chancellor Gerhard Schroeder proposed the following in a written piece appearing in the Financial Times. Three main criteria should be taken into account in assessing a country’s deficit: structural reforms, economic stagnation (rather than major recession) and specific items of expenditure for a Member States (such as the high cost for the German reunification or Germany’s high EU net contribution). He also wanted less intervention by European institutions in the budget levels of national parliaments. Schroeder further said that if the above criteria were fulfilled, no excessive deficit procedure should be initiated but the country should set out a programme on its own”.

In other words, any deficit should be tolerated, the European institutions should keep out of national business and it was up to the country to correct the fiscal situation…Nevertheless, the Schroeder proposal was not very welcomed among his colleagues who realized that these proposals would be to go too far and symbolize the death of the Pact as an instrument of fiscal discipline, and even if the final result was a more relaxed pact in some aspects, it should not be “killed” as in the proposal from Germany.

[1] Financial Times 22 March 2004

9.2 The final decision of the Council

On the day of the press conference of 27 June, when the two new Regulations were adopted, Commissioner Almunia said ”The reformed Pact presents a better and balanced framework, which improves the economic underpinning of our fiscal rules and reinforces its capacity to foster discipline while dealing with the diverse economic realities of the 25 EU members”[1]. The changes included in the two new Regulations underpinning the Pact are presented in figure 5[2] and explained in detail in the following parts of the chapter.

[1] Commission IP/05/798
[2] Public Finances in the EMU 2005

1. Changes in the preventive arm		
Medium-term objective (MTO)	All Member States (MS) have a medium-term budgetary objective (MTO) of 'close-to-balance-or-in-surplus'.	• Country-specific differentiation of MTOs according to stock of public debt and potential growth. • MTOs for euro area and ERM II MS are set between -1% of GDP and balance or surplus (in cyclically-adjusted terms and net of one-offs). • Implicit liabilities to be taken into account at a later stage, when modalities for doing so are agreed by the Council.
Adjustment path towards the MTO	No specific provisions.	• MS to take active steps to achieve the MTO. • Annual minimum adjustment for MS of the euro zone or of ERM-II of 0.5% of GDP. • The effort should be higher in '*good times*'. • '*Good times*' are identified as periods where output exceeds its potential level, 'taking into account tax elasticities'
Early policy advice	Early Warnings are adopted / addressed by the Council, upon recommendation of the Commission.	In addition, the Commission can issue direct '*early policy advice*' to encourage MS to stick to their adjustment path. To be replaced by '*early warnings*' in accordance with the Constitution once applicable.
Structural reforms	No specific provision.	Reforms will be taken into account when defining the adjustment path to the MTO and may allow a deviation from it under the following conditions: • Only major reforms (direct / indirect impact on sustainability); • safety margin to the 3% reference value is guaranteed; • the deficit returns to the MTO within the programme period; • detailed information is provided in the Stability/Convergence Programmes. Special attention to systemic pension reforms.
2. Difference s in the corrective arm		
Preparing a report under Article 104(3)	No obligation for the Commission to prepare a report if a deficit exceeds 3%.	• The Commission will always prepare a report in case there is a deficit above 3%. • The report will examine whether the exceptions in Article 104(2) apply. • It will take into account whether the deficit exceeds government investment expenditure and all '*other relevant factors*'.
Severe economic downturn	'*Severe economic downturn*' if there is an annual fall of real GDP of at least 2% for the preparation of report under Art. 104(3) by the Commission, and in decisions under 104(6) by the Council, if observations by the Member State concerned show that the downturn is exceptional in light of evidence of the abruptness of the downturn and the accumulated loss of output with respect to past trends. The Member States commit not to invoke the severe economic downturn when growth is above -0.75%.	An economic downturn may be considered '*severe*' in case of a negative growth rate or accumulated loss of output during a protracted period of very low growth relative to potential growth
'Other relevant factors' (ORF)	No specific definition of '*ORF*' and their role in the excessive deficit procedure.	• The Commission report under Art. 104(3) will take into account: – Developments in the medium-term economic position (potential growth, cyclical conditions, implementation of policies); – Developments in the medium-term budgetary position (public investment, quality of public finances, as well as fiscal consolidation in '*good times*', debt sustainability); – Any other factors, which in the opinion of the MS, are relevant in order to assess the

