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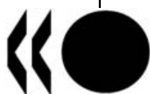

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STATISTICS DIRECTORATE
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Working Party on National Accounts

RECORDING GOVERNMENT ACTIONS TAKEN IN RESPONSE TO THE GLOBAL FINANCIAL CRISIS IN THE NATIONAL ACCOUNTS

To be held on 1-3 December 2010
OECD Conference Centre
Beginning at 9:30 a.m. on the first day

This document has been prepared by Charles ASPDEN (Consultant to the OECD) and will be presented under item 2 of the draft agenda (common day with WPFS)
At the 2009 National Accounts Working Party meeting delegates asked the OECD to consider the possibility of conducting a review of government interventions that occurred in relation to the recent financial crisis. The objective was to establish the comparability of approaches used by statistical offices to record these interventions in their accounts. Unfortunately it has not been possible to determine this as very few statistical offices have made this information readily accessible. This paper therefore considers the different types of major interventions made by governments and makes recommendations on how these interventions should in principle be recorded in the accounts, based on the 2008 SNA. Delegates are asked to comment on whether they disagree with the interpretations/recommendations set out in this paper using the table provided towards the end, and, in particular, to highlight areas where they have recorded interventions in a different way. Ideally this information should be provided to the OECD (Nadim Ahmad) before 30 November but, if this is not possible, delegates will have an opportunity to present their views during the session on the 1 December.
Countries are also strongly encouraged to consider creating a web-page that describes the statistical treatment and impact (size) of different government interventions related to the crisis on government deficit and debt figures.

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Foreword

The global financial crisis (GFC) began in the US about the middle of 2007 and subsequently spread to much of the rest of the world. While there are several factors that have contributed to the severity of the GFC, it is widely recognized that the trigger was the collapse of US house prices. This led to substantial losses by mortgage lenders and to other financial institutions that held mortgage-backed securities. This in turn led to a loss of confidence in many financial institutions, and banks became very cautious about making loans, including to other banks. The subsequent credit crisis impacted the real economy, with businesses and households finding it more difficult to borrow money. Falling house and share prices reduced household wealth that in turn led to lower consumption and created more non-performing loans for banks. The multiplier effect, reinforced by negative sentiment, led to a slowdown in world growth and recession in many countries.

As the GFC unfolded, governments and central banks responded to what seemed the most important problems at that time. Initially, responses were focussed on supporting the financial system and then attention had to be given to addressing the subsequent recession. Many of the actions taken by governments and central banks were out of the ordinary, both in character and magnitude. This raises questions as to how they should be recorded in the national accounts and whether OECD member countries have adopted a common approach. Given the public interest in the GFC and the steps taken by governments and central banks in response, one would have expected statisticians to inform their users as to how all the major actions had been recorded in the national accounts and to quantify them where possible. Some countries have made some attempt to keep their users informed, but most appear to have done very little or nothing. The US BEA is notable in that it has published a number of articles on its website that both describe how particular interventions are recorded in the national accounts and quantify their size.

This paper was originally intended to report the outcome of a review of the national accounting treatments of actions undertaken by governments and central banks in response to the GFC, as requested b delegates at the 2009 OECD National Accounts Working Party meeting. The review was to have compared treatments across countries and analyse their conformity to SNA principles using information from statistical office websites. In the event however this has proved to be impossible because so few countries have provided any details of how they have recorded actions taken in response to the GFC in a readily accessible way, if at all. It was therefore decided to take a different approach.

The paper begins by identifying different types of policy area and proceeds to systematically describe the different types of action taken in response to the GFC in each policy area, giving some specific examples. **The paper discusses how the actions should be recorded in the national accounts, and then invites countries to comment on these recommendations.**

Countries are also encouraged to consider the need for special web-pages that deal with how the crisis has been recorded in the accounts; focussing in particular on the impact on government deficits and debt, and breaking these impacts down by transactions/interventions type (following the classification of types described below).

ACTIONS TAKEN BY GOVERNMENTS AND CENTRAL BANKS IN RESPONSE TO THE GLOBAL FINANCIAL CRISIS

Introduction

1. The actions taken in response to the GFC can be grouped into four domestic policy areas: monetary policy, liquidity support, financial sector measures and fiscal policy[1]. These domestic interventions all relate to actions taken by governments and central banks in respect of their countries (including the ECB in respect of the euro zone). In addition, there have been interventions by international organisations, namely the IMF and the European Commission (EC), and some countries have grouped together to provide assistance to other countries.

2. In the context of responding to an economic slowdown, *Monetary policy measures* include interest rate cuts and quantitative and credit easing, all of which are aimed at easing monetary conditions. *Quantitative easing* involves a central bank purchasing government and non-government securities as a means of increasing the money supply in order to stimulate the economy. The central bank first credits its own account with money and uses it to purchase financial assets from financial institutions. The purchases, by way of account deposits, give banks money that they can then lend. Because the money used by the central bank to make the purchases comes from nowhere it is sometimes referred to as 'printing money', although it all happens electronically.

3. In a lecture at the London School of Economics in January 2009, Ben Bernanke, chairman of the US Federal Reserve, described the new tools being used by the US Federal Reserve in the wake of the GFC. In particular, he referred to the US Fed's actions to increase the money supply as *credit easing,* rather than *quantitative easing.* He distinguished credit easing from quantitative easing on the grounds that quantitative easing is not concerned with the composition of the assets purchased, while credit easing is. Further information of how credit easing has been applied by the US Federal Reserve[2] makes it clear that quantitative easing has, in effect, been combined with some of the other types of policy action described below, namely liquidity support and financial sector policies. Thus, at least in the case of the US, increases in the money supply through quantitative easing have been combined with other types of policy action.

