Chapter 9

The general government account

This chapter first describes general government accounts and outlines the composition of general government. Next, it explains how to calculate the four major public finance indicators: general government deficit, general government debt, general government expenditure, and taxes and compulsory social contributions.

OECD *Economic Surveys* on individual member countries always contain in-depth analysis of fiscal data, and they sometimes criticise government fiscal policy. Here are some extracts from the March 2013 report on France:

> "Since the late 1970s, the general government budget has always been in deficit, resulting in a trend increase in the public debt-to-GDP ratio. Hitting announced budget targets over the last three years has enhanced France's fiscal credibility, as reflected in the low interest rates on its public debt. The public debt-to-GDP ratio (Maastricht definition) is projected by the OECD to have risen from 57% in 2001 to 91% in 2012 before it reaches nearly 96% of GDP in 2014. Cutting public indebtedness substantially is crucial for ensuring macroeconomic stability and underpinning long-term growth. The public spending ratio would stabilise in 2013 at the same level as in 2011 and 2012, i.e. 56.3%. It should then gradually decline to 53.1% by 2017. However, specific measures for reducing spending have not yet been decided. Tax hikes may also be more attractive than spending cuts in the short run because they trigger less social resistance that might unnerve financial markets. But in the medium run, spending cuts are thought to hurt economic growth less than tax hikes, perhaps because they reflect a stronger and more lasting commitment. In light of already high taxes in France, placing too much reliance on tax hikes for fiscal consolidation could thus prove risky in the medium term." (OECD, 2013).

As shown in Table 9.1 below (published by INSEE, the French statistical office), the French public deficit was 7.5% of GDP in 2009, but was reduced to 4.8% in 2012, still considerably above the 3% ceiling set by the Maastricht Treaty for EU member countries. In addition, French public debt widely exceeded the other Maastricht ceiling of 60% of GDP in 2009 and rose further between 2010 and 2012. These results are due to the continuing upward drift in public spending (56.6% of GDP in 2012), while compulsory levies (taxes and social contributions), the main source of revenue for general government, continue to increase as a percentage of GDP (45.0% in 2012). The OECD economists also use an indicator called "*structural deficit*" to better understand the underlying trend in fiscal policies (see Box 9.1: "The cyclically adjusted financial balance").

All the indicators cited above come directly from the national accounts published by INSEE for the general government sector. This is not surprising. Because the central government is the major macroeconomic agent, it is

normal to use macroeconomic accounts for analysing its policy. But it is the Maastricht Treaty criteria, which are based on definitions contained in the national accounts, that intensified the use of national accounts by EU member countries to analyse their public finances (see the appendix of this chapter "Going further: The Maastricht criteria"). Since then, compilation of the government accounts has become a very significant part of the work of European national accountants, to the point that national accounts in Europe can be dubbed as accounts for GDP plus "S13-B9" (which is the code for the surplus/deficit of the general government). Macroeconomists should gain thorough knowledge of these definitions or risk talking nonsense.

Table 9.1. **The French general government account**

Percentage of GDP

	2009	2010	2011	2012
General Government Deficit[a]	-7.5	-7.1	-5.3	-4.8
General Government Debt[a]	79.2	82.4	85.8	90.2
General Government Expenditure	56.8	56.6	55.9	56.6
Taxes and compulsory social contributions	42.1	42.5	43.7	45.0

a) According to the Maastricht Criteria

Source: Insee Databases (2013): Statistical indices and series: Macroeconomic Database: National Accounts *www.bdm.insee.fr/bdm2/index?request_locale=en.*

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We start this chapter by describing the general government account via a simplified diagram. Then, we outline the composition of general government, and we end with how to calculate the four major public-finance indicators shown above in Table 9.1.

Box 9.1. **The cyclically adjusted financial balance (or "structural deficit")**

General government spending and revenues are often highly sensitive to economic developments. Tax revenues tend to decline during economic downturns as income and consumption slow down, while at the same time public spending may increase as more people become unemployed and qualified for social assistance or unemployment benefits. On the other hand, during upturns, public finances improve as tax revenues boom and the number of those receiving social benefits usually declines. These fluctuations in tax revenue and public expenditure– in the absence of any discretionary change in policy – make it difficult to assess whether the fiscal stance is expansionary, neutral or restrictive for a given period, and to judge whether fiscal balances are sustainable in the long run.

Box 9.1. **The cyclically adjusted financial balance (or "structural deficit")** *(cont.)*

To respond to these key questions, economists have developed the concept of cyclically adjusted fiscal balances– often called "structural balances" or "structural deficits" when negative – by untangling structural and cyclical components of the general government balances of the national accounts. To derive these cyclically adjusted fiscal balances, one has to: (1) define what would be the potential (or structural) output of a country (see Chapter 4); and (2) estimate how tax revenue and public spending react when the actual output deviates from its potential during the economic cycle. Girouard and André (2005) provide a detailed view on the methodology used at the OECD. One should note that some one-off factors may make comparisons of cyclically adjusted public finance data across time and countries dubious if not corrected for. Examples include the transfer of future pension liabilities from a public enterprise to the general government sector accompanied by a transfer of existing pension fund assets from the enterprise to the general government sector. Under SNA 93, this improved the cyclically adjusted balance at the time of the transfer but result in deterioration in the longer-term. Thus the economists in the EU Commission and in OECD remove not only the impact of the economic cycle, but also the impact of these "one-offs". However, the definition of a one-off remains itself fuzzy.

