MGDD Progression Comparison with SNA and ESA

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MGDD Progression Comparison with SNA and ESA: Introduction

This packet provides a comparative overview of the three primary manuals governing the compilation and reporting of national accounts statistics for EU member countries, and highlighting important inconsistencies between the MGDD and underlying SNA and ESA documents.

1. **MGDD:** *Manual on Government Deficit and Debt: Implementation of ESA 2010* published regularly by Eurostat. First published in 1999, the MGDD "provides guidance on the appropriate treatment of statistical issues raised in the European Union regarding government financial statistics. It is an indispensable complement to ESA 2010 and an important tool for statisticians and specialists dealing with public finance issues. It also helps to better understand the methodology applied to government finance data for the EDP [the EU's Excessive Deficit Procedure defined in the Maastricht Treaty]."

2. **SNA:** *System of National Accounts, 2008* published jointly by the EC, IMF, OECD, UN, and WB. SNA is a "statistical framework that provides a comprehensive, consistent and flexible set of macroeconomic accounts for policymaking, analysis and research purposes." The SNA is considered the international standard for all countries to report national accounts, "facilitating the integration of these statistical systems to achieve consistency with national accounts."

3. **ESA:** *European System of Accounts (ESA 2010)* published by Eurostat. The European System of National and Regional Accounts is a legally mandated, internationally compatible statistical reporting framework for EU member states to provide a "systematic and detailed description of a total economy." ESA 2010 is "broadly consistent with" SNA 2008 in "definitions, accounting rules and classifications," but "incorporates certain differences, particularly in its presentation, which is more in line with its specific use within" the EU.

MGDD Inconsistencies Timeline

SN	Date	Event
1.	May 2002	MGDD 2002 published. Accurately reflects that ESA93 and SNA95 provide very little guidance on debt reshedulings, concessionary loans, and related transfers ("Relevant Topics"). Bart Meganck, Director listed in Preface.
2.	Dec 2009	SNA 2008 published.
3.	Oct 2010	MGDD 2010 published. First edition since MGDD 2002. Omits mentioning new SNA 2008 guidance consistent with Ipsas on Relevant Topics exists; continues to cite SNA93. François Lequiller, Director listed in Preface.
4.	Mar 2012	MGDD 2012 published. No change from MGDD 2010. Again omits mentioning new SNA 2008 guidance consistent with Ipsas on Relevant Topics exists; continues to cite SNA93. François Lequiller, Director listed in Preface.
5.	Apr 2013	ESA 2010 published.
6.	Nov 2013	MGDD 2013 published. Significant inconsistencies and omissions with regard to SNA 2008 and ESA 2010, which provide guidance consistent with Ipsas on Relevant Topics. François Lequiller, Director listed in Preface.

MGDD vs. SNA: Three Inconsistencies

Debt Rescheduling:
MGDD 2013 (published 11/2013) Comment on SNA 2008: Regarding rescheduling of a loan, notes that topic is mentioned, “but in a rather descriptive way only in 20.107 (b)…whereas there is no mention of a possible capital transfer.” 1

2

SNA 2008 (published in 12/2009) Actual Content: A new section titled “Debt reorganization” with a subsection titled “Debt rescheduling and refinancing” with five extensive points. Furthermore, there is a specific reference to a “capital transfer”

MGDD 2012 Comment on SNA 93 concludes no changes from rescheduling, which is consistent with SNA 93 (ignoring updated text in SNA 2008).

Concessional Loans: 3
MGDD 2013 (published 11/2013) Comment on SNA 2008: No comment.

SNA 2008 (published 12/2009) Actual Content: Two new points on concessional loans cite a transfer/current transfer and call for disclosure in supplementary tables, given the impact has “not been fully developed”.

MGDD 2012 Comment on SNA 93 provides little guidance, which is consistent with SNA 93.