4. Liquidity support It is normal practice for central banks to provide short-term loans to chartered banks to meet their short-term liquidity needs, with very high quality assets used as collateral. In response to the GFC, central banks increased their liquidity support through broadening access to other financial institutions, extending the collateral framework (e.g. accepting lower quality assets as collateral, such as high-quality mortgage-backed securities), more frequent auctions, or longer maturities. In some cases, loans were provided to non-financial corporations (e.g. General Motors).

5. In addition, banks in some countries found it difficult or very expensive to acquire foreign currency (chiefly US dollars)[3]. When commercial banks think there is a risk in providing loans to banks in other currency zones they demand a risk premium, and this has been happening to a variable extent since

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1 This categorisation is based on the one used in the 2009 IMF paper, 'How to Stop a Herd of Running Bears? Market Response to Policy Initiatives during the Global Financial Crisis' by Yacine Aït-Sahalia, Jochen Andritzky, Andreas Jobst, Sylwia Nowak, and Natalia Tamirisa

2 Credit Easing: A Policy for a Time of Financial Crisis by *John Carlson, Joseph G. Haubrich, Kent Cherny, and Sarah Wakefield* of the Federal Reserve Bank of Cleveland, February 2009.

3 'The Financial Crisis through the Lens of Foreign Exchange Swaps' by Crystal Ossolinski and Zurawski, June quarter 2010 Bulletin, Reserve Bank of Australia.

the advent of the GFC, with some currencies affected more than others. This has led some central banks to provide foreign currency liquidity through swap agreements with other central banks. For example, on several occasions, starting in December 2007, the ECB and US Federal Reserve have arranged to provide euro zone banks with loans of one-month maturity in US dollars[4]. The loans are sourced from the Fed's Term Auction Facility (TAF) and financed through a currency arrangement between the Fed and the ECB. In effect, the ECB acquires US dollars from the Fed via the TAF and then lends them to euro zone banks. The interest rate payable by the banks is a fixed rate equal to the marginal rate of the simultaneous tenders at the Fed's (TAF) loan auction.

6. *Financial sector policies* include the tools commonly utilised to resolve systemic banking crises, but may also include ad hoc bailouts of particular financial institutions:

- *Asset purchase* programs use public funds to buy risky assets from banks to shield them from losses. Banks profit from asset purchase programs to the extent that credit risk is removed from their balance sheets, and also because the purchases may put a floor on market prices in banks' trading books. The category also includes ring-fencing of bad assets, which may be conducted either off-balance sheet through a special purpose entity absorbing the assets, or on the balance sheet through asset guarantees. Asset purchases usually involve signing a loss-sharing agreement between a public institution providing funds and the bank receiving them. The measure can either be adopted for a single institution or as a system-wide facility for a given asset class.

- *Liability guarantees* are system-wide guarantees for newly issued or existing wholesale financing. Should a financial institution covered by the guarantee be unable to meet its liability, the guarantor (the government or central bank) will meet the liability. In the wake of the GFC, existing guarantees provided by the central bank to chartered banks in its role as the lender of last resort were raised and extended to cover a wider range of liabilities – not just deposits – and a wider range of financial institutions. In the case of the US, several investment banks became chartered banks.

- *Recapitalisation* is the direct injection of capital, either partially, or fully, originating from public funds. Some recapitalisations have been done on ad hoc basis, while others have been part of system-wide programmes, such as the U.K. Bank Recapitalisation Fund. Recapitalisation can amount to nationalisation when government assumes a controlling stake in a financial or non-financial corporation.

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[4] 'Some lessons from the global financial turmoil' speech by by José Manuel González-Páramo, Member of the Executive Board of the ECB, IIF Conference on "Global Financial Turmoil: Next Steps for the Industry" London, 9 September 2008

Table 1 Examples of actions taken by governments and central banks in response to the GFC

Type	**Measures**	**Examples**
Monetary policy		
Interest rate cuts		Large interest rate cuts by central banks made throughout the OECD, starting in US in 2007.
Quantitative and credit easing	Increasing the money supply by purchasing financial assets using 'new money'	US Fed buys long-term government bonds in March 2009. Bank of England announces purchases of government bonds in March 2009, with further purchases in August 2009. Bank of Japan announces purchases of government bonds in January and March 2009. ECB announces purchases of covered bonds in May 2009.
Liquidity support		
Domestic currency liquidity support	Relaxation of collateral framework; change in funding terms or auction schedule; support of money markets	US Fed introduces the Term Auction Facility (TAF) in December 2007, followed by the Term Securities Lending Facilities (TSLF) and the Primary Dealer Credit Facility (PDCF) in early 2008. US Fed launches Term Asset-backed Securities Loan Facility (TALF) in March 2009 and Asset-backed Commercial Paper (ABCP) Money Market Fund Liquidity Facility in September 2008. BoE introduces the Special Liquidity Scheme in April 2008 and extends it in September 2008. BoE announces it will accept a broader range of collateral in exchange for long-term repos in March 2008. BoE introduces Corporate Bond Secondary Market Purchase Scheme in March 2009. ECB announces in May 2010 its intention to intervene in secondary markets to purchase public and private debt securities. In Spain a fund (FAFA) was created in October 2008 to boost financing by financial institutions to individuals and firms by acquiring from credit institutions, on a voluntary basis and under market conditions, high-quality Spanish financial assets backed by loans granted to individuals, firms and non-financial institutions; giving priority to new loans, this being understood as loans granted after 7 October 2008.
Foreign currency swaps	FX swaps & FX funding	ECB offers US dollar funding in December 2007 and again in May 2010 to euro zone countries.
Financial sector policies		
Impaired asset purchases	Asset purchases	US Troubled Assets Relief Program (TARP) (went beyond financial sector to include motor vehicle manufacturers)
	Ring fencing of bad assets and asset guarantees	US Fed's SPEs (Maiden Lane I, II, III) for buying impaired assets (Bear Stearns, AIG) were first introduced in March 2008. UK Asset Protection Scheme introduced in January 2009.
Liability guarantees	Guarantees for old or new liabilities	Irish Government Guarantee Scheme introduced in September 2008. UK Credit Guarantee Scheme and US Temporary Liquidity Guarantee Program both introduced in October 2008.
	Provision of lender of last resort	Northern Rock liquidity support facility announced by BoE in September 2007. US Fed's acceptance of applications by investment banks to be chartered banks (e.g. Goldman Sachs and Morgan Stanley in September 2008).

