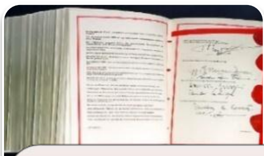
Conselho das Finanças Públicas
Portuguese Public Finance Council

Classification of one-off budgetary items

Carlos Marinheiro

7th Meeting of OECD Parliamentary Budget Officials and Independent Fiscal Institutions
Vienna, 16-17 April 2015

Some background info



1992 Maastricht Treaty
- Reference values for the deficit and public debt defined according to the national accounts standard (ESA)
- Convergence criteria

1999 €uro
- SGP enters into force
  - Emphasis on 3% deficit ceiling
  - Just 1 year to correct an excessive deficit

Governments have incentives to resort to <u>deficit decreasing one-offs</u>
- **Improve** headline & cyclically adjusted **balance**
- 'easy' measures, which **leave the government's net worth unchanged**
- imply no political cost

2005: SGP reform emphasis on:
- **Structural balance**
- Improvement in structural balance
- MTO

Focus on structural balance: *Risk of artificial improvement to structural deficit?*
- ***Critical*: Proper classification of deficit increasing one-offs**
- Goodhart's law again?

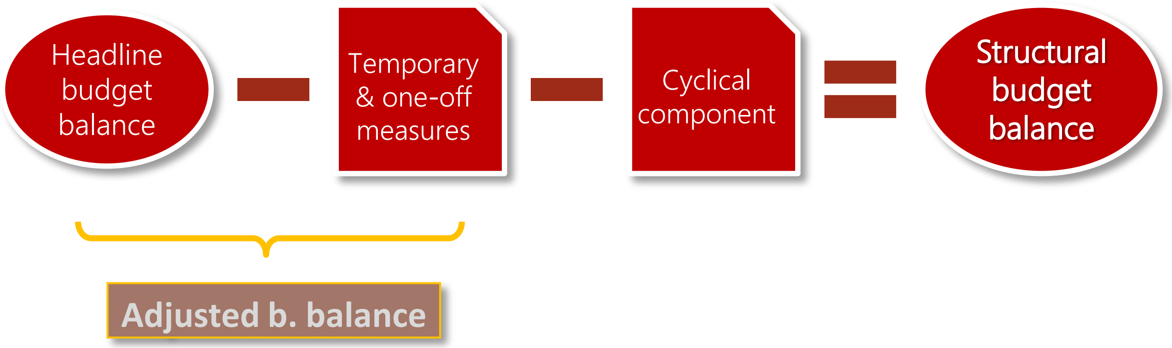
Goodhart's Law states that 'any observed statistical regularity will tend to collapse once pressure is placed upon it for control purposes'

***Central message to IFIs:* Need for absolute transparency in the classification of one-offs**

Relevance

A proper classification of one-offs and other temporary measures is essential to:

- Analyse the headline budget balance, and its evolution over time
- To compute the structural budget balance as required in the Stability and Growth Pact (SGP)
  - The medium-term objective (MTO) is defined in cyclically adjusted terms net of one-off and other temporary measures



SGP Code of Conduct definition

One-off and temporary measures are measures having a transitory budgetary effect that does not lead to a sustained change in the intertemporal budgetary position.

Footnote 3 of the Code of Conduct gives just a few examples:

- the sales of non-financial assets;
- receipts of auctions of publicly owned licenses;
- short-term emergency costs emerging from natural disasters;
- tax amnesties;
- revenues resulting from the transfers of pension obligations and assets.

Source: Specifications on the implementation of the Stability and Growth Pact and Guidelines on the format and content of Stability and Convergence Programmes, 3 September 2012

Most comprehensive European Commission's text on one-off and temporary measures: Public finances in EMU 2006

- Text presents "**an <u>indicative</u> list of types of operations that could be considered as one-off and temporary measures**" (EC, 2006).

- **Rationale for isolating temporary influences on the budget is to identify the more permanent or the underlying budgetary trends and efforts**
  - Avoid 'easy' [deficit-reducing] measures, which leave the government's net worth unchanged and imply no political cost
  - EC wanted to make sure that the "minimum structural effort", defined as a change in the structural balance, «will ensure that respect of the nominal deficit limits of the EU fiscal framework is achieved through the implementation of sustained consolidation packages rather than by the use of non permanent measures.»
  - In the past, one-off measures were on average deficit-reducing → "were used as a mean to improve the budgetary figures"
- **Yet, this text is not legally binding**

Most comprehensive EC text on one-off and temporary measures: Public finances in EMU 2006

Common features:

- **Have only a temporary influence on the headline and the cyclically-adjusted fiscal position**
  - **Their impact on the general government balance is concentrated in one or a very limited number of years**
  - Unanswered question: **How many years?** 1 to 3?
- **Such measures are non-recurrent.** When deciding whether a particular measure is non-recurrent, the measure should be assessed in the context of the chain of measures of the same type
  - For instance, although each **investment** project is unique, a specific investment decision should be seen in the context of a continuity of investment decisions over time. As a rule, such measures should therefore **not be considered** as one-off and temporary measures, **unless their size is exceptional.**