1. A simplified diagram for general government

General government (GG) constitutes a very important **institutional sector,** including central government, local authorities and the social security funds. In federal countries (such as Germany) state authorities (called "Länder" in Germany) are also included. The official code for general government in the national accounts is "S13". Put simply, this sector has two functions: the production of non-market services (education, health care, defence, policing, etc.) and the redistribution of income (social benefits, subsidies). To finance the cost of these functions, general government levies taxes and social contributions. Part of these resources is used to pay public employees' salaries, as well as the intermediate consumption and investment needed to produce non-market services supplied free of charge. The rest is redistributed in the form of social benefits or subsidies.

National accountants use a common accounting framework for all the institutional sectors, be they private companies or government. However, it is worth remembering that government agencies are structured differently than firms. For one thing, government services have no selling prices, since they are free of charge. For another, most general government agencies are not aiming

to make an operating profit. Economists in fact use different aggregates depending on whether they are looking at firms or at general government: in the case of firms, they look mainly at the profit ratio (net operating surplus/value added), while for general government they look mainly at **net lending/net borrowing** (which is coded as "B9").

Box 9.2. **Why is such importance attached to item B9?**

For general government, B9 (net lending/borrowing) is equal to revenue minus expenditure. A negative B9 shows the existence of a public deficit or "net borrowing", which, as it names indicates shows that the government has to borrow to finance it. General government must strive not to spend more than it earns, on a structural basis. In general, net borrowing leads to an increase in the public debt and hence in the interest charges that have to be borne by future generations. A positive B9 means the existence of net lending, or a "surplus", enabling the government to reduce its debt. B9 is one of the main criteria in the Maastricht Treaty (see Going further at the end of the chapter). As a result, European countries pay a lot of attention to this balance.

Several non-European countries – for example, the United States – prefer to use a different balance, namely net saving (B8N). The disadvantage of the B9 aggregate is that it can become negative as a result of investment by government, which, in most cases, is positive in nature because it can contribute to future output. Net saving (B8N) has the advantage of being unaffected by a particular amount of investment in a given period, reflecting solely current operations, namely current revenue and current expenditure (including consumption of fixed capital). The rule that countries using this balance B8N impose on themselves is that current revenue should, on average, cover current expenditure, allowing that investment can be financed through borrowing. This is often referred to as the "golden rule".

The following simplified picture of the general government account illustrates how national accounts manage to bring the specific "non-market" operations of general government into the common framework. As in the case of the other institutional sectors, the account is in traditional "T" form, with "Uses" on the left and "Resources" on the right. The shaded areas of the account represent the monetary flows actually recorded (in other words, the revenues and expenditures) which are: taxes and social contributions under "resources"; employee compensation, intermediate consumption, subsidies, social benefits, interest on the public debt and GFCF under "uses". At the bottom of this shaded section, there is a row showing the balance representing net borrowing/net lending. All these amounts are calculated at current prices.

We now have to add to this framework items that are not based on monetary transactions (since prices are zero). This invented (or "imputed") portion is shown in italics in the un-shaded areas. In the top right-hand corner of the account, as resources, we see **output of non-market services** defined as equal to total costs (compensation plus intermediate consumption plus consumption of fixed capital – see Chapter 4). As a result, the profit – or to be more precise, the net operating surplus (NOS) – is zero, which should come as no surprise when dealing with non-profit institutions. This non-market output is provided to households and firms, but it is not recorded as consumption by these sectors but as consumption by the government itself. Thus, to counterbalance this "imputed" output of general-government resources, the "Uses" section of general government includes an entry for final consumption by general government, which equals non-market output (simplifying somewhat – see Box 9.4. "Definition of final consumption expenditure of general government" further down the chapter).

General government account: simplified diagram

The shaded areas show monetary flows, the un-shaded areas imputed flows

Uses	*Resources*
	Output of non-market services
Compensation of employees	
Intermediate consumption	
Consumption of fixed capital	*Profit = NOS = 0*
Subsidies	Taxes
Social benefits	
Debt interest	
	Social contribution
Final consumption equal (with some simplification) to output of non-market services	
GFCF	
Net lending/ net borrowing	

It is very important to note that "final consumption by general government" is an accounting convention. General government does not actually consume its output. Households and firms consume that output as public services. However, because there are no observable monetary transactions (the services are free of charge), national accountants have given up on the idea of attributing this consumption specifically to households or to

firms, and they have attributed it to general government itself. Note also, however, that the addition of the "imputed" items (output of non-market services and final consumption) makes no difference to the bottom line of the account (i.e. net lending/net borrowing), because the addition to resources is exactly offset by the addition to uses. In the end, net lending/net borrowing remains equal to the difference between actual revenue and expenditure.