Recapitalisation	Capital injection and nationalisation	US TARP Capital Purchase Program for nine US banks announced in October 2008. French government injects capital into six banks via preference shares or subordinated debt in December 2008. BoE introduces UK Bank Recapitalisation Fund in October 2008. From first quarter of 2009, US government commences GSE program with purchases of the preferred stock of Fannie Mae and Freddie Mac.
International and bilateral assistance		IMF loans and credit lines provided to countries. The introduction of the European Financial Stability Facility in May 2010.
Fiscal policy	Fiscal stimulus packages	Stimulus packages introduced by many OECD countries, starting with the US in January 2008. They include cuts in personal income tax and taxes on production, accelerated depreciation for capital expenditures, making unemployment benefits more easily available, one-off payments to households, subsidies for manufacturers, and increases in government spending on education, training, R&D and infrastructure.

7. *International and bilateral assistance* has mainly taken the form of providing loans to national governments by international organisations and other governments, and for other governments to act as guarantors for loans made on the market.

8. *Fiscal measures* include all policy actions that aim at stimulating domestic demand through increases in expenditures or reductions in taxes.

9. Table 1 provides some examples of government and central bank actions categorised to the five policy areas.

10. There has been considerable variation amongst OECD countries in the range of policy actions taken to support financial institutions and the extent to which they have been used. In countries where banks suffered large losses (due to non-performing mortgages or mortgage-backed securities), such as Iceland, Ireland, UK and US, governments and central banks have had much to do to restore the health of their financial sectors. By contrast, in those countries where banks suffered relatively small losses, such as Australia, Canada, Italy and New Zealand, governments and central banks only needed to support their financial institutions through the worst of the crisis, chiefly by means of liability guarantees.

11. All countries have employed monetary policy measures. Interest rates were cut dramatically in OECD countries, and while they remain just above zero in most OECD countries, in a few countries interest rates are on their way back up. Most, if not all, OECD countries have introduced a fiscal stimulus package, but the size varies greatly between countries. Table 2 shows IMF estimates of the size of stimulus packages (i.e. the impact on a government's fiscal balance) relative to annual GDP for the G20 countries. It excludes the impact on the fiscal balance of the fall in revenue and increase in expenditures due to the downturn itself, i.e. the automatic stabilisers.

12. Through 2007-2009, governments and central banks were concerned with restoring their financial institutions to health, facilitating adequate liquidity in the financial systems and stimulating growth in their economies. The actions taken by government came at a cost, and when combined with the impact of recession on government revenues and expenditures (the automatic stabilisers) they led to a substantial deterioration in government fiscal balances and balance sheets throughout the OECD. By 2010, government deficits and debt had reached such high levels that there were concerns of default on government bonds by some European countries, in particular. This led the EU Council to establish the European Financial Stabilisation Mechanism (EFSM) in May 2010 – see below.

Recording GFC-inspired policy actions in the national accounts

13. Guidance on how to record government and central bank actions in response to the GFC has been provided in respect of the first three policy areas described above (monetary policy, liquidity support and financial sector policies) by Anne Harrison in the November 2009 issue of SNA News and Notes, and by Eurostat in a technical note attached to a news release on 15 July 2009.

14. Anne's article, *The 2008 SNA and the Financial Crisis,* was largely based on a paper she presented to the Advisory Expert Group (AEG) in November 2008. As well as providing guidance on how to deal with particular issues raised by the GFC, the purpose of the paper was to determine how well the 2008 SNA supported the recording of transactions and other flows that occurred in the wake of the GFC, and to determine if any changes were required to the near final text of the 2008 SNA. The AEG agreed that the 2008 SNA adequately met the challenge, and only a few minor clarifications were required.

Table 2 G20 Countries: Estimated size of fiscal stimulus packages, 2008-10[1]

Country	Size (in percent of GDP)		
	2008	**2009**	**2010[2]**
Argentina	0.0	1.3	n.a.
Australia	0.7	0.8	0.3
Brazil	0.0	0.3	0.2
Canada	0.0	1.5	1.3
China	0.4	2.0	2.0
France	0.0	0.7	0.0
Germany	0.0	1.5	2.0
India[3]	0.0	0.5	n.a.
Indonesia	0.0	1.3	1.1
Italy	0.0	0.2	0.1
Japan	0.4	1.4	0.4
Korea	1.0	1.5	0.3
Mexico	0.0	1.0	n.a.
Russia	0.0	1.7	n.a.
Saudi Arabia	2.4	3.3	3.5
South Africa[4]	1.3	1.3	n.a.
Spain	3.1	1.1	0.3
Turkey	0.0	0.0	n.a.
United Kingdom	0.2	1.4	-0.1
United States	1.1	1.9	2.9
Total (PPP weighted average)	**0.5**	**1.4**	**1.3**

Source: Note by the staff of the IMF for the G20 meeting 31 January-1 February, 2009

1. The figures in this table reflect the budgetary cost of the stimulus measures in each year. They are based on packages announced through to late January 2009. The figures do not include (i) "below-the-line" operations that do not have an impact on the fiscal balance, (ii) measures that were already planned for; or (iii) banking-sector support measures. Some figures represent IMF staff's preliminary analysis.
2. For 2010, 'n.a.' is used for countries for which no information is available on the size of their fiscal packages.
3. Fiscal year basis
4. No official stimulus package has been announced. Figures shown are an estimate of the discretionary fiscal impulse, based on IMF staff calculations.