MGDD vs. ESA: Three Inconsistencies

Debt Rescheduling:
MGDD 2013 (published 11/2013) Comment on ESA 2010: Cites "no real guideline" in ESA 2010 and mention is only made in 20.236 without specifying that the difference is in nominal terms, which according to MGDD using nominal is the correct conclusion.

1

2

ESA 2010 (published on 4/2013) Actual Content: A new section titled "Debt Operations" with several subsections including "Debt assumption and cancellation" and "Other debt restructuring". Within this section, it's quite clear that rescheduling is not in nominal value terms but is the difference in value, as defined in Chapter 5 and Debt Operations, which determines the amount of the capital transfer.

MGDD 2012 Comment on ESA 95: References standard loan valuation as not impacted by changes in market prices. No mention of ESA 95, which contains no directly relevant text.

Concessional Loans:
MGDD 2013 (published 11/2013) Comment on ESA 2010: A new low interest rate loan section (as part of public policy activities), which concludes that there is no recording of an implicit benefit.

3

ESA 2010 (published on 4/2013) Actual Content: Two new two points on concessional debt/loans which clearly cite a transfer/capital transfer, which is to be recorded as a memorandum item.

MGDD 2012 Comment on ESA 95: Indirect references consistent with indirect references.

MGDD Progression Comparison with SNA and ESA

(March and December 2012 OSIs/PSIs occurred between MGDD 2012 and 2013 publications.)

SN	Publication	Key Text: Applicable Debt Valuation Principles
1.	**MGDD 2012 and 2013**	None.
2.	**SNA 2008**	3.156 Valuation according to market-value equivalent is needed for valuing financial assets and liabilities that are not traded in financial markets or are traded only infrequently. For these assets and liabilities, it will be necessary to estimate <u>fair values</u> that, in effect, approximate market prices. The present value of future cash flows can also be used as an approximation to market prices, provided an appropriate discount rate can be used. 3.157 Market values, fair values, and nominal values should be distinguished from such notions as amortized values, face values, book values, and historic cost. a. <u>Fair value is a market-equivalent value</u>. It is defined as the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction. It thus represents an estimate of what could be obtained if the creditor had sold the financial claim.
3.	**SNA 1993**	2.68. Transactions are valued at the actual price agreed upon by the transactors. Market prices are thus the basic reference for valuation in the System. In the absence of market transactions, valuation is made according to costs incurred (non-market services produced by government) or by reference to market prices for analogous goods or services (services of owner-occupied dwellings). 2.69. Assets and liabilities are valued at current prices at the time to which the balance sheet relates, not at their original prices. Theoretically, national accounts are based on the assumption that assets and liabilities are continuously revalued at current prices, even if estimates are in fact made only periodically. The appropriate valuation basis for assets and liabilities is the price at which they might be bought in markets at the time the valuation is required. Prices observed in markets or estimated from observed market prices should preferably be used. Current prices may be approximated for balance sheet valuation in two other ways: by accumulating and revaluing transactions over time or by estimating the discounted present value of future returns expected from a given asset (see also chapter XIII).
4.	**ESA 2010**	1.94 With the exception of some variables concerning population and labour, the ESA 2010 system shows all flows and stocks in monetary terms. Flows and stocks shall be measured according to their <u>exchange value</u>, i.e. the value at which flows and stocks are in fact, or could be, exchanged for cash. <u>Market prices</u> are, thus, the ESA's reference for valuation.
5.	**ESA 1995**	1.51. With the exception of some variables concerning population and labour, the system shows all flows and stocks in monetary terms. The system does not attempt to determine the utility of flows and stocks. Instead, flows and stocks are measured according to their exchange value, i.e. the value at which flows and stocks are in fact, or could be, exchanged for cash. Market prices are thus ESA's basic reference for valuation.