There are exceptions to the rule that only actual flows affect the calculation of net lending/net borrowing. For example, when a government writes off debt owed by a developing country, no payment is made, but the amount is still recorded as a capital transfer expenditure in the national accounts, and thus affects net lending/borrowing.

To conclude, note that the simplified diagram of the government account presents four major quasi-principles: (1) the important balance is net lending/net borrowing, which is the difference between actual revenue and expenditure, (2) non-market output by definition equals total costs; (3) the net operating surplus of general government is zero; (4) by convention, general government consumes what it produces.

2. Detailed structure of the general government account

A complete set of accounts for France in 2011 (including the financial accounts and balance sheets) is shown on the following two pages. These accounts illustrate how the general government accounts are integrated into the national accounts, from production to balance sheet. In contrast to the earlier T-shaped model, with uses on the left and resources on the right, we have in this case shown the uses below the resources. However, this is merely a matter of presentation and does not affect the analysis.

As is typical, each account ends with a balance, which is coded with an initial capital B (for example, "B1 Value added, gross") shown under uses in the upper part of the account and under resources in the lower part. For example, the balance of the production account is gross value added, which is then shown again under resources in the generation of income account. Certain intermediate balances (disposable income, for example) are shown even though they have little meaning in the case of general government and are only rarely commented on by economists. By contrast, the final balance, "B9 net lending/net borrowing" is highly significant. Certain secondary transactions are grouped together under miscellaneous, because they are marginal and of interest only to specialists.

Let us start by taking the upper part of the accounts. The output of general government consists essentially of **non-market output** (EUR 376.8 billion in 2011),

whose definition and evaluation have been explained in the diagram and in Chapter 4.

The official title of this entry is "Other non-market output", but we have simplified this in the text and in the diagram.

But there is also a certain amount of market output, and output for own final use (together amounting to EUR 59.4 billion). The former consists of sales by general government (publications, sales of medicines by hospitals, exports of warships from naval shipyards, sales of water supply by communal syndicates). Output for own final use consists mainly of the costs of producing in-house software.

After deducting from total output intermediate consumption of EUR 109.6 billion (which represents all the current operating costs of functioning, such as paper, telephone, rentals, etc.), general government shows gross value added of EUR 326.7 billion, equivalent to 16.3% of GDP (see Box 9.3: "Limitations and pitfalls"). Most of the expenditure in the generation of income account consists of compensation of civil servants (EUR 262.7 billion), which includes actual and imputed social contributions (see Chapter 6). The imputed contributions are fairly high for general government because, in France, the state is itself the manager of the pension system for its employees and therefore does not pay employers' contributions. This item therefore has to be imputed in order to evaluate the actual cost of employing civil servants.

Table 9.2. **Non-financial accounts of general government**
France, 2011

	Production Account	
	Total resources	
P11_P12	Market output and output for own final use	59.4
P13	Non-market output	376.8
	Total uses	
P2	Intermediate consumption	109.6
B1G	Gross domestic product/ Gross value added	326.7
K1	Consumption of fixed capital	53.8
B1N	Net domestic product/ Net value added	272.9
	Generation of income account	
	Total resources	
B1N	Net domestic product/ Net value added	272.9
	Total uses	
D1	Compensation of employees	262.7
	Miscellaneous	6.3
B2N	Net operating surplus	3.8

Table 9.2. **Non-financial accounts of general government** *(cont.)*
France, 2011

	Allocation of primary income account	
	Total resources	
B2N	Net operating surplus	3.8
D2	Taxes on production and imports, receivable	305.2
	Miscellaneous	-13.4
	Total uses	
D41	Interest	52.6
B5N	Net national income/ Net balance of primary incomes	242.9
	Secondary distribution of income account	
	Total resources	
B5N	Net national income/ Net balance of primary incomes	242.9
D5	Current taxes on income, wealth etc.	224.6
D61	Social contributions	375.6
D7	Other current transfers	14.3
	Total uses	
D5	Current taxes on income, wealth etc., payable	0.1
D62	Social benefits other than social transfers in kind	388.7
D631	Social transfers in kind (via market producers)	122.0
D7	Other current transfers	64.9
B6N	Net disposable income	403.7
	Use of income account	
	Total resources	
B6N	Net disposable income	403.7
	Total uses	
P3	Final consumption expenditure	490.0
P31	– Individual consumption expenditure	320.5
P32	– Collective consumption expenditure	169.5
B8N	Net saving	-86.2
	Capital account	
	Total resources	
B8N	Net saving	-86.2
	Net capital transfers	-9.1
	Total uses	
P5	Gross capital formation	62.5
	– GFCF	62.7
	– other	-0.2
K1	Consumption of fixed capital	53.8
P5N	Net capital formation	8.7
B9	Net lending (+)/Net borrowing (-)	-105.9

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Table 9.2. **Financial accounts of general government**