		excess over the reference value. • '*ORF*' will be considered in the steps from Article 104 (4) to (6)) only if the excess over the reference value is temporary and the deficit remains close to the reference value. Any deficit above 3% that is neither close to the reference value nor temporary will be considered excessive. • If the Council has decided that an excessive deficit exists, the ORF will also be considered in the subsequent procedural steps of Article 104 (except in Article 104(12), i.e. abrogation, and when deciding to repeat steps in the EDP).
Systemic pension reforms	No specific provision.	• These are treated like an 'ORF', but under strict conditions also with a role in abrogation. • Consideration to the net cost of the reform will be given regressively for the initial five years after a MS has introduced the reform (or five years after 2004).
Increasing the focus on debt and sustainability	No specific provision.	• The debt criterion, and in particular the concept of a debt ratio 'sufficiently diminishing and approaching the reference value at a satisfactory pace' will be applied in qualitative terms. • The Council will formulate recommendations on the debt dynamics in its opinions on the stability and convergence programmes.
Extending deadlines for taking effective action and measures		Deadlines are extended: • for a decision under 104(6) – from 3 to 4 months after notification; • for taking effective action following 104(7) - from 4 to 6 months; • for moving to 104(9) – from 1 to 2 months; • for taking action following a notice under 104(9) – from 2 to 4 months.
Minimum fiscal effort	No specific provision.	Countries in excessive deficit are required to achieve a minimum fiscal effort of at least 0.5 % of GDP as a benchmark.
Initial deadline for correcting the excessive deficit	The excessive deficit has to be corrected in the year following its identification, unless there are '*special circumstances*'.	The rule remains; possible extension by one year based on '*ORF*' and on the condition that minimum fiscal efforts have been taken.
Repetition of steps in the EDP	Not foreseen.	Deadlines for correcting the ED can be extended if: • effective action has been taken by the MS concerned in compliance with the initial recommendation or notice, and • unexpected adverse economic events with major unfavourable budgetary effects occur during the correction phase.

Source: Commission services.

Definition of excessive deficits

The definition of *excessive deficit* is unchanged. The Maastricht criteria continue to be 3% deficit and 60% debt. A breach of the limit will also still trigger a warning of the European Commission followed by detailed recommendations on how and when the deficit is to be reduced. Ultimately the Member State may be fined (although this has never happened).

Severe economic downturn redefined

In order to reformulate the exceptionality clause more in line with the economic reality in the EU Member States, the conditions of severe economic downturn are now less demanding and defined as "an excess over the reference value which results from a negative growth rate or from the output loss accumulated during a protracted period of very low growth relative to potential growth".

Other relevant factors - all expenditures are not the same

The revised Pact has introduced an element of flexibility in the mechanism to be applied when assessing the compliance or otherwise with the relevant criteria, by introducing a number of new parameters into the picture.

The revised Pact acknowledges that not all expenditures are identical, even though all expenditures contribute to a potential excessive deficit situation. In particular it is relevant to distinguish between recurrent expenditure of an administrative nature and expenditure which prepares for the future, and which therefore should result in future receipts or savings. It could be said that a reference to "quality" has been introduced when assessing the expenditures. This new aspect will be taken into account by DG ECFIN when analysing compliance with the Maastricht criteria.

Article 3 of Council Regulation 1056/2005 reads in this aspect:

"The Commission, when preparing a report under Article 104(3) of the Treaty shall take into account all relevant factors as indicated in that Article. The report shall appropriately reflect developments in the medium term economic position (in particular potential growth, prevailing cyclical conditions, the implementation of policies in the context of the Lisbon agenda and policies to foster research and development and innovation) and developments in the medium-term budgetary position (in particular, fiscal consolidation efforts in "good times", debt sustainability, public investment and the overall quality of public finances). Furthermore, the Commission shall give due consideration to any other factors which, in the opinion of the Member State concerned, are relevant in order to comprehensively assess in qualitative terms the excess over the reference value and which the Member State has put forward to the Commission and to the Council. In that context, special consideration shall be given to budgetary efforts towards increasing or maintaining high level financial contributions to fostering international solidarity and to achieving European policy goals, notably the unification of Europe if it has a detrimental effect on the growth and fiscal burden of a Member State. A balanced overall assessment shall encompass all these factors."

Other relevant factors 2 – systematic pension reforms

Pension reforms are also treated as "other relevant factors" in the revised SGP and Article 5 of the Council Regulation 1056/2005 reads: "The Commission and the Council, in all budgetary assessments in the framework of the excessive deficit procedure, shall give due consideration to the implementation of pension reforms introducing a multi-pillar system that includes a mandatory, fully funded pillar".

When assessing whether the excessive deficit has been corrected, the Commission and the Council will compare the developments of the nominal deficit figures under the EDP with the net costs related to the implementation of the second pillar. Over the first five years after the implementation of such a reform, and following a regressive distribution, the deficit figures can be corrected for the net costs of the pension reforms. The correction will be for 100% of the net costs in the first year, for 80% in the second year, and for 60%, 40%, and 20% in the third, fourth and fifth years. For Member States that have already implemented such reforms, the same five-year mechanism would apply, starting in 2005.

While these provisions are generally designed to provide further incentives for increasing the long-term sustainability of pension systems, they pertain particularly to a number of new Member States (like Poland, Slovakia and Latvia), which have recently started with the build-up of a fully funded second pillar. While most of these countries are currently in EDP, a certain proportion of the excessive deficit is attributable to the pension reform. Thus, the agreement reached by the Council on the treatment of second-pillar pension reforms in the EDP may have implications for the assessment of fiscal convergence in line with the deficit criteria laid down in the Treaty for deciding on membership in the euro-zone.