SN	Publication	Key Text: Debt Rescheduling
6.	**MGDD 2013** (Published 29 Nov 2013)	**VII.3.3.2 Rescheduling of a loan** 22. There is no real guideline for treating such a case in ESA10. Mention is only made of debt restructuring in ESA10 20.236 which states the same principle related to the difference in value (without specifying that it is in nominal terms). <u>It is mentioned in SNA2008 but in a rather descriptive way indicating only in 20.107 b that it "may or may not result in a reduction in present value terms" whereas there is no mention of a possible capital transfer</u>. Therefore, this manual brings a necessary clarification and in useful practical guidance for national accountants. *[Note: MGDD contains a typo on the section reference; 20.107 b. should be 20.106 b.]*
7.	**SNA 2008** (Published Dec 2009)	Section title: Debt reorganization 22.106 b. <u>Debt rescheduling or re-financing. A change in the terms and conditions of the amount owed, which may result or not in a reduction in burden in present value terms</u>. Subsection title: Debt rescheduling and refinancing 22.109 *Debt rescheduling (or refinancing)* is an agreement to alter the terms and conditions for servicing an existing debt, usually on more favourable terms for the debtor. Debt rescheduling involves rearrangements on the same type of instrument, <u>with the same principal value and the same creditor as with the old debt</u>. Refinancing entails a different debt instrument, generally at a different value and may be with a creditor different than that from the old debt. 22.110 Under both arrangements, the debt instrument that is being rescheduled is considered to be extinguished and replaced by a new debt instrument with the new terms and conditions. <u>If there is a difference in value between the extinguished debt instrument and the new debt instrument, part is a type of debt forgiveness by government and a capital transfer is necessary to account for the difference</u>. 22.111 Debt rescheduling is a bilateral arrangement between the debtor and the creditor that constitutes a formal deferment of debt-service payments and the application of new and generally extended maturities. The new terms normally include one or more of the following elements: extending repayment periods, reductions in the contracted interest rate, adding or extending grace periods for the repayment of principal, fixing the exchange rate at favourable levels for foreign currency debt, and rescheduling the payment of arrears, if any. 22.112 The treatment for debt rescheduling is that the existing contract is extinguished and a new contract created. The applicable existing debt is recorded as being repaid and a new debt instrument (or instruments) of the same type and with the same creditor is created with the new terms and conditions. 22.113 The <u>transaction is recorded at the time both parties record the change in terms in their books, and is valued at the value of the new debt</u>.

SN	Publication	Key Text: Debt Rescheduling
8.	**MGDD 2012** (Published 19 Mar 2012)	**VII.3.3.2 Rescheduling of a loan** 29. There is no real guideline for treating such a case. Mention is only made of rescheduling of loans in 11.23 of SNA93 ("changes in claims resulting from debt rescheduling should be reflected in the financial account when the terms of the debt contract (maturity, interest rate, etc.) change [...]". Nevertheless, some conclusions may be derived from considerations stemming from financial rules and national accounts principles. 30. The main point is that a loan is a contractual arrangement. The split between repayment of the principal and payment of interest is determined in the loan contract, even for loans with floating rates, and can only be changed by contract. 31. It has particularly to be noted that a loan has no market price: see ESA95 6.51. The changes which may occur on financial markets for interest rates for similar loans has thus no direct impact on the principal outstanding of existing loans. Moreover, such changes may have no influence on the future amounts of interest, and thus no influence on the split between principal and interest.
9.	**SNA 1993**	11.23 There are a number of circumstances that may lead to reduction or cancellation, by other than normal repayment, of liabilities. These are treated in various ways in the SNA. A debtor and creditor may become parties to a bilateral agreement (often referred to as "debt forgiveness") that a financial claim no longer exists. Such an agreement gives rise in the SNA to the recording of a capital transfer payable/ receivable (recorded in the capital account at the time the debt forgiveness occurs) and the simultaneous extinction of the claim (recorded in the financial account). <u>Changes in claims resulting from debt assumption or rescheduling should be reflected in the financial account when the terms of the debt contract (maturity, interest rate, etc.) change, or when the institutional sector of the creditor or debtor changes, as these are considered new contractual arrangements</u>. However, all other changes in claims resulting from write-offs and write-downs are excluded from the financial account. Specifically, a creditor may recognize that a financial claim can no longer be collected because of bankruptcy or other factors and he may remove the claim from his balance sheet. This recognition (by the creditor) should be accounted for in the other changes in volume account. (The corresponding liability must also be removed from the balance sheet of the debtor to maintain balance in the accounts of the total economy.)... 14.51 (b) Forgiveness of the loans, where a capital transfer offsets the reduction of the debtor's liability and the position is reduced on the liability side; 14.51 (c) <u>Rescheduling of the loan, so that a new arrangement in effect replaces the old loan, with the new loan's nominal value to be the basis of valuation and a holding gain/loss recorded if the new nominal value is less than the old value</u>...