2 Principles:

1) **Only measures having a significant impact on the general government balance should be considered**
   - Unanswered question: Which threshold?
2) [*Asymmetric view*]: **As a rule no deficit-increasing measures should be excluded from the calculation of the fiscal effort.**
   - Yet, «***Exceptions** could be made in cases where there is a high degree of **certainty** on the **transitory nature of the measure** and on the fact that it will not be extended in time or repeated*.»
   - The provisions on one-off and temporary measures were primarily introduced in order to avoid that deficit-reducing one-off and temporary measures are treated as structural measures. **They should not create incentives for Member States to present some deficit-increasing operations which could have a permanent character as one-off measures.**
   - ***The exclusion of permanent deficit-increasing measures from the calculation of the fiscal effort would lead to an 'artificial' improvement of the fiscal effort, which would not reflect an improvement of the underlying fiscal position.***

Most comprehensive EC text on one-off and temporary measures: Public finances in EMU 2006

EC «Indicative and open list of one-off measures» of 2006

Deficit reducing

- **Tax amnesties** implying a one-off tax payment.
- **Sales of non-financial assets** (real estate; publicly owned licenses; and concessions)
- **Temporary legislative changes in the timing of outlays or revenues** with a positive impact on the general government balance.
- Exceptional revenues linked to the **transfer of pension obligations** [in ESA95]
- Changes in revenues or expenditure consecutive to Court or other authorities rulings.
- **Securitisation operations** with a positive impact on the general government balance.
- **Exceptional revenues from State owned companies.**

Deficit increasing

- ***Short-term emergency costs associated with major natural catastrophes or other exceptional events*** *(e.g. military actions. others)*
- *Changes in revenues or expenditure consecutive to* ***Court rulings or consecutive to European Commission decisions***.

Not in the 2006 text, but in recent practice:

- Financial crisis → **Government support to the financial sector**
- More recently, COM(2015) 12 final **initial cash contributions to the European Fund for Strategic Investments**

Practical classification issues

- **Availability of information**
  - prior to the occurrence of the transaction
  - and even after its occurrence, including the full impact in all fiscal aggregates
    - *for example, some expenditure one-offs might have an impact in tax revenue, which is difficult to disentangle*
- **Choice of the minimum threshold per transaction**
  - 0.05% or 0.1% of GDP as guideline?
- **How to classify borderline cases?**
  - **How to define non-recurrent transactions?**
    - *Decision taken in real-time creates an additional difficulty*
  - **What to do with additionally prolonged or repeated measures?**
    - *What to do when a measure classified as one-off continues producing effect beyond the retained short-time horizon? Revision of the list of one-offs retroactively?*
  - **Should any relevance be given to the volatility of the budgetary aggregate where the transaction is classified?**
    - *intermediate consumption is very stable; capital transfers & investment more volatile*
  - **Deficit increasing statistical decisions** regarding the reclassification of entities/ guaranteed debt/ etc.
    - Extent of government control
    - Non-recurrent nature (*but what about a sequence of different entities not known in advance?*)

Deficit increasing transactions

- To avoid an artificial improvement to the estimated fiscal effort, the **prudent approach**, behind the asymmetric criterion requires that **as a rule deficit increasing measures should not be excluded from the fiscal effort calculation.**

- Exceptions could only be considered when there is a high degree of certainty as to the transitory or unrepeatable nature of those operations.

The case of Portugal, CFP approach to some deficit increasing transactions: special factors

Large scale transactions that are not pure one-off measures, but depend upon Government action (or upon statistical decisions), and **increase expenditure solely in the year in which they occur, not producing a permanent change in the expenditure level could be classified as special factors,** and taken into account in the overall assessment of the progress towards the MTO.

- *The CFP's approach in this field is similar to that of the* ***Bank of Portugal*** *(in its Board of Directors Report 2011), which held that special factors were*:
  - **"transactions that affect the public sector deficit momentarily but which under the Eurosystem definition may not be treated as temporary measures".**

European Commission’s practice

- AMECO database includes aggregated figures for one-offs (total, revenue and expenditure)
  - 2015 Winter forecast (ESA2010), since 2010 only
  - Previously (ESA95), for the period 2003-2014
- **But there is no systematic detailed information on the classification of one-off operations** for each Member-State
  - **Not possible to evaluate whether there are classification inconsistencies overtime and across countries**
- **The French Government has a similar view on the Commission following a case-by-case approach**: «***En pratique, face à cette absence de définition juridiquement contraignante des one-offs à l’échelon européen, la Commission adopte donc une approche au cas par cas.***»
  - *Source*: Rapport annexe à la loi de programmation des finances publiques pour les années 2014 à 2019, Annexe 5 : Périmètre des mesures exceptionnelles et temporaires à exclure du solde structurel www.legifrance.gouv.fr/affichLoiPubliee.do?idDocument=JORFDOLE000029526142&type=general&legislature=14%E2%80%8E

Concluding issues

- A proper classification of one-offs is essential to estimate the structural balance
- EC does not publish systematic detailed information on the classification of one-off operations regarding each Member-State
  - Besides the quoted CC disposition there is no legal text or even soft law regulating the classification of one-offs
  - There is no sufficient transparency
  - It is necessary to ensure consistency (over time and across countries)
- There are sensitive borderline issues
- IFIs need to be transparent on their classification of one-offs
- *Should IFIs agree on some common guidelines?*