15. It is worth noting that although the 2004 update of the 1993 SNA provides adequate categories of financial instruments to record the transactions and other flows taken by governments and central banks in response to the GFC, the 2008 SNA provides additional useful guidance. First, it provides guidance on the treatment of special purpose entities (SPEs) (or special purpose vehicles (SPVs)), such as Maiden Lane I, II and III, and the European Financial Stability Facility (EFSF). Second, it provides guidance on the criteria to be applied for recording non-performing loans, and recommends that non-performing loans should be recorded at fair value as memorandum items. More generally, the chapters on institutional units and sectors (chapter 4) and the financial account (chapter 11) have been updated and are more helpful in addressing the issues raised by the GFC than their 1993 SNA counterparts. Parts of chapter 22, which covers the general and public sectors, are also very apt. While some of the recommendations concerning financial assets and financial transactions differ between the 1993 and 2008 SNAs, referring to the latter for guidance does not mean it is necessary to adopt the 2008 SNA recommendations in preference to those of the 1993 SNA.

16. The Eurostat *news release is titled, New decision of Eurostat on deficit and debt: the statistical recording of public interventions to support financial institutions and financial markets during the financial crisis*[5]. Attached to the news release is a technical note, the Eurostat Guidance Note, which describes the issues of interest, describes the Eurostat decision on how each issue should be dealt with and provides guidance on how each decision should be implemented.

17. Most of the matters of interest for the national accounts regarding monetary policy, liquidity support and financial sector policy actions concern the acquisition of financial assets by the central bank, government or a government SPE. In principle, transactions in financial assets and liabilities should be recorded at the market price at the time the transactions occur. However, when financial assets and liabilities are not being traded, such as can occur in situations of financial distress and as has happened at times during the GFC, it is necessary to estimate a market price equivalent – the fair value. In recording the acquisition of financial assets by governments and central banks during the GFC, the principal question is whether the amount paid is a fair value of the assets acquired. If it is not then with the exception of loans the difference between the fair value and the actual amount paid should be recorded as a capital transfer. The Eurostat Guidance Note provides detailed advice on how to answer the question of whether the transaction is at fair value and how to go about estimating it if it is not for a number of different types of transaction.

Units

18. The government SPEs created in the wake of the GFC need to be classified to an institutional sector.

> **Recommendation (1):** *If they act independently and carry the risks and rewards associated with the assets and liabilities they hold then they should be treated as publicly-owned financial institutions. If they fail this criterion then they should be treated as part of general government.* [6]

Quantitative easing

19. Quantitative easing takes place in two steps. First, the central bank credits its own account (with money from nowhere), and, second, it uses the money to acquire financial assets from other financial institutions.

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[5] http://epp.eurostat.ec.europa.eu/portal/page/portal/government_finance_statistics/methodology/guidance_accounting_rules

[6] Paragraph 22.52 of the 2008 SNA

Recommendation (2): *The first step – the appearance of money – should be recorded in the other changes in volume of assets account*.

Recommendation (3): *The second step is simply a trade of financial assets that should be recorded in the financial account.*

20. As noted earlier, quantitative easing may, or may not, be combined with liquidity support and other actions taken by the central bank, such as purchases of impaired assets – see below.

Domestic currency liquidity support

21. Domestic currency liquidity support by the central bank normally takes the form of short-term lending to the charted banks with the use of very high quality collateral, such as government bonds or very highly-rated non-government securities. In the wake of the GFC, central banks expanded their normal practices in several ways: lengthening the term of the loans; acquiring assets (such as high quality mortgage-backed securities that in normal circumstances would be acceptable but were distrusted by other financial institutions in their anxious state following the collapse of Lehman Brothers) in exchange for government securities; and providing liquidity to financial institutions other than chartered banks. In a few instances, loans have been provided by governments to non-financial corporations (e.g. general motors).

The Maiden Lane SPEs[1]

The Maiden Lane LLCs (limited liability companies) are some of the most esoteric components of the Federal Reserve's balance sheet. All three are tied to pools of assets that the Fed has lent against to stabilize specific companies and asset classes. Maiden Lane I consists of a loan to J.P. Morgan that is backed by a pool of securities that were obtained from the acquisition of Bear Stearns in March 2008. The pool consists primarily of investment-grade residential and commercial mortgage-backed securities. According to the agreement with J.P. Morgan, the first $1 billion of collateral losses will be borne by the acquiring bank.

Maiden Lane III was created after billions of dollars were loaned to AIG. The insurer had extended credit protection—in the form of credit default swaps—on billions of dollars' worth of collateralized debt obligations (CDOs). When AIG's credit rating was downgraded, the credit default swap holders ordered collateral postings at levels that threatened the company's solvency. Beginning in late November 2008, the Fed loaned funds to Maiden Lane III so that it could begin to purchase the CDOs upon which the credit default swap contracts had been written (the CDOs also serve as collateral for the Fed loan). The entity could then begin the process of unwinding the swaps—since it held the assets they derived value from—to stabilize both the derivatives market and AIG.