Increased debt focus

The revised Pact also implies increased focus on debt and sustainability. Countries must increase efforts to reduce government debt below 60% of GDP at a satisfactory pace, and the higher the debt to GDP ratios of Member States, the greater the effort should be to reduce the rate. For countries in which the debt ratio is above the reference value, the Council will formulate recommendations on debt dynamics in its opinions on the Stability and Convergence Programmes.

Extended deadlines

The deadlines for the excessive deficit procedure have been changed (extended) in the revised Pact. The Council shall decide on the existence of an excessive deficit within four months of the reporting dates (EDP notifications 1 April or 1 October) compared to three months before. The Member States will then be given 6 months maximum to take effective actions (that used to be four months in the old Pact). The excessive deficit should be corrected in the year following the identification, unless there are special circumstances. In this case it can be extended one additional year, which is also a change compared to the old Pact. The deadline may even be revised if unexpected adverse economic events with major unfavorable budgetary effects occur. Longer deadlines can also be set for new and future Member States, i.e. in the case of Member States being placed in excessive deficit immediately following their accession. The extended deadlines can be seen as part of the flexibility element, in particular by introducing the new element of "special circumstances". It is also meant to stimulate countries to take effective and permanent actions rather than to rely on one-off measures.

9.3 Implications for the Commission: DG ECFIN and Eurostat

The revised SGP has quite substantial implications for the work of the Commission and in particular DG ECFIN. However, Eurostat's role has not been very affected. Below follow some considerations on the impact of the changes in the corrective arm of the SGP.

Other relevant factors

In case of a country being close to, or over 3%, DG ECFIN has to undertake a detailed analysis of all expenditures to see whether they fall into the categories stated in Article 3 of Regulation 1056/05. This requires access to, and analysis of, detailed data on expenditure. Today countries provide annual expenditure data to Eurostat via the ESA95 transmission programme (table 11 - expenditure by general government and by function). Only the most aggregated level "first level" is compulsory today. Last year Eurostat initiated a project on COFOG "second level" data, involving the creating of a taskforce, in order to have more disaggregated data. The work is ongoing and supported by DG ECFIN and the *European Policy Committee Working Group on Quality of Public Finances.* Several Member States have made a big effort to deliver second level data and during a transitional period the focus will be to make all Member States provide the items particularly important for the SGP like expenditure on research and development and education. Public expenditure in the pension systems/reform are also important and must be given special attention in the analysis.

The effect on Eurostat's direct EDP work is actually minor. Eurostat will continue its main activity trying to evaluate whether the figures as reported by Member States on deficit and debt levels are correct or not. In the case of deficit data, Eurostat will assess whether B.9 (net lending/net borrowing) reported by Member States is coherent with national accounts concepts and rules. None of the government expenditures previously included in the calculation of the deficit have been excluded and three percent will still be the limit above which the Commission would potentially open an excessive deficit procedure. The analysis of "other important factors" comes at a later stage when DG ECFIN is assessing the countries being close to or over 3%.

As mentioned in the presentation on the changes, “The MTO should be differentiated between countries on the basis of their debt ratio and be net of one-off and temporary measures”. Although DG ECFIN is the main actor in this field, Eurostat may be involved to assess the accounting effects of such one-off and temporary operations, for example concerning the time of recording.

Apart from COFOG data there is also an increased demand for Eurostat data in general. The point on the "implementation of policies in the context of the Lisbon agenda" will require better employment statistics. The policies to "foster Research and Development and innovation" require data in this area. This constitutes a problem as COFOG second level data (as mentioned above), are today only delivered by a few countries, and the data compiled by other departments of Eurostat do not follow the same methodology as COFOG.

Conclusions

As it can be seen from the above analysis, a range of important changes have been introduced in the revised Pact. The main feature is continued fiscal stability, but the diverse economies of the Member States are also taken into consideration. It also stimulates structural reforms like pension reforms and long-term investments by excluding some type of expenditures in the assessment. Particular importance has been given to expenditures originating from research and development, education, public investments, debt reduction, pension reforms, achieving European policy goals and fostering international solidarity, when assessing the fulfilment of the Maastricht criteria. In parallel to the flexibility elements above, longer deadlines for correction of the deficit have also been introduced. The effect on Eurostat's work in the revised SGP is however minor.

9.4 The revision of Regulation 3605/93 on the application of the Protocol of the Excessive Deficit Procedure

Whereas the effect on Eurostat of the revised SGP is small, the analysis below shows that the revised Council Regulation 3605/93 has far-reaching effects on Eurostat work.

In the context of the revision of the SGP, and in particular after the Greek case, an intensive debate started not only on the rules underpinning the SGP but on the quality of the data reported by Member States, the independence and reliability of the National Statistical Institutes and last but not least, the role of Eurostat. As reported in the chapter on Greece, the question *How could this happen?* was asked by surprised observers.

