NATIONAL STATISTICS OFFICE • MALTA

General Government Deficit and Debt First transmission based on ESA 2010 methodology

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1.0 Background

Following the publication of Regulation (EU) No 549/2013 of the European Parliament and of the Council of 21 May 2013, as from September, all European Union (EU) Member States are required to adopt a new methodology for the compilation of their respective national accounts time series. Through this regulation, the previous methodology, the European Systems of National and Regional Accounts (ESA 1995) has been replaced by the new methodology, ESA 2010.

Since the general government is one of the sectors making up the total national economy, the compilation of debt and deficit for this sector must follow the ESA 2010 methodology. To support the new methodology, Eurostat prepared an updated 'Manual on Government Deficit and Debt'.

On 30 September, Malta submitted its bi-annual report on the General Government Deficit and Debt, which was compiled in accordance with ESA 2010.

This note highlights the revisions to the deficit and debt brought about by the adoption of the new methodology, as well as those due to benchmark and other routine updates.

2.0. Changes due to the implementation of ESA 2010

2.1 Sector Classification

For a unit to be classified inside the general government sector, it should not be a separate unit from government, it should be an institutional unit controlled by Government and it should be a non-market unit. In ESA 1995 and ESA 2010, the <u>quantitative</u> criterion is applied to check if a publicly controlled non-financial unit is able to undertake a market activity. Based on this criterion, for a government unit to be considered as a market producer it must cover more than 50 per cent of its production costs through sales. If the unit is not a market producer, it must be classified within the general government sector.

The definition of <u>sales</u> remained unchanged in ESA 2010: it includes normal sales excluding taxes on products and including all subsidies on products. On the contrary, payments to cover an overall deficit or not linked to the volume or value of the activity are excluded (capital transfers and other subsidies on production).

The definition of <u>production costs</u> was supplemented, under ESA2010, by the addition of "net interest charges" as a measure of the "costs of borrowed capital". As also defined in ESA 1995, production costs consist of intermediate consumption, compensation of employees, consumption of fixed capital (i.e. depreciation), other taxes on production *plus*, under ESA 2010, net interest charges.

ESA 2010 gives more importance, compared to ESA 1995, to the <u>qualitative</u> aspects of the criteria used for the delimitation of the general government sector. The qualitative criteria assess the existence of real market conditions and the level of competition between producers for similar activities and the degree of freedom of choice for the consumers/users of goods and services offered by the unit. For instance, a unit is classified inside the general government sector if it sells only to government and does not compete with private producers.

Based on these new principles the NSO reclassified the following entities:

- *Malta Information Technology Agency (MITA) - failed the qualitative aspect given that it is the government's arm in the information and communication technology sector. As a result it was reclassified inside the General Government Sector for the whole time series (from 1995 onwards).*
- *Malta Freeport Corporation – on applying the new quantitative test, the ratio was below the 50 per cent threshold between 1999 and 2011 and therefore it was reclassified inside the general government sector. From 2012 onwards, Malta Freeport Corporation was classified inside the non-financial sector on account of better financial results.*

2.2 Treatment of mobile phone licences and concession fees

In ESA 1995, as a general rule, the sale of a mobile phone licence or a concession for a number of years had to be recorded as a sale of a non-financial asset, with a one-off impact on general government net borrowing/net lending on the year when the licence is allocated.

In ESA 2010, for an asset to be recognised as such, it is explicitly mentioned that "the transfer of risks and rewards results in a separate and transferable permit with a realisable value." (para. 15.28). This rule is applicable to any permits as it is also applicable for "permits to undertake specific activities" and "the benefit to the holder in excess of the value accruing to the issuer is treated as an asset if the permit holder can realise this by transferring the asset." (15.34)

In the case of a licence or a permit granted for a given period of time, such an asset would not be transferable if it is clearly stated in the contract (and, at least at inception, in an irrevocable way) that the original holder of the licence has to own it until the final maturity of the contract ("no exit"), whatever the effective use (or its extent) of the licence/permit. The holder may even be obliged to use the licence (to provide services to final users) at the risk of penalties.