Maiden Lane II's purpose also traces back to AIG. In previous years, the insurer had lent some of its large securities holdings to other companies in exchange for cash collateral, which it then invested in mortgage-backed debt products. This produced higher yields than more traditional investments like Treasury securities. However, increasing residential delinquencies and defaults caused the mortgage investments to lose both value and liquidity. Many securities borrowers stopped rolling over their loans and instead demanded their cash back, particularly after AIG was downgraded in September 2008. In December, the Federal Reserve extended a loan to AIG to meet cash redemptions and stabilize the value of the mortgage-backed securities. The loan collateral (mortgage bonds) is represented in the Maiden Lane II vehicle.

1 A slightly edited extract from Credit Easing: A Policy for a Time of Financial Crisis by *John Carlson, Joseph G. Haubrich, Kent Cherny, and Sarah Wakefield* of the Federal Reserve Bank of Cleveland, February 2009.

Recommendation (4): *Unless there is evidence to the contrary, it would normally be assumed that when a central bank lends money to provide liquidity support it expects be repaid and no capital transfer is taking place. If a part, or all, of the loan is later forgiven then a capital transfer should be recorded at that time. If it is written off as a bad debt then it is recorded in the other changes in the volume of assets account. If there is strong evidence at the time the loan is granted that it will not be repaid in full then a capital transfer should be recorded at that time.*

Foreign currency liquidity support

22. Foreign currency liquidity support has been provided by some central banks because commercial banks have demanded a risk premium for providing loans to banks in other currency zones. In doing so, the central banks have been taking on the risk, and this is reflected in the lower interest rates charged on their foreign exchange loans compared with those charged by commercial banks.

Recommendation (5): *To this extent the central banks have been providing a subsidy to the commercial banks who have received the loans. Paragraphs 7.122-7.126 of the 2008 SNA provide guidance on how the transactions and associated subsidy should be recorded.*

Impaired asset purchases

23. Governments and central banks have bought impaired financial assets from financial institutions in order to restore confidence in the financial system, provide financial institutions with liquidity, and in some cases to avoid them going into bankruptcy. Governments and central banks have either made the purchases directly or through specially created SPEs. In the latter case, it is necessary to determine whether the SPEs are independent of government or not.

Recommendation (6): *The transactions should be recorded in the financial account. In principle, the purchases of the impaired assets, other than loans, should be recorded at their fair value. If there is a significant difference between the actual price paid and the fair value then this should be recorded as a capital transfer.*

24. The difficulty in implementation is to determine what the fair value is. The Eurostat Guidance Note provides quite comprehensive step-by-step guidelines on how to deal with government (including government SPE) purchases of financial assets other than loans when the prices paid may be above their fair value. For convenience they are reproduced in Annex A.

Recommendation (7) *Purchases of loans are recorded at their nominal value unless they become tradable and are traded within an established market value. However, if non-performing loans are recorded at their nominal value in the accounts then the 2008 SNA recommends that they should also be recorded at their fair value as memorandum items*[7]*. If a market for the loans develops and the loans are regularly traded then they are reclassified as securities and recorded at market value. When a government buys a loan at nominal value and the fair value is much less, no capital transfer for the difference in value is recorded. However, if there is reliable information that some loans are irrecoverable then their value is reduced to zero as an other volume change in the balance sheet of the corporation and a capital transfer should be recorded from government to the corporation for their former nominal value. If there is some possibility that some part of the loan may be recoverable in the future then the loans are reclassified (at their zero value) from the balance sheet of the corporation to that of the government at the time the capital transfer is recorded*[8]*. If the value of the loans subsequently increases, this is shown as a revaluation item in the government's balance sheet*[9].

Liability guarantees

The 2008 SNA identifies three types of loan guarantee:

- financial derivatives, such as credit default swaps,
- standardised guarantees, and
- one-off guarantees

[7] Paragraph 13.67 of the 2008 SNA

[8] Section 3 of part D of chapter 22 of the 2008 SNA

[9] Paragraph 22.145 of the 2008 SNA

25. Their characteristics are comprehensively described in part 3 of chapter 17 of the 2008 SNA.

26. Standardised guarantees are much like non-life insurance and are treated as such in the 2008 SNA[10]. There are three parties involved: the borrower (debtor), the lender (creditor) and the guarantor. The guarantor undertakes to make good any loss the lender will suffer if the borrower defaults. A defining feature of standardised guarantees is that the guarantor is able to estimate what the expected risk of default is, just like a non-life insurer is able to estimate the expected value of claims. This is possible because the guarantor is usually providing this service for a large number of borrowers and there is a past history that enables a reasonable estimate of the risk of default to be made. The guarantor is thus able to set a fee that covers the risk *plus* the cost of providing the service *plus* a profit margin, if desired. The output of the guarantor is equal to the value of the fees *plus* the fee supplements (the property income earned on the fees) *less* the expected value of defaults.

27. One-off guarantees are usually provided on an ad hoc basis and for a limited period of time, and they are recorded quite differently in the national accounts. Unlike standardised guarantees, it is not possible to reliably form an expectation of what the risk of default is for a one-off guarantee, and it is therefore not possible to accurately determine what part of the fee payable is for providing the service. By convention, the output of the guarantor is defined to be the fee charged. There are also no transactions recorded in the secondary distribution of income account, and any payment made by the guarantor in response to a default is recorded as a capital, rather than current, transfer.

28. In most circumstances one-off guarantees give rise to contingencies that are not recognised as a financial asset/liability. However, if they are granted by governments to financially distressed corporations with a very high likelihood of being called then they are treated as being called at inception[11].