France, 2011

	Financial account	
	Changes in liabilities (flows of transactions)	133.3
F2	Currency and deposits	7.1
F3	Securities other than shares	125.1
F4	Loans	-9.6
F5	Shares and other equity	
F6	Insurance technical reserves	
F7	Other accounts payable	10.8
	Changes in assets (flows of transactions)	27.5
F1	Monetary gold and SDRs	
F2	Currency and deposits	15.9
F3	Securities other than shares	-4.7
F4	Loans	7.0
F5	Shares and other equity	-4.8
F6	Insurance technical reserves	0.0
F7	Other accounts receivable	14.1

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Balance sheet of general government, 2011

	Value at beginning of 2011	Transactions	Consumption of fixed capital	Revaluation	Other volume changes and adjustments	Value at end of 2011
Non-financial assets	1 693.8	63.0	53.6	54.6	5.6	1 763.4
Financial assets (consolidated)	921.4	31.4		-30.0	-1.1	921.7
Financial liabilities (consolidated)	2 030.9	135.3		11.6	0.1	2 177.8
Net worth	584.3	-40.9	53.6	13.1	4.4	507.2

Source: Insee Databases (2013): Statistical indices and series: Macroeconomic Database: National Accounts *www.bdm.insee.fr/bdm2/index?request_locale=en*; and OECD (2014), "General Government Accounts: Main aggregates", OECD National Accounts Statistics (database), doi: *http://dx.doi.org/10.1787/data-00020-en* and OECD (2014), "Financial Accounts: Consolidated flows, annual", OECD National Accounts Statistics (database), doi: *http://dx.doi.org/10.1787/data-00022-en*.

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The net operating surplus, which measures profit, is equal to EUR 3.8 billion, which is practically zero at this level of macro accounts. This is something of a surprise, since it was stated earlier that the profit of general government was zero by definition. The fact is that the diagram was an oversimplification, since small parts of the government sector operate as market enterprises (for example, certain water-supply units), so they record

Box 9.3. **Limitations and pitfalls of percentages of GDP**

All the main public-finance indicators are normally expressed as percentages of GDP, in other words, the amounts in current prices divided by GDP at current prices and then multiplied by 100. This permits international comparisons, such as comparing countries' deficits (expressed in billion euros or dollars or any other currency), which would otherwise have little meaning, since for the same absolute level of deficit a large country is much more capable of financing its shortfall than a small country with correspondingly smaller taxation and borrowing potential. Presentation as a percentage of GDP is applied to all public finance indicators and especially to total government expenditure and total fiscal burden, which is the sum of taxes and compulsory social contributions. These two latter indicators are widely used to measure the importance of the government's role in the economy, which in France is quite large (largest among the OECD countries). However, this approach is open to criticism. GDP is the sum of the values added. Strictly speaking, therefore, the importance of government activity in relation to GDP should be measured as the contribution of its value added to GDP, that is, 16.3% in the case of France. But even using this more rigorous yardstick, France would still have one of the largest ratios of government activity to GDP in the OECD.

operating profits or losses. The amounts remain very small, however, and it should be remembered that, as a matter of principle, **the net operating surplus of general government is zero**. One might even call this one of the fundamental equations of the national accounts.

Then we have the two major accounts "allocation of primary income and secondary distribution of income."

The differentiation between the two accounts ("primary" and "secondary") is somewhat artificial and should not be considered an important feature.

In them are resources commonly called "indirect taxes" but known in the national accounts as **"taxes on production and imports"** (EUR 305.2 billion), most of which in the case of France consist of VAT (Value-Added Tax) and the TIPP (internal tax on petroleum products). Among uses, note the size of the item for interest on the public debt (EUR 52.6 billion). Note also, further down, the substantial sum derived from so-called direct taxes, known in the national accounts as "**taxes on income and wealth**" (EUR 224.6), which include income tax and corporate profits tax, as well as numerous other taxes, including, the

wealth tax in the case of France. The resources also include the substantial amount of social contributions received by the social security funds (EUR 375.6), which are subsequently redistributed to households. Note that social security funds are not financed exclusively through social contributions but also through more general taxes, and sometimes through borrowing. Taxes and social contributions are measured on an "accrual basis" (see box "Accrual accounting and government accounts" at the end of this chapter).

The analysis of social benefits in the national accounts is somewhat complicated. The classification distinguishes **social benefits other than social transfers in kind** (D62) and **social transfers in kind** (D631). A large part of the payments to households by social security and other social insurance or social assistance units (pensions, maternity allowances, family allowances, death benefits, etc.) is recorded under D62. It is this part (EUR 388.7 billion) that appears as a use in the general government account under "social benefits" (and as a resource in the household account). However, another substantial part (EUR 122.0 billion) is classified under D631. This includes repayments from the health sector of social security – medicines, medical visits and costs of transporting patients – payment of household and medical assistance in the home and housing allowances. Somewhat strangely, these are not shown as social benefits received by households but as "social transfers in kind", in a subsidiary account called "adjusted disposable income", and they are counted as final consumption expenditure of general government, and not as consumed by households.