Under ESA 2010, there is absolutely no doubt that licences with such a no-exit clause cannot be recorded as an asset and hence should be recorded as property income (rent: D45). Thus, there will be no "one-off" revenue entry in government accounts (price to be paid at the time of the transfer) and therefore, this amount should be spread over the life time of the licence.

In Malta's case, after analysing the contracts of the mobile phone licences and the lottery concession, it emerged that the mobile phone operators do have a transferability clause inserted in their contract but this is not the case for the lottery concession. The 2012 agreement does not bestow rights to the operator to assign or transfer the National Lottery license to a third party. This resulted in a revision in 2012, whereby the concession fee of €39.1 million, which was previously being recorded in full, started being accounted for on an accruals basis for the duration of the concession.

2.3 Other main changes with no impact on the deficit

2.3.1 R&D Capitalisation

Research and Development (R&D) is the creative work undertaken on a systematic basis to increase the stock of knowledge, and the use of this stock of knowledge for the purpose of discovering or developing new products, including improved versions or qualities of existing products, or discovering or developing new or more efficient process of production. With the ESA 2010, R&D expenditure is being capitalised. For own-account and non-market R&D, where sales cannot be observed, R&D output is valued as the sum of costs of production, and recorded as output for own final use.

R&D capitalisation has a neutral effect on the deficit as it is recorded as a positive impact on total revenue (increase in output for own final use) and on total expenditure (gross fixed capital formation).

2.3.2 VAT Own Resources

The change in the treatment of the VAT own resources in ESA2010 compared to ESA 1995 is:

- Under ESA 1995 the VAT-based third EU own resources, collected in Member States by general government and remitted to the Institutions of the European Union (S.212) was recorded as VAT (D.211) directly paid to the Institutions of the European Union;

- Under ESA 2010, the VAT-based third EU own resources, collected in Member States by general government and remitted to the Institutions of the European Union (S.212) is recorded as VAT (D.211) directly collected by the government. The amount collected is then transferred to the EU (D.761).

The implication is a positive (symmetric) impact on general government total revenue and total expenditure by definition neutral on net lending (+)/ net borrowing (-). Moreover, the change in methodology does not impact the tax burden.

3.0 Changes due to the benchmark and routine revision

Benchmark revisions occur as a result of new data being available to the National Statistics Office. In this respect, for the October 2014 EDP Notification there were major revisions related to the availability of audited accounts for Malta Shipyards Limited between 2004 and 2008, which also effected the 2003 calculation of the impact of the debt assumption and cancellation with regards to the restructuring in the shipyard sector.

In 2003 Government restructured the shipyards sector with the closure of the Malta Drydocks Corporation and the Malta Shipbuilding Company Limited and the creation of a new company (Malta Shipyards Limited). At that time, the restructuring of the shipyard sector through the ‘Dockyard and Shipbuilding Yard (Restructuring) Act, 2003’, accounted for €123.3 million deficit for 2003. This amount was calculated after the deduction of €11.3 million (valuation of fixed assets that were to be transferred to Malta Shipyards as a financial lease) and €19.2 million (debtors transferred to Government). Following new information recently made available to the NSO, these two deductions were reversed. Thus, the effect of the restructuring of shipyards sector in 2003 was increased to €153.8 million. Other revisions in the period 1995 to 2003 were related to the non-payment of interest expenditure to Government by the Malta Shipbuilding Company Ltd.

Malta Shipyards Limited was classified inside the General Government sector in 2008 as reported in a dedicated press information notice “The effect of the reclassification of Malta Shipyards Ltd on Malta’s Gross Domestic Product” published in May 2009. In this note NSO highlighted that audited financial statements for Malta Shipyards Limited for 2004 and onwards were not available. Now that the accounts were made available to NSO, Malta Shipyards’ data in the National Accounts for the period 2008 to 2010 has been revised.

Traditionally, routine revisions occur mainly in the second EDP Notification compared to the first EDP Notification, as by September the audited accounts for most of the local government sector and extra budgetary units are normally made available to NSO. Other minor revisions are also recorded in the Treasury Department accruals templates.