29. While few countries have yet adopted the 2008 SNA and may consider the recommendations of the 2008 SNA concerning standardised guarantees irrelevant for their current recording of loan guarantees, the issue will have to be addressed when they eventually do adopt the 2008 SNA. It is therefore important for international comparability that agreement be reached on how to record loan guarantees provided by governments and central banks for financial institutions.

> **Recommendation (8):** *There seems to be a strong case for treating longstanding guarantees provided by central banks (or governments) to financial institutions as standardised guarantees because there is a long history over which it is possible to estimate the risk of default.*
>
> *It is not so easy to argue that guarantees introduced temporarily in the wake of the GFC should be treated as standardised guarantees. Unlike longstanding guarantees, these guarantees were introduced after the GFC struck and the history of defaults prior to the GFC provides a poor guide of the risk of default during the GFC. It is therefore more appropriate to treat temporary guarantees introduced after the GFC began as one-off guarantees.*

30. Eurostat has required EU member countries to provide supplementary tables recording revenue and expenditures related to certain types of interventions by general government concerning financial

[10] Paragraphs 17.211-221 of the 2008 SNA

[11] Paragraphs 17.212 and 22.128-129 of 2008 SNA

institutions during the GFC. None of the 19 country reports (as of 31March 2010) on Eurostat's website[12] records any calls on loan guarantees to financial institutions.

Recapitalisation

31. Strictly speaking, recapitalisation only occurs when an equity instrument issued by a financial or non-financial institution is acquired. Equity comprises all instruments and records acknowledging claims on the residual value of a corporation after the claims of all creditors have been met. Equity instruments include[13] ordinary shares and participating preferred shares. Participating preferred shares (or preference shares) are equity securities. They are equities because they provide for participation in the residual value of the corporation on dissolution, and they are securities because they provide for a return (fixed or determined by a formula) agreed at the time of acquisition, much like a loan.

32. In response to the GFC, governments may have acquired a broader range of financial assets in the name of 'recapitalisation'. They include non-participating preference shares (recorded as debt securities) and subordinated debt. While a number of governments 'recapitalised' financial institutions, some also recapitalised non-financial corporations (e.g. General Motors).

33. In recording the transactions, it is necessary to determine exactly what sorts of financial assets have been acquired by government and whether the financial assets have been purchased at fair value. For if government has paid more than fair value then a capital transfer should be recorded. The Eurostat Guidance Note refers to the ESA95 *Manual on Government Deficit and Debt* (MGDD), which points to accumulated losses and the prospects for future returns to determine whether a capital transfer has occurred.

> **Recommendation (9):** *The Note recommends that if a government makes a capital injection into a financial corporation that has incurred losses for more than one accounting period then the injection should be recorded as a capital transfer.*

34. With regard to the prospects for future returns, the Note refers to threshold rates of return established by the European Commission's State Aid authorities (which are based on the recommendations of experts in the field) to determine whether a government is providing state aid. The Note proposes that the difference between the threshold rates and the expected rate of return on the capital injection could be used to partition the capital injection into the acquisition of a financial asset and a capital transfer.

35. If a government acquires a majority of the ordinary shares in a corporation, it acquires control and the corporation is effectively nationalised. Preferred shares do not have voting rights, and their acquisition by government cannot lead to nationalisation unless they are subsequently exchanged for ordinary shares.

International and bilateral assistance

36. The IMF has been very active since the onset of the GFC on numerous fronts: coordinating government actions, providing advice, providing loans, and refining and extending credit lines to meet

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[12] http://epp.eurostat.ec.europa.eu/portal/page/portal/government_finance_statistics/excessive_deficit/supplementary_tables_financial_turmoil

[13] Paragraph 11.83 of the 2008 SNA

country needs. Some IMF loans to poor countries are at concessional interest rates. In fact, starting in 2011, the IMF intends charging zero interest rates on concessional lending[14].

37. In paragraph 22.124, the 2008 SNA addresses the issue of concessional interest rates to a foreign government. It acknowledges that this could be seen as a current transfer from the lender to the borrower, determined by the difference between the relevant market rate and the actual rate charged. If such a transfer were recognised, it would usually be recorded as a current transfer (international cooperation) and the interest recorded would be adjusted by the same amount. However, the 2008 SNA says the means of incorporating the impact of concessional debt has not been fully worked out within the SNA and the international accounts. Therefore, until such time that it is, the 2008 SNA recommends that information on concessional debt should be provided in supplementary tables.

38. The IMF is not the only international organisation to provide loans countries in response to the GFC. In May 2010 the European Financial Stabilisation Mechanism was announced.

European Financial Stabilisation Mechanism

39. The EFSM was part of a package of measures announced jointly by the European Commission (EC), IMF and ECB. Other measures to be taken included interventions by the ECB to improve liquidity in euro zone countries by buying government debt securities on secondary markets (without quantitative easing), reactivating the supply of three- and six-month liquidity to banks, and, via bilateral currency swaps with the US Federal Reserve, provide US dollar loans to euro zone financial institutions.

40. The EFSM announced by the EC has in fact two parts. The first part is capable of providing loans of up to 440 billion euros up until 30 June 2013, via a newly-created SPE called the *European Financial Stability Facility* (EFSF) that is incorporated in Luxembourg. According to the European Financial Stability Facility Agreement, published on 7 June 2010, it is envisaged that financial support to euro-zone countries by the EFSF in conjunction with the IMF shall be on comparable terms to the (110 billion euros worth of) loans already advanced by euro-zone countries and the IMF to Greece. The EFSF loans will be conditional on countries entering into a memorandum of understanding in relation to budgetary discipline and economic policy guidelines. The EFSF shall finance the loans by issuing or entering into bonds, notes, commercial paper, debt securities or other financing arrangements that are backed by irrevocable and unconditional guarantees by the governments of euro-zone countries (in proportion to their voting rights at the ECB). There is provision for countries to stop being guarantors for future loans if they get into financial difficulties and for the remaining countries to pick up the slack.