The process towards acting against countries not fully implementing the ESA95 rules did however start seriously before the Greece case. Already in June 2004, the ECOFIN Council acknowledged deficiencies in the compilation and reporting of fiscal statistics, and in particular their vulnerability to political and electoral cycles[1] . After having noted that "*reliable statistics are essential for the credibility of the excessive deficit procedure"* it invited the European Commission *"to strengthen the monitoring of the quality of the reported fiscal data and to report back to the Council before the end of 2004'*". It also invited the Commission to make, by June 2005, a proposal for the development of "*minimum European standards for the institutional set-up of statistical authorities"… …which reinforce the independence, integrity and accountability of the Member States' national statistical institutes. These standards should also help to address the specific concern on the quality of fiscal statistics"*.

The European Commission adopted on 3 September 2004 a communication on *Strengthening economic governance and clarifying the implementation of the Stability and Growth Pact*[2]. The communication suggested possible improvements to the enforcement of the EU fiscal framework and announced that it was going to prepare minimum standards for the institutional set-up of statistical authorities. The intention was again communicated by Commissioner Almunia in a press conference on 23 September on the Greek fiscal notification of September 2004. On 1 December 2004 the Commission adopted the Eurostat report on Greece and finally on 22 December 2004 the Commission defined a strategy to improve the quality of fiscal statistics[3].

If the revision of the SGP originated mainly from the German and French affairs (with the Greek case contributing at the end), the quite substantial revision of Regulation 3605/93 mainly originated from the Greek case. The Commission had been put under enormous pressure during several months already due to the substantial revisions of data by some Member States and when the extent of the Greek case became fully known, it was clear that something had to be done. The Commission had to present strong actions in order to avoid losing face.

9.4.1 The initial proposal by the Commission

The proposal presented by the Commission on the 22 December 2004 defined the strategy to improve the governance of the European system of fiscal statistics and consisted of three lines of action:

- Building up the legislative framework
- Improving the operational capacities of Eurostat and DG ECFIN and
- Establishing European standards on the independence of national statistical institutes.

[1] Communication of the Commission to the Council and the European Parliament on the need and means to update the quality of budgetary statistics (COM(2002)670 final
[2] COM (2004) 581 final
[3] Commission IP/04/1530

If the last point was already on the table since June the same year, the first two ones were "new" and partly quite controversial. We will soon see why.

Building up the legislative framework:
The Commission says in its Communication from 22 December: *As the law stands the Commission does not have the right to monitor public accounts directly, much less to compile the data in the stead of Member States… …insofar as Eurostat, as a statistical authority, must be able to actually verify the figures provided, there is a need to supplement the current provisions with an instrument which would consolidate the following aspects: The recognition of audits on the basis of documents consisting of a right for the Commission to directly examine public accounts…the establishment of the on-the-spot checks consisting of verification missions… … precisely defining exceptions to confidentiality… …the rules under which these checks are to operate*;

Improving the operational capacities of Eurostat and DG ECFIN
The Commission communication from 22 December reads: *Eurostat operational capacity has to be addressed… … this will include the following: systematic planning of verification missions in addition to the missions which are currently carried out… …mobilization of all existing expertise which already exists in the Member States… … budgetary support for the goal of reinforcing and making systematic the checks on the accounts of national public administrations.*

The first proposal on giving Eurostat legal auditing rights was met with suspicion by many Member States, which did not appreciate the possibility of being accused of cheating or not being trustable. The British said "The solution to a particular problem in Greece should not be the uprooting of national statistical bodies which have proven credibility with the markets"[1]. The Germans and Austrians expressed similar views, in the Council and in the press. Even delegates at Eurostat's Financial Accounts Working Group (FAWP) expressed the unpleasant feeling of collective punishment. A long discussion and negotiations followed and the Commission proposal was not endorsed by the Council until November 2005, and the new Regulation was adopted on 22 December 2005 only, exactly one year after the Commission proposal. The final decision differed from the initial proposal as will be seen below, and the main controversial issue was the audit missions proposed.

As far as the proposed increased operational capacity is concerned, much can be said. When the Greek report came out, the press focused quite a lot on the staffing of the unit responsible for the work on the excessive deficit in Eurostat. The Commissioner and the Director-General were quite optimistic in their statements on the number of officials directly involved in the EDP work, when asked by the journalists at the first press conference, and the figure given at that time ("une vingtaine des functionnaires") continued to be the official truth for a long time (even if anyone with access to the internet could easily have disputed the number). But, as a result finally both DG ECFIN and Eurostat have been allocated additional posts in spite of the ever shrinking EU budget for administration. However, as the EDP domain is considered (among) the most complex of all statistical domains and additionally is put under high political pressure, new officials cannot easily be recruited. The special audit unit, which was created at Eurostat as an immediate outcome of the Greek case, stayed undermanned for some

[1] The Guardian 2004, Row over powers for EU statistics, 21 October

time while waiting for allocation of posts and the final outcome of the amended Council Regulation 3605/93.