SN	Publication	Key Text: Concessional Loans
10.	**MGDD 2013** (Published 29 Nov 2013)	None.
11.	**SNA 2008** (Published Dec 2009)	22.123 Debt issued on concessional terms. There is no precise definition of concessional loans, but it is generally accepted that they occur when units lend to other units and the contractual interest rate is intentionally set below the market interest rate that would otherwise apply. The degree of concessionality can be enhanced with grace periods, frequencies of payments and a maturity period favourable to the debtor. Since the terms of a concessional loan are more favourable to the debtor than market conditions would otherwise permit, <u>concessional loans effectively include a transfer from the creditor to the debtor.</u> 22.124 <u>Loans with concessional interest rates to a foreign government could be seen as providing a current transfe</u>r equal to the difference between the actual interest and the market equivalent interest. If such a transfer were recognized, it would usually be recorded as current international cooperation, and the interest recorded would be adjusted by the same amount. However, the means of incorporating the impact within the SNA and international accounts have <u>not been fully developed</u>, although various alternatives have been advanced. Accordingly, until the appropriate treatment of concessional debt is agreed, <u>information on concessional debt should be provided in supplementary tables</u>.

SN	Publication	Key Text: Concessional Loans
12.	**MGDD 2012** (Published 19 Mar 2012)	IV.6.1.8 MDB concessional loans are characterized by a very low interest rate and long maturities with grace periods. IDA credits typically have maturities of 35 or 40 years with a 10-year grace period on repayment of principal. There is no interest charge, but credits do carry a small service charge of 0.75 percent on disbursed balances. These are not only below market interest rates, but do not even cover funding and administrative costs. IV.6.1.9 The treatment in national accounts of government injections in MDBs depends on the type of loans provided by multilateral development banks. Injections into MDB facilities whose main or sole purpose is to provide concessional loans at marginal or zero interest rate should be recorded as capital transfers, while investments in MDB facilities providing non-concessional loans should be recorded as acquisition of other equity, as set out in ESA95, paragraph 5.95 (c):...
13.	**SNA 1993**	7.42. Remuneration in kind may also include the value of the interest foregone by employers when they provide loans to employees at reduced, or even zero rates of interest for purposes of buying houses, furniture or other goods or services. Its value may be estimated as the amount the employee would have to pay if average mortgage, or consumer loan, interest rates were charged less the amount of interest actually paid. The sums involved could be large when nominal interest rates are very high because of inflation but otherwise they may be too small and too uncertain to be worth estimating.