41. The interest rate which will apply to each loan is intended to cover the cost of funding incurred by the EFSF and shall include a margin that shall provide remuneration for the guarantors. In addition, there will be an up-front service fee of 50 basis points on the principal to cover the operational costs of the EFSF and any costs and fees it incurs in raising finance not covered by the interest charged. The EFSF will retain the service fees and margins. It will be wound up when the last loan is repaid and then disburse its assets to the loan guarantors according to their contribution.

42. The second part of the EFSM is the provision of loans and credit lines of up to 60 billion euros, which is operated by the EC and is available to all EU members, not just those in the euro zone. Funding for this facility is raised on the markets by the EC, using the EU budget as collateral.

[14] IMF Support for Low-income Countries, Factsheet, 3 September 2010

Recommendation (10): *It appears that under the EFSM all loans are to be provided at market interest rates, and no transfers will take place. The guarantees provided by the guarantors to the EFSF have the characteristics of one-off guarantees and should be recorded as such. The guarantors should be credited with their share of the service fee payable by borrowers in their accounts receivable over the life of each loan. In addition, interest earned on the service fees from the time they are paid at the commencement of each loan until the EFSF is wound up should be recorded in the accounts receivable of the guarantors, based on the ledgers to be maintained by the EFSF.*

Fiscal policy

43. Governments have employed a very wide range of fiscal policy measures to stimulate their economies[15]. Some measures, such as straight cash transfers to tax payers, as happened in Australia, were intended to stimulate demand immediately. Other measures were more targeted, such as providing additional training, spending more money in helping the unemployed find work, investing in infrastructure, investing in R&D, and investing in greenhouse gas abatement. The IMF estimates that in terms of their impact on fiscal balances of the G20 countries, about one third was from the revenue side (tax cuts) and two thirds from the expenditure side[16].

Motor vehicle scrappage schemes

44. Most of the actions taken present no difficulties for recording in the national accounts because they are a common form of transaction. Relatively novel types of action that may raise questions are car scrappage schemes. These have been implemented in different ways by countries, and it is a matter of analysing in detail how each one works in order to determine how they should be recorded in the national accounts. Here we consider several different forms of scheme and consider how they should be recorded in the national accounts. The author has found it difficult to find details of motor vehicle scrappage schemes from official sources for many OECD countries, and so, with the exception of scenario 1, the US case, the analysis is based on scenarios using information obtained from unofficial sources.

Scenario 1

A credit is provided to customers who purchase a new qualifying vehicle (i.e. meets certain criteria, such as a high standard of fuel efficiency) when they trade in a used qualifying vehicle (above a certain age, low standard of fuel efficiency). It does not matter how lax or stringent the qualifying criteria are for the vehicle being purchased or the vehicle being scrapped as far as the national accounts are concerned. The credit is applied by the dealer to reduce the price the purchaser pays, and the dealer then claims a reimbursement from the government.

Recommendation (11.1): *The credit works like a negative sales tax by reducing the purchasers' price of new qualifying vehicles. It should therefore be recorded as a subsidy on a product*[17].

Scenario 2

As for scenario 1, except the government pays the purchaser directly.

[15] See Part 1 Chapter 1 of Going for Growth, OECD, 2010

[16] Note prepared by IMF for a meeting of deputies from the G-20 in London, 31 January to 1 February 2009.

[17] Paragraph 7.100 of the 2008 SNA

> **Recommendation (11.2):** *The payment is recorded as a transfer: a current transfer when the purchase of a new vehicle is made by households (consumption expenditure), and a capital transfer when the purchase of a new vehicle is made by a business or government (fixed capital formation).*

Scenario 3

As for scenario 2, except the government makes the payment to the purchaser as a tax credit.

> **Recommendation (11.3):***In this case the treatment in the national accounts hinges on whether the tax credit is payable or non-payable*[18]*. If it is payable then the payment is recorded as a transfer, as per scenario 2. If it is non-payable then it is recorded as a reduction in the income tax liability of the purchaser.*

Scenario 4a

A credit is provided to owners who scrap a used qualifying vehicle (above a certain age, low standard of fuel efficiency) without a need to purchase a new vehicle. The credit is applied by the scrapper to increase the payment made to the owner of the vehicle to be scrapped, and the scrapper then claims a reimbursement from the government.

> **Recommendation (11.4):** *The credit should be recorded as a subsidy on a product, as per scenario 1.*

Scenario 4b

A payment is made directly to owners who scrap a used qualifying vehicle (above a certain age, low standard of fuel efficiency).

> **Recommendation (11.5):** *If the payment is made directly to the owner of the vehicle to be scrapped or by a payable tax credit then it is recorded as a transfer, as per scenario 2. If the payment is via a non-payable tax credit then it is recorded as a reduction in the income tax liability of the owner of the vehicle, as per scenario 3.*

Country comments on recommendations

Countries are invited to comment on the recommendations above:

a) do countries agree with them, if not what do they propose?

b) are there variations of actions that need to be addressed, if so what do they propose?

c) are there issues that have not been addressed at all, if so could they be described?

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[18] Tax credits can sometimes be payable, in the sense that any amount of the credit that exceeds the tax liability is paid to the beneficiary. In contrast, some tax credits are non-payable and are limited to the size of the tax liability.