Establishing European standards on the independence of national statistical institutes

This action covers all statistics and not only fiscal data. On 24 February 2005 the Statistical Programme Committee (the SPC), including all Directors-General of the national statistical institutes, unanimously adopted a European Statistics Code of Practice. This Code of Practice includes 15 principles ranging from professional independence of data compliers, statistical confidentiality, impartiality and objectivity, accuracy, reliability and timeliness of data to adequacy of resources of statistical institutes. Three months later the Commission endorsed this code, recommending that Member States recognize it as a common set of standards at the European level for statistical authorities, and set up a reporting system to monitor adherence with the European Statistical System[1].

9.4.2 The content of Regulation 2103/2005 as regards the quality of statistical data in the context of the excessive deficit procedure

The content of Regulation 3605/93 was explained in detail in chapters 3 and 4 and therefore this chapter will only raise the most important changes in the amended Regulation and in particular the consequences for the work of Eurostat. The new Regulation incorporates also several elements previously included in *the Code of Best Practice on the compilation and reporting of data in the context of the excessive deficit procedure* from 2003.

Schedule of reporting

The reporting dates have been changed from 1 March and 1 September, to 1 April and 1 October, in order to ensure consistency with the deadlines for the ESA95 transmission programme and other government related legislation.

Publicity

Member States shall make public the data reported to the Commission. This is a new requirement, as apart from the Eurostat press release on deficit and debt (and the recent publication of the notification tables by DG ECFIN shortly after the press release), these data were previously not public.

Inventories

The EDP inventories, as mentioned in chapter 5, will now have to be made public. They will also constitute an essential element in the assessment by Eurostat on the quality of data.

Treatment of complex methodological request

This is an area where the rules have been formalized, demanding written requests from the Member States on all accounting questions. E-mail requests directed to the official responsible at Eurostat will in principle not be accepted, but a note should be sent to the

[1] COM (2005) 217

Director of national accounts at Eurostat. The request may also lead to CMFB consultations as described in chapter 5.5. The rules for consultations have not changed though.

<u>Provision of deficit and debt figures</u>

Eurostat must provide the actual government deficit and debt data (that is publish the EDP press release) within three weeks of the reporting deadline.

<u>Questionnaires related to the notification tables</u>

Eurostat shall send out so called pre-notification questionnaires to Member States after consultation of the CMFB. It will no longer be allowed to send ad-hoc questions without consulting the CMFB as was the practice in the past.

<u>Reservations on the quality of data and amendments</u>

In case Eurostat cannot give a reasonable assurance on the quality of data, Eurostat may publicly express reservations when publishing the data (so called footnotes in the press release). The assessment criteria are specified in the Regulation and are identified as checking compliance with the accounting rules, completeness, reliability, timeliness and consistency.

In the case of reservations in the press release, the Member State concerned and the President of the EFC will be informed no later than three working days before the publication date.

<u>Process improvement plan</u>

In case Eurostat express reservations according to above, it will have to launch an improvement plan. A methodological visit will be organized before the reservation can be removed.

<u>Missions</u>

Whereas Regulation 3605/93 does not mention missions at all, the Code of Best Practice on the compilation and reporting of data in the context of the excessive deficit procedure (see chapter 4.2) states that countries should be visited at least every second year. However, with the new Regulation, the missions now have a legal basis and a more prominent role, which does not come as a surprise as the possibility for Eurostat to check more carefully national data in missions was one of the reasons for the revised Regulation in the first place. The Regulation talks about dialogue and methodological missions. Dialogue visits refer to the missions Eurostat has undertaken for over ten years, and which are described in chapter 4. In principle these will not change. What is new in this context is that the reports (or a summary version including main findings) shall be made public after being agreed with the Member States.

Additionally the Regulation talks about possible methodological visits *"enhancing the monitoring of the reported data"... ... Methodological visits should only be undertaken in cases where the Commission (Eurostat) identifies substantial risks or potential problems with the quality of the data, especially when it relates to the methods, concepts and classifications applied to the data, which Member States are obliged to report"*

This text should be read against the initial proposal and it is clear that what was initially thought of as being long ”two weeks” missions have been reduced to very specific and short missions. The current interpretation is that the missions should be undertaken with the aim at being part of the follow-up of a working programme, with the objective to lift as promptly as possible a reservation identified in the data assessment (see reservations in the press release above).

9.4.3 Conclusions

To conclude, the revised Council Regulation implies substantial changes in the work of the Member States and Eurostat. The Commission assessment on the application of the Code of Best Practice on the compilation and reporting of data in the context of the Excessive Deficit Procedure reads *"In essence, the Regulation is about securing from a legal point of view existing good practices (as laid down in the Code of Best Practice) aiming at a more systematic approach for the dialogue with Member States, and bringing more transparency and accountability to the whole process through the publication of the data reported by Member States, the inventories, and the mission reports"*. The Commission declaration above encompasses very well the spirit of the revised Regulation and it can only be added here that the Regulation clearly increases the importance and role of Eurostat in the assessment of data provided by Member States, while at the same time increasing the pressure and focus on its work.