This explains why the sum recorded as **(P3) final consumption expenditure of general government** (EUR 490.0 billion) is higher than the non-market output (EUR 376.8 billion), contrary to what was shown in the simplified diagram. The fact is that, as explained in the previous paragraph, the major part of the **social transfers in kind**, the part corresponding to purchases by general government of goods and services produced by market producers and supplied to households, is recorded as final consumption expenditure by general government and not as social benefits. To complicate matters even more, the national accounts record a small portion of the sales by general government under "partial payments" by households. In the case of France, these consist mainly of daily hospital fees, which in fact represent a very small fraction of hospitalisation costs. This part of the consumption expenditure of general government has to be removed, since it is recorded directly under household consumption. Thus, the formula that precisely defines the final consumption expenditure of general government is therefore more complicated than the one in the simplified diagram and is shown in Box 9.4:

Box 9.4. **Definition of final consumption expenditure of general government**

P3/S13 Final consumption expenditure of general government = P13/S13 Non-market output – P131/S13 Partial payments by households + [D6311 + D63121 + D63131]/S13 Social transfers in kind corresponding to purchases of products supplied to households via market producers. This gives, in billion euros: 376.8 – 8.9 + 122.0 = 490.0. Unfortunately, the last two figures in the bracket are not shown in the main table published by INSEE for general government and one has to go to the subsidiary accounts to find them.

Final consumption expenditure of general government is itself split into **individual consumption expenditure** (EUR 320.5) and **collective consumption expenditure** (EUR 169.5). The former includes expenditure by general government that can be unmistakably attributed to households, consisting essentially of spending on healthcare and education. The latter covers all other expenditure, i.e. that part of which it cannot be said with certainty who the consumers are, households or enterprises. These are collective expenditure items, such as general administration, defence, policing, etc. It was shown in Chapters 3 and 5 that by adding together individual consumption expenditure and household expenditure, one obtained **households' actual final consumption**, a concept used for international comparisons, in particular.

It will be seen from looking at other rows in the account that the column "uses" include net capital formation of general government, which is equal to GCF (EUR 62.5 billion) *minus* consumption of fixed capital (EUR 53.8 billion). Finally, there is the now familiar item **net lending/net borrowing of general government (B9A)**, which in 2011 was a negative EUR 105.9 billion, representing net borrowing or, in common terms, a public deficit. This balance is the most important Maastricht criteria. It closes the sequence of accounts known as the **non-financial accounts** of general government.

The non-financial accounts are then followed by the financial accounts, showing how general government has financed the deficit. As can be seen on the side of "changes in liabilities" (see Chapter 8 for definitions), this was done mainly by issuing securities – i.e. Treasury bonds, called in France BTF (short-term), BTAN (medium-term) or OAT (long-term) – for a sum of EUR 125.1 billion. We shall not comment here on the smaller financial transactions of the government, but it is worthwhile to comment on the "balance of transactions in financial assets and liabilities", which is another name for net lending/net borrowing (in fact, it has a similar code: B9B). It will be seen that,

unlike the household and enterprise accounts, the B9B balance is exactly equal to the B9A balance, demonstrating the higher quality of the general government account compared to business or households accounts (see box "Sources" at the end of this chapter).

As can be seen in the row entitled "financial liabilities" on the balance sheets, the substantial issuance of Treasury bonds has contributed to a rise in the public debt (EUR 135.3 billion). The amount of public debt, as defined in the national accounts (which differs from the definition of public debt according to the Maastricht treaty) is EUR 2 177.8 billion. INSEE estimates that the total assets of general government at current prices amount to EUR 2 685.0 billion, of which EUR 1 763.4 billion is non-financial assets (land, buildings, other construction) and EUR 921.7 billion of financial assets (essentially listed or non-listed shares in public-sector enterprises). It is interesting to note that the net worth of the general government estimated by INSEE actually increased during 2011, while at the same time the government has very significantly increased its debt. These messages are contradictory: the first is positive, the second negative. The positive message should be considered with caution, because the increase in the net worth is essentially due to the estimated re-evaluations of the non-financial assets of the government (+54.6). This probably corresponds to estimated holding gains on government buildings. But these estimates are very approximate, and because it is probably difficult to sell some of the government buildings, this is only "potential" revenue.

3. What is the scope of the general government?

The figures shown in the national accounts for the totality of general government clearly depend on the scope of this sector. It is obvious that parts of the administration, like the Finance Ministry or the Education Ministry, are included. In fact, all the units financed through the budget discussed in Parliament are included. But there are many entities, particularly in France, that are commonly said to be "on the border" between public and private. In the national accounts, one says that they are on the frontier "between the market and non-market sectors". For example, are the French public utility Électricité de France (EDF) and the French Post Office, both of which have long exercised a public monopoly, part of general government? Does a university or a secondary school form part of general government? Since the net lending/net borrowing of general government is equal to the sum of the net lending/net borrowing of the bodies included in it, knowing which entities are part of general government is essential to reliable calculation of the public deficit and, above all, a calculation that is internationally comparable.

National accountants pay particular attention to the decision-making process in deciding which **institutional units** form part of general government. Institutional unit means an economic decision-making centre, characterised by autonomous decision-making in carrying out its principal function, and a complete set of accounts. Autonomy in decision making is judged by the unit's ability to make commitments, take on debts and award contracts in its own name. If a unit does not have these characteristics, it has to be included in the institutional unit that makes these decisions for it.