Country comments on recommendations

Type	**Comments**
Units	(a) (b) (c)
Monetary policy	
Quantitative and credit easing	(a) (b) (c)
Liquidity support	
Domestic currency liquidity support	(a) (b) (c)
Foreign currency swaps	(a) (b) (c)
Financial sector policies	
Impaired asset purchases	(a) (b) (c)
Liability guarantees	
Recapitalisation	(a) (b) (c)
International and bilateral assistance	(a) (b) (c)
Fiscal policy	
Motor vehicle scrappage	(a) (b) (c)
Any other issues	

ANNEX A

Eurostat decision and guidance on the purchase of assets and defeasance

The issue

45. Purchases of existing financial assets commonly involve equity and securities other than shares with the acquisition of loans taking place in some cases. The term "defeasance" is used to describe a situation where government buys directly impaired assets from financial institutions, or creates a public body to undertake this task.

Decision

46. The purchase by government of financial assets (notably securities other than shares) will be recorded as financial transactions if they take place at or very close to a market price, which may be determined (directly or by proxy) by reference to the following steps:

Step 1. Is the market adequately operating? Examples of features which would indicate this are a balance of buyers and sellers, market clearance, sufficient market volumes to establish a market price, smoothly evolving prices and/or an absence of large bid/offer spreads.

If yes, the appropriate valuation is the market value. If no, continue to step 2.

Step 2. Is the conduct of the transaction undertaken in such a way as to determine a market value? An example of this would be a conventional auction with many bidders.

If yes, the amount paid is considered to be a market value. If no, continue to step 3.

Step 3. Is the price paid greater than the carrying value of the asset in the business accounts of the seller? The conditions for this step are that the carrying value should be based on suitable business accounting principles and should correspond to a point in time reasonably close to the time of the transaction.

If yes, impute a capital transfer for the difference between the price paid and the book value.

If no, but the conditions set out above for step 3 are met, the amount paid is considered a market price. If these conditions are not met, continue to step 4.

Step 4. Is the price paid based on a demonstrably independent valuation founded on a market-based technique, or is at or close to a recent (possibly average) price observed in an adequately operating market for the same or very similar securities?

If yes, the price paid is considered to be a market value.

If no, provisionally record the price paid as equivalent to the market value, then continue to step 5.

Step 5. Has the asset been sold or re-valued in the year following the transaction?

If yes, analyse to see if the sale value can be considered as arising from a market under similar conditions as the original purchase, or if the accounting revaluation makes an assumption of markets under similar conditions as the original purchase. If this is the case, impute a capital

transfer (at the moment of sale or revaluation) where the sale or new carrying value is lower than the original payment to purchase the asset.

If no, keep the existing recording from step 4 above.

Step 6. Has the asset been sold at a later stage following the transaction?

If yes, and if steps 3-4 above were used to determine the initial value at time of purchase, compare the sale value with the original purchase price of the assets. Where the original price paid was higher, impute a capital transfer for the difference at the time of sale.

If no, keep the existing recording from steps 1-4 above.

Analysis

47. Commonly, financial institutions in difficulties hold a portfolio of impaired assets whose market value may or may not be determinable. An operation may be conducted to move these assets into a separate body in exchange for a payment (perhaps in the form of a swap arrangement), thereby "cleaning" the bank's balance sheet. This is termed in the ESA95 *Manual of Government Deficit and Debt* (MGDD) as "financial defeasance" (see part II chapter II.5.2, which is in the process of update by the MGDD Editorial Committee). The statistical classification of the defeasance body, if one is created, is an important factor in determining the potential impact on the government account.

48. With regard to the purchase of loans, ESA95 specifies that loans are to be recorded at nominal value in national accounts balance sheets. The MGDD (section II.5.2) makes the assumption that loans are sold by financial institutions at their redemption value, however it specifies that "if there is reliable information that these loans are irrecoverable (fully or for nearly their total amount)" then they should be written off by the financial institution before they are sold to the defeasance body, and therefore the operation should be partitioned into financial and nonfinancial transactions (the latter reflecting the difference between the price paid and the value of the loans after write-off) when they are purchased by the defeasance body.

49. Valuation is a key factor in the recording of purchases of assets. ESA95 (paragraph 5.134) says that "financial transactions are to be recorded at transaction values" and (in paragraph 5.136) that where the "financial transaction is undertaken other than for purely commercial considerations, the transaction value is identified with the current market value of the financial assets and/or liabilities involved". This means that if government has paid more than the market price for the assets, by a non-negligible amount, then a government expenditure (capital transfer) is to be recorded for the difference between the two values at the time of purchase. Nevertheless, this might be difficult or impossible to determine where no reliable market price exists due to financial turmoil, and therefore statisticians would need to exercise caution in the recording of operations in these conditions.

50. The Eurostat Decision sets out a series of steps to follow, in the case of purchase of securities other than shares, and it is important that the correct order of steps is followed.

51. With regard to Step 3, it is important to underline that "suitable business accounting principles" refer to a "fair valuation" which has been undertaken in line with international financial reporting standards, or equivalent national standards; it would not be appropriate to take an accounting valuation based on a historic cost basis, where no account has been taken of market movements.

52. The purpose of Step 6, which is to be activated if steps 3 or 4 have been applied and the assets are sold more than one year after their initial purchase, is to provide the statistician with further evidence of the

soundness of the valuation process in steps 3 and 4. Where the statistician concludes that the original valuation was unsoundly based and was too high, a capital transfer, equivalent to the sale value minus the original purchase price, is recorded at the time of sale from government to the unit which sold the assets to government. A capital transfer to government should not be recorded if the value at which the asset is sold by government is higher than the value at which it was purchased by government.