9.5 The future of the Stability and Growth Pact – some thoughts

Will it survive?

If the answer to this question should have been presented one year ago, at the beginning of the study, the reply would have been "probably not". As described earlier in this chapter, the political pressure, developments in Member States and in particular Germany and France, the revision of the Greek data, statements by the Commission and the Council etc., all pointed in one direction: The SGP and its supporting legislation needed a thorough overview. In fact, this process of change was rather advanced already in the beginning of 2005, but there was uncertainty about the final outcome.

In parallel, the discussions on the independence of the Statistical Institutes, on the accountability of Eurostat, the quality of data provided by Member States etc. pointed in the same direction: A revision of the overall legal framework was necessary.

One year later we have a revised SGP and even a revised Regulation 3605/93 and it is of course too early to say whether it will really work. Two approaches can be used when discussing the future of the Pact; the content of the Pact itself or the political reality surrounding it.

There are several elements in the revised Pact improving the quality of the EU budgetary framework. The new rules allow greater flexibility in dealing with special circumstances and country-specific problems. However, flexibility will remain bound by the provision that any excess over three percent remains temporary and limited, and no category of spending is excluded from the definition of the deficit.

The new steps toward increased transparency, especially in the context of the revised regulation 3605/93, will hopefully reinforce the rules. The emphasis on long-term sustainability makes the fiscal rules more useful.

On the other hand, the extended deadlines for corrections are more flexible, which might be risky if they are moved forward several times, due to good or bad reasons. There are also elements of technical complexity in the revised rules, such as the quality of public finances, the temporary measures and the cost for some expenditure like European integration etc. Some of these issues were already mentioned in the context of the changed role of DG ECFIN.

Even if the changes mentioned above have improved the quality and probably the functioning of the Pact, the economic and political reality, which will impact the results more than the content of the Pact, is unchanged. Starting from the element leading to the revision of the Pact in the first place, the cases of Germany and France, it is clear that the success of the reform will depend on how effectively the rules are implemented in the coming years and what actual efforts will be made by Member States to curtail fiscal imbalances; Will the big Member States continue to ignore the 3 percent rule and its consequences? Will more countries use possibilities like the new element of "other relevant factors" etc? Or will they take the political risk to undertake forceful structural adjustments in their economies? Will the new Member States strive for EMU membership or will they find the price for joining too high? Will countries continue to abide to one-off operations instead of long-term reforms? Will the Council have the courage to actually impose fines on Member States? Will the economy of the euro-zone continue to be sluggish or will growth and employment take off? Will countries have the strength to prepare for bad times during good times? Will the electoral manipulation of fiscal policy continue? There are many questions, all playing an important role in the future life of the SGP, and to which an answer cannot be provided today.

In general I think that the new Pact has a better chance to survive now due to the new elements of flexibility, allowing the shift from the full focus on one single figure, as was the case in the past. As stated in the final paragraph on the chapter on Greece, the Commission and Member States realised that when so much (the respect of the Stability and Growth Pact and possible sanctions) depends on so little (one single figure being under the three percent threshold) the inducements to start tampering with this figure, as well as possible rewards obtained from doing it, are substantial. The revised pact has decreased the risk of such behaviour by being more flexible, long-term focused and by adapting to national situations. On the other hand, as the list of actual and potential sinners gets longer and longer, one can safely predict that the Pact will remain at the core of the policy debate in Europe and there will be new proposals for reforms coming up sooner or later.

10. REFERENCES

Balassone et al, 2005, *Fiscal Rules: Indicators and underlying statistical frameworks*, Bank of Italy

Banco de Portugal, 2005, *Constancio report (Relatorio da Comissao para analise da situacao orcamental)*, May, Portugal

Banco de Portugal, Instituto Nacional de Estatistica, Direccao-Geral do Orcamento do Ministerio das Financas, 2002, *Relatorio da Commissao para a analise das contas publicas,* Portugal

BBC News, 2004, *European press review*, 22 March

Begg I, Schelke W, 2004, *The Pact is dead – long live the Pact*, National institute of Economic Review 189, July, London

Bier W. et al, 2004, *Extended statistics for the support of the Stability and Growth Pact*, ECB, Frankfurt

Brown M. and Chambers A., 2005, *How Europe's government have enronized their debts*, Euromoney, September

Buti Marco and Franco Daniele, 2005, *Fiscal Policy in the Economic and Monetary Union,* Edward Elgar publishing

Couré B., Pisoni-Ferry J, 2005, *Fiscal policy in EMU: towards a sustainability and growth pact,* Bruegel Working Paper, December, Brussels