The general government sector is comprised of institutional units whose main activity is either to produce non-market goods and services or to redistribute income and national wealth. Non-market producers are those that provide services – and sometimes goods – free of charge, or at prices that are **not economically significant.** This original concept plays an important role in determining whether a unit is inside or outside the general government. The international system of national accounts defines prices that are not economically significant as "prices which do not have a significant influence on the amounts the producers are willing to supply, or on the amounts purchasers wish to buy". In practice, many countries interpret this criterion as meaning "prices that cover less than half the cost of production". Take the case of EDF, the large French electricity enterprise. EDF is indisputably an institutional unit (having a complete set of accounts), but it does not produce non-market goods and services, since electricity is sold at economically significant prices (prices cover costs: EDF makes, most often, a profit). Like the other large French public enterprises, (Railways, Post Office) EDF is thus included in the enterprise sector, not the general government. Now take the case of a statistical office like INSEE. It is not an institutional unit because it has very limited financial autonomy and cannot contract significant debts in its own name. It is therefore included as part of its supervisory institutional unit, the Finance Ministry, which is itself included in the unit known as central government. INSEE therefore forms part of general government via the central government unit under which it comes. On the basis of these general principles, national accountants have developed a decision-making tree containing three even more precise questions (see Box 9.5 below).

Box 9.5. **The decision-making tree regarding inclusion in general government**

The tree is made up of three interlinked questions:

First question: Is the unit an institutional unit? If so, go on to the next question; if not, it is included in the institutional unit it comes under (as we saw in the example of the statistical office discussed earlier in the text).

Second question: Is it public? Meaning: is it controlled by a unit that is itself part of general government? If so, go on to the next question; if not, it does not form part of general government.

Third question: Does it produce non-market goods and services? This criterion here is whether goods and services are sold at "prices that are not economically significant", a concept that in practice is often measured by whether sales regularly represent less than 50% of the production costs. If so, it is classified in general government.

Let us apply the decision-making process above to a farm. Is it an institutional unit? Yes. Is it controlled by a part of general government? No. Farms, therefore, however much they receive in the way of subsidies in France, do not form part of general government. Now take the case of "Réseau Ferré de France", the public enterprise that manages the railway infrastructure in France (while the SNCF manages transport on that infrastructure). It is an institutional unit. It is controlled by general government (its managers are appointed by central government). However, its sales (tolls paid by SNCF) cover slightly more than 50% of its costs. It is therefore not part of general government.* Even using this tree, however, there remain problematical cases, such as that of financial units, because measuring their sales presents practical problems.

* The reform of SNCF/RFF introduced in June 2014 might interfere with this conclusion.

Table 9.3. shows the general government sector in the case of France (figures in brackets show the total expenditure of each element, in order to give an idea of its importance[1]). As can be seen, the general government sector is itself broken down into three sub-sectors: central government (S1311), local government (S1313) and social security funds (S1314).

The international classification contains four subsectors, including S1312, which consists of the "states" level in the case of a federation. For example, in Germany, the subsector S1312 consists of the "Länder".

Central government in the narrow sense of "the State" is the largest unit of general government, and its expenditure and revenue constitute the largest

part of the overall general government account (expenditure amounting to EUR 414.6 billion). Central government in France also includes the accounts of almost 800 organisations collectively known as "various central government agencies". These are institutional and quasi-institutional units meeting the criteria set out above. They include the universities, all the specialised higher-educational schools, the CEA (Atomic Energy Commissariat) and the CNRS (National Centre for Scientific Research). This clearly shows the importance of the public sector in France in education and research.

Table 9.3. **Composition of the French general government sector**

General government (S13) (Total expenditure in 2011: EUR 1 118.5 bn)	Central government (S1311)	State (S13111) (Total expenditure in 2011: EUR 414.6 bn)	General budget Special Treasury accounts Ancillary budgets Treasury operations
		Various central government agencies (S13112) (Total expenditure in 2011: EUR 79.5 bn)	Comprises roughly 800 bodies of varying legal status, in many cases public establishments of an administrative nature, reflecting the tradition of State centralisation and intervention in France, especially in the fields of higher education, research and cultural activities.
	Local government (S1313) (Total expenditure in 2011: EUR 235.31bn)	Local authorities (S13131) (Total expenditure in 2011: EUR 215.7 bn)	"Communes", "départements", régions, inter-communal syndicates, urban communities and non-market "régies" (semi-official enterprises).
		Various local government agencies (S13132) (Total expenditure in 2011: EUR 34.1 bn)	Non-market units that are part of communes or locally financed; Chambers of commerce; secondary schools, etc.
	Social security funds (S1314) (Total expenditure in 2011: EUR 532.1 bn)	Social insurance funds (S13141) (Total expenditure in 2011: EUR 508.2 bn)	General social security system; special funds; other supplementary pension funds for employees and independent workers
		Bodies controlled by social insurance (S13142) (Total expenditure in 2011: EUR 84.6 bn)	Public hospitals; other bodies

Source: Insee Databases (2013): Statistical indices and series: Macroeconomic Database: National Accounts *www.bdm.insee.fr/bdm2/index?request_locale=en*.