SN	Publication	Key Text: Debt Rescheduling
14.	**MGDD 2013** (Published 29 Nov 2013)	**VII.3.3.2 Rescheduling of a loan** 22. There is no real guideline for treating such a case in ESA10. Mention is only made of debt restructuring in ESA10 20.236 which states the same principle related to the difference in value (without specifying that it is in nominal terms). It is mentioned in SNA2008 but in a rather descriptive way indicating only in 20.107 b that it "may or may not result in a reduction in present value terms" whereas there is no mention of a possible capital transfer. Therefore, this manual brings a necessary clarification and in useful practical guidance for national accountants. *[Note: MGDD contains a typo on the section reference; 20.107 b. should be 20.106 b.]*
15.	**ESA 2010** (Published 12 April 2013)	Section Title: Debt Operations Subsection Title: Debt assumption and cancellation 20.221 Debt operations can be particularly important for the general government sector, as they often serve as a means for government to provide economic aid to other units. The recording of these operations is covered in Chapter 5. The general principle for any cancellation or assumption of debt of a unit by another unit, by mutual agreement, is to recognise that there is a voluntary transfer of wealth between the two units. This means that the counterpart transaction of the liability assumed or of the claim cancelled is a capital transfer. No flow of money is usually observed, this may be characterised as a capital transfer in kind. 20.225 Debt cancellation (or debt forgiveness) is the extinction or reduction of a claim by agreement between the creditor and the debtor. The creditor records a capital transfer payable for the amount cancelled and the other unit records a capital transfer receivable. Mutual agreement is often presumed though not formally established in case of government forfeiting claims, such as in the case of student loans and lending to farmers. 20.228 When debtor governments offer to repay the debt in anticipation, at a value below the principal value which includes interest in arrears, the event leads to an entry in the capital account with an impact on the government net lending/net borrowing, as a grant by the creditor is presumed. 20.234 Write-downs and write-offs are internal accounting actions by the creditor and are often not recognised as transactions, because they are not carried out by mutual agreement... 20.236 Debt restructuring is an agreement to alter the terms and conditions for servicing an existing debt, usually on more favourable terms for the debtor. The debt instrument that is being restructured is considered to be extinguished and replaced by a new debt instrument with the new terms and conditions. If there is a difference in value between the extinguished debt instrument and the new debt instrument, it is a type of debt cancellation and a capital transfer is necessary to account for the difference. Chapter 5: 5.19 Financial transactions are recorded at transaction values, that is, the values in national currency at which the financial assets and/or liabilities involved are created, liquidated, exchanged or assumed between institutional units, on the basis of commercial considerations. 5.21 ...However, in cases where the counterpart transaction of a financial transaction is, for example, a transfer and therefore the financial transaction may be undertaken other than for purely commercial considerations, the transfer value is identified with the current market value of the financial assets and/or liabilities involved.

SN	Publication	Key Text: Debt Rescheduling
16.	**MGDD 2012** (Published 19 Mar 2012)	**VII.3.3.2 Rescheduling of a loan** 29. There is no real guideline for treating such a case. Mention is only made of rescheduling of loans in 11.23 of SNA93 ("changes in claims resulting from debt rescheduling should be reflected in the financial account when the terms of the debt contract (maturity, interest rate, etc.) change [...]". Nevertheless, some conclusions may be derived from considerations stemming from financial rules and national accounts principles. 30. The main point is that a loan is a contractual arrangement. The split between repayment of the principal and payment of interest is determined in the loan contract, even for loans with floating rates, and can only be changed by contract. 31. It has particularly to be noted that a loan has no market price: see ESA95 6.51. The changes which may occur on financial markets for interest rates for similar loans has thus no direct impact on the principal outstanding of existing loans. Moreover, such changes may have no influence on the future amounts of interest, and thus no influence on the split between principal and interest.
17.	**ESA 1995**	**Distributive transactions (no directly relevant recheduling text)** 4.165 The writing-off of debt is not a transaction between institutional units and therefore does not appear in either the capital account or the financial account of the system. If the creditor decides such a write-off, it should be recorded in the other changes in the volume of assets accounts of the creditor and the debtor. 4.27 b) [and 4.82 b)] the cancellation of the debt by mutual agreement between the government and the debtor. <u>This cancellation is treated as a capital transfer from the government to the debtor in the capital account</u>, with a simultaneous extinction of a claim in the financial account.