Croneborg M., 2005, *Eurons fundament omdanas*, Europaposten, Stockholm

Dagens Nyheter, 2004a*, Här är pensionens delar,* 24 May

Dagens Industri, 2004b, *Ringholm räknar med att få räkna in PPM i statsfinanserna,* 9 March

Dagens Industri, 2004c*, Sverige får inte räkna med PPM systemet i statsfinanserna*, 2 March

The Economist, 2005, *Europe's Stability Pact, a case for nationalism*, 22 January

Euroactiv, 2005, Editorial, *Creative accounting hides stability pact breaches*, 6 October

Euractiv, 2005, *How flexible should the Eurozone be*, 20 January

EFC, 2005, *Specification on the implementation of the Stability and Growth Pact*, Brussels

EFC, 2005, *Opinion on the Code of best practice and reporting of data in the context of the excessive deficit procedure*, Brussels

EFC, 2005, *Opinion on the content and format of the Stability and Convergence Programmes,* Brussels

EFC, 2002, *Opinion on the Code of best practice and reporting of data in the context of the excessive deficit procedure,* Brussels

EFC, 2001*, Opinion on the content and format of the Stability and Convergence Programmes,* Brussels

EFC, 1998*, Opinion on the content and format of the Stability and Convergence Programmes,* Brussels

Financial Times, 2003, *Eurostat's new rules on securitization operations*, 6 July

European Commission, 2002-2005, *Stability programmes*, Brussels

European Commission, 2002-2005, *Convergence Programmes*, Brussels

European Commission, 2005, *Administrative arrangements in relation to draft Council Regulation amending Regulation 3605/93 as regards the quality of the data in the context of the excessive deficit procedure*, 18 October

European Commission, 2005, *One-off and temporary measures,* 14 October

European Commission, 2005, *Report from the Commission, Portugal, Report prepared in accordance with Article 104(3) of the Treaty*, SEC (2005) 838, 22 June

European Commission, 2005, *Stability and growth pact: Commission proposes to amend underlying regulations*, IP/05/449, Brussels

European Commission, 2005, COM (2005)217 *Communication from the Commission to the European Parliament and to the European Council on the recommendation on the independence, integrity and accountability of the national and Community Statistical Authorities*, Brussels

European Commission, 2005, *Stability and Growth Pact reform: European Commission welcomes agreement on new regulations*, The Press release IP/05/798, Brussels

European Commission, 2005, *New Member States must speed up practical preparation for successful changeover to the euro, report shows*, Press release IP/05/1371, Brussels

European Commission, 2005, *November 2004 update of the convergence programme of Sweden (2004-2007), An assessment,* 25 January 2005

European Commission, 2005, Directorate General for Economic and Financial affairs, 2005, *Public Finances in EMU 2005, No 3/2005,* Brussels: European Communities

European Commission, 2004, SEC 1630 – *communication from the Commission to the Council. The action taken by the Czech Republic, Cyprus, Malta, Poland and Slovakia in response to the Council recommendations under the excessive deficit procedure*, Brussels

European Commission, 2004, Press release IP/04/530, Brussels

European Commission, 2004, *strengthening economic governance and clarifying the implementation of the Stability and Growth Pact*, 3 September

European Commission, 2004, Directorate General for Economic and Financial affairs, 2004, *Public Finances in EMU 2004, No 3/2004,* Brussels

European Commission, 2003, Directorate General for Economic and Financial affairs, 2003, *Public Finances in EMU 2003*, No 3/2003, Brussels

European Commission, 2003, *Code of Best Practice on the compilation and reporting of data in the context of the excessive deficit procedure*, Brussels, 18 February

European Commission, 2002, *Commission Regulation 351/2002 amending Regulation 3605/93 as regards references to ESA95*, 25 February

European Communities, 1992, Maastricht Treaty

European Communities, 1973, *Treaties establishing the European Communities*, Luxembourg

European Council, 2005, *Council Regulation 2103/05 amending Regulation 3605/93 as regards the quality of statistical data in the context of the excessive deficit procedure,* 12 December, Brussels

European Council, 2005, *Council Regulation 1055/05 amending Regulation 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure*, 27 June, Brussels

European Council, 2005, *Council Regulation 1056/05 amending Regulation 1466/97 on the strengthening of surveillance of budgetary positions and the surveillance and coordination of economic policies*, 27 June, Brussels

European Council, 2005, *Presidency Conclusions*, 22-23 March

European Council 2005, *Council opinion on the updated Convergence Programme of Sweden*, 18 January, Brussels

European Council: 2003, *Opinion on the code of best practice on the compilation and reporting of data in the context of the excessive deficit procedure*, Brussels 12 February

European Council, 2000, *Council Regulation 2516/2000 on the recording of taxes and social contributions*, 7 November, Brussels

European Council, 2000, *Council Regulation 475/2000 amending Regulation 3605/93*, 28 February, Brussels