StatLink http://dx.doi.org/10.1787/888933144135

The local authorities comprise the regions (22 in number in 2014), the "departements" (101) and the "communes" (around 36 000) together with the numerous and varied bodies attached to them. Lastly, the social security funds include the major funds for employees and independent workers (CNAM: sickness, CNAF: family, CNAVTS: retirement), UNEDIC (unemployment

insurance), the supplementary pension schemes (AGIRC, ARRCO), and, the largest item, the public hospitals – or more precisely, the hospitals participating in the public hospital service.

4. The principal public-finance indicators

These are the four indicators shown in the table at the beginning of this chapter: (1) the public deficit; (2) the public debt; (3) public expenditure; (4) total taxes and social contributions. They are usually shown as percentages of GDP (in other words divided by GDP at current prices and then multiplied by 100). In the case of the EU countries, the first two indicators are among the Maastricht criteria that are reported (or "notified") to the European Commission. The other two are not central to the national accounts but derived from them. They do not form part of the Maastricht criteria.

Public deficit: item B9A "net lending/net borrowing of general government". When the item is negative, it is a public deficit and when positive, a public surplus.

Public debt: the amount of public debt on the balance sheets of general government. In the case of EU countries, the "notified" (or Maastricht-reported) public debt is appreciably different from debt as it appears in the national accounts, for three reasons. First, the notified debt is consolidated, meaning that debts owed by one general government unit to another are cancelled out, for example, the debt of central government vis-à-vis local authorities. Second, the notified debt is valued at face value and not at market prices as is done in the national accounts. Finally, the notified debt includes only part of the debt, excluding that relating to pension liabilities, the still unpaid accrued interest and certain very short-term debt (commercial borrowing and advances). Exercise 8, at the end of this chapter, shows the reconciliation of the two definitions.

Public expenditure: this is total actual expenditure, meaning monetary payments by general government.[2] This indicator is widely used to measure the size of the role played by general government in the national economy. French governments of both main political tendencies have always regarded it as an important indicator and tried to reduce it.

Total taxes and social contributions: this indicator has much in common with the previous one, but it is measured by general government revenue and not expenditure. As its name indicates, it reflects the taxes and actual contributions (in other words, not including imputed contributions) that households and firms must pay to various parts of general government. The figure is very high for France by comparison with other countries (see Table 9.4), and all governments have tried to reduce it.

In France, this indicator is called "prélèvements obligatoires" translated as "compulsory levies".

It should be stressed that, for EU countries, the figures include taxes paid to the EU institutions (including the European Community portion of Value-Added Tax). For this reason, it is more accurate to refer to taxes and social contributions *payable to general government and EU Institutions*.

Table 9.4. **Taxes and compulsory contributions**
Percentage of GDP, 2010

France	42.9
Germany	36.1
Italy	42.9
Sweden	45.5
United States	24.8
OECD – Total	**33.8**

Source: OECD (2012), "Economy-wide regulation", OECD Product Market Regulation Statistics (database), doi: 10.1787/*data-00593-en*.

StatLink http://dx.doi.org/10.1787/888933144143

Notes

1. The sum of the lower parts is sometimes larger than the higher level. This is because, moving up one level, the consolidation of certain cross-transactions means that they cancel each other out. For example, certain transfers between central government and local authorities are counted as expenditure by central government but not by general government, since this expenditure appears elsewhere as revenue for local authorities that are part of general government.
2. In principle only, because in practice it includes some amounts that are not actually paid, such as imputed contributions (included in compensation of employees) or gross fixed capital formation in the form of software produced for own account. Moreover, this amount includes (somewhat bizarrely) certain "negative expenditures", such as the proceeds from the sales of mobile telecommunications licences.

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Key points

- The general government sector consists of institutional units producing non-market goods and services or carrying out transactions that redistribute income or national wealth.
- Non-market output is the sum of the costs involved: intermediate consumption, compensation of employees, consumption of fixed capital.
- The net operating surplus of general government is, by definition, basically zero.
- In the national accounts, accounting convention requires that the non-market output of general government be accounted for as if it were consumed by general government itself.
- The consumption expenditure of general government is equal to the non-market output (minus partial payments) plus the social benefits in kind purchased by general government for the benefit of households.
- The public deficit is measured by item B9 "net lending/net borrowing" of general government. If this is negative, it means a deficit; if it is positive, a surplus.
- Total taxes and social contributions consist of taxes and actual social contributions paid by households and firms to general government, and in the case of the EU countries, to the European institutions.