SN	Publication	Key Text: Concessional Loans
18.	**MGDD 2013** (Published 29 Nov 2013)	V.6.1.1 As a part of public policy activities, governments provide loans at a lower interest rate than the market rate observed at the time of loan issuance (sometimes called "concessional loans"). V.6.2.4 The ESA 2010 rules do not require to record in national accounts the implicit benefit element, i.e. the difference between the market interest rate and the interest rate contractually agreed, in order to reflect all transactions undertaken by government by reference to market conditions. As set out in ESA 2010, the amount of interest recorded on an accrual basis follows the contractual interest rate agreed at inception between the creditor and the debtor. V.6.2.5 It must be stressed that the impact on net lending/borrowing (B.9) is already reflected implicitly in national accounts as a difference between the cost of government financing and the low interest revenue from the loans granted by the government in the context of its public policy. V.6.2.6 In this context, the interest has to be recorded on the basis of the contractually agreed interest rate. Consequently, no implicit benefit for the debtor is recorded in national accounts.
19.	**ESA 2010** (Published 12 April 2013)	20.241 Debt issued on concessional terms. There is no precise definition of concessional loans, but it is generally accepted that they occur when units of the general government sector lend to other units in such a way that the contractual interest rate is intentionally set below the market interest rate that otherwise would apply. The degree of concessionality can be enhanced with grace periods, frequencies of payments, and a maturity period favourable to the debtor. Since the terms of a concessional loan are more favourable to the debtor than market conditions would otherwise permit, concessional loans effectively include a transfer from the creditor to the debtor. 20.242 Concessional loans are recorded at their nominal value just as other loans, but a capital transfer is recorded as a memorandum item at the point of loan origination equal to the difference between the contract value of the debt and its present value using a relevant market discount rate. There is no single market interest rate that should be used to measure the capital transfer. The commercial interest reference rate published by the OECD may be applicable when the loan is issued by one of its member countries. Chapter 5: 5.19 Financial transactions are recorded at transaction values, that is, the values in national currency at which the financial assets and/or liabilities involved are created, liquidated, exchanged or assumed between institutional units, on the basis of commercial considerations. 5.21 ...However, in cases where the counterpart transaction of a financial transaction is, for example, a transfer and therefore the financial transaction may be undertaken other than for purely commercial considerations, the transfer value is identified with the current market value of the financial assets and/or liabilities involved.

SN	Publication	Key Text: Concessional Loans
20.	**MGDD 2012** (Published 19 Mar 2012)	IV.6.1.8 MDB concessional loans are characterized by a very low interest rate and long maturities with grace periods. IDA credits typically have maturities of 35 or 40 years with a 10-year grace period on repayment of principal. There is no interest charge, but credits do carry a small service charge of 0.75 percent on disbursed balances. These are not only below market interest rates, but do not even cover funding and administrative costs. IV.6.1.9 The treatment in national accounts of government injections in MDBs depends on the type of loans provided by multilateral development banks. Injections into MDB facilities whose main or sole purpose is to provide concessional loans at marginal or zero interest rate should be recorded as capital transfers, while investments in MDB facilities providing non-concessional loans should be recorded as acquisition of other equity, as set out in ESA95, paragraph 5.95 (c):...
21.	**ESA 1995**	4.05.k Employee loans: remuneration in kind may also include the value of the interest foregone by employers when they provide loans to employees at reduced, or even zero, rates of interest. This value may be estimated as the amount the employee would have to pay if average mortgage (when buying houses) or consumer loans (when buying other goods and services) interest rates changed, less the amount of interest actually paid. An imputed payment from the employee is rerouted in the primary distribution of the income account back to the employer. 5.136 (Accounting Rules for Financial Transactions – Valuation) ...However, in cases where the counterpart transaction of a financial transaction is, for example, a transfer and therefore <u>the financial transaction is undertaken other than for purely commercial considerations, the transaction value is identified with the current market value of the financial asset and/or liabilities involved.</u>