European Council, 1997, *Council Regulation 1466/97 on the strengthening of surveillance of budgetary positions and the surveillance and coordination of economic policies,* Brussels

European Council, 1997, *Council Regulation 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure,* Brussels

European Council: 1997 *Resolution of the European Council on the Stability and Growth Pact*, 17 June 1997, Amsterdam

European Council, 1993, *Council Regulation 3605/93 on the application of the Protocol on the excessive deficit procedure annexed to the Treaty establishing the European Community*, 22 November, Brussels

European Union, 1992, *Protocol on the excessive deficit procedure to the high contacting partners,* Brussels

Eurostat 2006, *First provision of deficit and debt data for 2005*, Eurostat press release 48/2006, Luxembourg

Eurostat 2005, *Provision of deficit and debt data for 2005*, Eurostat press release 120/2005, 26 September, Luxembourg

Eurostat, 2005, *The treatment of transfers from the EU budget to the Member States*, Press release 22/2005, 15 February, Luxembourg

Eurostat, 2004, *Treatment of Public-Private-Partnerships*, Press release 18/2004, 11 February, Luxembourg

Eurostat, 2004, *Classification of funded pensions schemes in case of government responsibility or guarantee*, Press release 30/2004, 2 March, Luxembourg

Eurostat 2004, *Report by Eurostat on the revision of the Greek government deficit and debt figures,* 22 November, Luxembourg

Eurostat, 2003, *Payments to government by public corporations in the context of the transfer to government of their unfunded pensions obligations*, Press release 120/2003, 21 October

Eurostat, 2003, *Capital injections by government units into public corporations*, Press release 98/2003, Luxembourg

Eurostat 2002, *Second notification of deficit and debt data for 2001*, Eurostat press release 116/2002, 30 September

Eurostat 2002, *Securitisation operations undertaken by general government*, Press release 80/2002, 3 July

Eurostat, 2002, *ESA95 Manual on government deficit and debt including all subsequent chapters,* Luxembourg

Eurostat, 2000, *A guide to the Co-decision procedure*, Luxembourg

Eurostat, 2000, *ESA95 Manual on government deficit and debt*, 2000*,* Luxembourg*,*
,

Eurostat, 1996, *European System of National and Regional accounts*, Luxembourg

Expressen, 2006, *Letter to the editor*, 19 January

Haagard Jensen T. and Kjaergaard Larsen J, 2004, *The Stability and Growth Pact- status in 2004*, Denmark

Von Hagen and Wolff, 2004, *What do deficits tell us about debt? Empirical evidence on creative accounting with fiscal rules in the EU*, Deutsche Bank, Germany

Financial Times, 2005, *Juncker achieves small miracle as deal rewritten*, 22 May

The Guardian, 2004, *Row over powers for EU statistics,* 21October

ISTAT, 2005, *Conti Economici Nazionali anni 2001-2004,* Communicato Stampa, 1 March 2005, Italy

ISTAT, 2005, *Revisioni delle stime dell'indebitamenti netto delle amministrazioni pubbliche per gli anni 2000-2004*, Nota per la stampa, 24 May 2005, Italy

Laliberte Lucie, 2004, *The relationship between macroeconomic statistics guidelines and accounting standards*, IMF

Le canard enchaine, 2006, *Breton a dopé les recettes de 12 milliards pour rester dans les clous de Bruxelles*, 25 January

Ljung Bengt, 2004, Ringholm: *Bearbetar Eurostat for att behalla PPM:s inom Offentliga finanser,* Nyhetsbyran Direkt, 11 September

Ljung Bengt, 2004, *Ringholm I PPM-kamp med EU*, Nyhetsbyran Direkt, 13 September

Mc Coy D., 2004, *The SGP, the case for reform*, The Economic and Social Research Institute, Ireland

Milesi-Ferretti 2001, *Good, bad or ugly? On the effects of fiscal rules with creative accounting*

Monetary Committee of the European Communities, 1991, *Report by the alternates on the excessive deficit procedure*, 12 April, Brussels

Parker Georg, 2005, *Germany wins compromise on EU deficit limits*, Financial Times, 21 March

Rostokowski J., 2004, *the SGP – essential and unfeasible,* Center for Social and Economic Research, April, Warsaw

Regeringskansliet, MoF, *Update of Sweden's convergence programme*, November 2004, Sweden

Savage, 2005, *Making the EMU*, Oxford University Press

Standard and Poor's, 2004, *Republic of Italy LT ratings lowered to AA – on weak public finances; outlook and stable,* RatingsDirect, 7 July

Times online, 2005, *French Minister accused of trickery over budget*, 19 October

Websites

DG ECFIN
http://europa.eu.int/comm/economy_finance

EUROSTAT
http://europa.eu.int/comm/eurostat

Notification tables for Sweden, April 2006 :
http://epp.eurostat.ec.europa.eu/pls/portal/docs/PAGE/PGP_DS_GFS/PGE_DS_GFS_3/SE_MAR06.PDF