4.0 Revised Tables

Table 1. Revisions in the General Government deficit 1995-2013

€ million

Year	Deficit in ESA 1995	Change in deficit due to implementation of ESA 2010	of which:- sector classification	of which:- treatment of lottery concession fee	Change in deficit due to benchmark revisions	Change in deficit due to routine revisions	Deficit in ESA 2010
1995	112.1	1.3	1.3		-7.7		105.7
1996	253.1	1.2	1.2		-8.4		245.9
1997	250.2	-1.3	-1.3		-8.7		240.1
1998	343.2	-1.1	-1.1		-9.0		333.2
1999	260.5	4.8	4.8		-9.9		255.4
2000	235.7	2.7	2.7		-10.6		227.8
2001	264.1	7.7	7.7		-11.1		260.8
2002	253.5	1.6	1.6		-11.8		243.3
2003	414.4	0.0	0.0		18.2		432.6
2004	213.2	-0.4	-0.4		0.0		212.8
2005	142.1	-3.2	-3.2		0.0		138.9
2006	140.9	-0.2	-0.2		0.0		140.8
2007	128.4	2.2	2.2		0.0		130.5
2008	273.7	5.4	5.4		-20.9		258.2
2009	219.0	-4.5	-4.5		-10.3		204.2
2010	223.7	-5.3	-5.3		-0.8	0.2	217.9
2011	183.6	-1.3	-1.3		0.0	-0.4	182.0
2012	224.7	34.1	-2.9	37.0	0.0	4.4	263.2
2013	203.0	-6.4	-2.4	-3.9	0.0	5.3	202.0

Table 2. Revisions in the General Government debt 1995-2013

€ million

Year	Debt in ESA 1995	Change in debt due to implementation of ESA 2010	of which - sector classification	Change in debt due to routine revisions	Debt in ESA 2010
1995	1,044.9	0.0	0.0		1,044.9
1996	1,236.0	0.0	0.0		1,236.0
1997	1,582.2	0.0	0.0		1,582.2
1998	1,841.5	0.0	0.0		1,841.5
1999	2,075.0	286.0	286.0		2,361.1
2000	2,219.2	300.0	300.0		2,519.2
2001	2,483.9	307.1	307.1		2,791.0
2002	2,564.5	285.7	285.7		2,850.2
2003	3,039.2	249.3	249.3		3,288.5
2004	3,249.3	242.9	242.9		3,492.3
2005	3,355.3	254.8	254.8		3,610.1
2006	3,253.6	226.6	226.6		3,480.3
2007	3,385.1	207.1	207.1		3,592.1
2008	3,632.5	212.9	212.9		3,845.5
2009	3,962.6	199.0	199.0		4,161.5
2010	4,257.7	204.5	204.5	0.0	4,462.2
2011	4,607.3	201.8	201.8	0.0	4,809.1
2012	4,871.2	0.7	0.7	0.0	4,871.9
2013	5,243.1	0.0	0.0	-2.1	5,241.0

5.0 Changes due to the GDP

The General Government deficit and debt-to-GDP ratios were also affected by revisions to the GDP (denominator). For further information on the revisions in the GDP kindly refer to news release 195/2014 'A new Framework for National Accounts' published on 17 October 2014. This news release is available at:
http://nso.gov.mt/statdoc/document_view.aspx?id=3885&formAction=init&backUrl=%2fsite%2fpage.aspx.

Table 3.1. Revisions in the General Government deficit ratios

as a % of GDP

	2010	2011	2012	2013
Deficit in ESA 1995	3.5	2.7	3.3	2.8
Deficit in ESA 2010	3.3	2.6	3.7	2.7
Total revisions	**-0.2**	**-0.1**	**0.4**	**-0.1**
Revisions due to deficit	-0.1	0.0	0.5	0.0
Revisions due to GDP	-0.1	-0.1	-0.1	-0.1

Table 3.2. Revisions in the General Government debt ratios

as a % of GDP

	2010	2011	2012	2013
Debt in ESA 1995	66.0	68.8	70.8	73.0
Debt in ESA 2010	67.6	69.8	67.9	69.8
Total revisions	**1.6**	**0.9**	**-2.9**	**-3.2**
Revisions due to debt	3.1	2.9	0.0	0.0
Revisions due to GDP	-1.5	-2.0	-2.9	-3.2