Going further

The Maastricht criteria

When the European countries decided to introduce the euro as a common currency, it was necessary to reach agreement on fiscal policy in order to prevent bad fiscal management in one country from affecting the others. If one country allows deficits to build up and thus increases its public debt at the expense of future generations, it can destabilise the whole euro zone as the financial markets will push interest rates to unsustainable levels, thus necessitating the rescue of the country. Despite all the constraints of Maastricht criteria, this is what happened in 2009 in Greece, and since this year the whole Euro zone is struggling against the domino effect of this initial catastrophe. This has led the EU Commission to strengthen the constraints and to extend its analysis to the competitiveness imbalances in the Euro zone. These imbalances were hidden by the existence of a single currency. Returning to statistical measurement, policy makers continue to impose fiscal rules on all EU governments, via the so-called "Maastricht Treaty". Because the national accounts provided the best internationally comparable accounting framework, the Maastricht Treaty outlined criteria based on the definitions in the national accounts. On 1 April and 1 October each year, performance in relation to these criteria is "notified" to the European Commission. The first of these criteria is the notified public deficit, measured by item S13-B9 in the national accounts. This must be less than 3% of GDP. The second criterion is the notified public debt (see definition in the text) which has to be less than 60% of GDP. Since the introduction of these criteria, Eurostat has put considerable effort into recommending comparable treatment among countries, even in the most difficult cases. The financial prowess of government Treasuries is in fact just as great as that of other big players in the financial markets. In the end, the relevance, comparability and transparency of public accounts have benefited considerably from the use of national accounts.

The two Maastricht criteria on the deficit and debt levels are in fact linked, since a deficit can be expected to lead to an increase in debt. In fact, at the origin, there was a mechanical link between the thresholds of 3% and 60%: 3% of deficit is the amount that stabilises the debt at 60% of GDP, assuming

that nominal GDP increases by 5% (which was more or less the case in the 1990s). Some economists criticise the Maastricht criteria on the grounds that they should take the economic situation into account. They think it is absurd to ask a country in the throes of a recession to cut expenditure in order to meet the criterion; at time when tax revenue is declining, this would tend to intensify the recession. The European Commission is therefore moving toward an interpretation based more on longer-term trends, by setting a target for a reduction of the structural deficit, in other words the deficit adjusted for the impact of the economic cycle. (The structural deficit is explained in the box "Cyclically Adjusted Financial Balance"). At the same time, it is interesting to note that the debt criterion appears to go somewhat against the fundamentals of capital management theory, because it focuses on "gross debt", not taking into account assets held. Capital management theory prefers "net debt", which equals liabilities minus assets. This is because for a given amount of gross debt, the diagnosis for two countries can differ widely depending on their assets.

For example, one country may have no assets, while another has considerable shareholdings. By selling these shares, the second government can reduce its debt, which is not true of the first. In practice, however, the assets of general government are difficult to measure and some of these assets are not easy to sell. This probably explains why the Maastricht Treaty refers only to gross debt and not net debt. However, this can result in certain paradoxes (see Exercise 7).

Data Sources: How are the figures obtained?

The general government accounts are the most precise of the national accounts. For this sector, unlike the situation for households and firms, national accountants have all the accounts of the institutional units making up the sector and not just a statistical sample. The compilation method used for general government therefore becomes less statistical and more accounting oriented. In France, the accounts of central government, the social security system and the thousands of local entities are transmitted to the "Direction de la Comptabilité Publique" (Public Accounts Directorate) in the Finance Ministry. Here, a special service consisting of some 30 people transforms the thousands of accounts and budget headings into the aggregates used in the national accounts, following the very detailed directives supplied by INSEE. The compilation method nevertheless remains statistical for the initial estimates, at a time when not all the accounts, especially those of the social security, are yet available. For 2012, for example, INSEE published its initial estimates of the accounts of general government on the 27 March 2013. These initial estimates are to be subsequently revised.

There are two fortunate consequences of the excellence of government-accounts data: (1) In many countries, there is little to no need to reconcile the balances of the non-financial accounts and the financial accounts (B9A and B9B, respectively) for the general government (i.e. the so-called "statistical discrepancy" is very small). (2) National accountants can use government data to improve the compilation of accounts for the other sectors. For example, since they include comprehensive data for social contributions received by general government, and since these necessarily correspond to the social contributions paid, the figures can be used to improve the enterprise account, which is not exhaustive in this respect. Because of this, national accountants say that the general government account acts as a "pilot" account.

Tricks of the trade: Above and below the line

For the non-specialist in public finances, analysing the accounts of numerous public entities is a nightmare when it comes to adding together (or "consolidating") several of these. This is because of the numerous flows between these entities, making it easy to get lost in the complexity of relationships, with the result that mistakes can be made in calculating the overall deficit. The national accounts provide a simple benchmark that can even be expressed mathematically: the net lending/net borrowing item is an additive variable. In other words, the overall net lending/net borrowing for a group of units is precisely equal to the sum of their individual net lending/net borrowing. It is therefore easy for national accountants to measure the impact of the reclassification of a government unit. The net lending/net borrowing of this unit can be added to that of general government as a whole, without needing to know anything about its complex relations with others.

Reference is sometimes made to "above-the-line" and "below-the-line" accounting. What do these obtuse terms mean? Are they used to hide something? No. These expressions are sometimes used by national accountants to describe whether a given operation will have an impact on the deficit. The "line" in question is item B9A, the net borrowing/net lending of the capital account. An operation is classified as "above" this line (corresponding to its actual location in the sequence of accounts) if B9A is affected, and "below" this line if there is no impact. Let us take an example. Central government can obtain cash (to buy back part of its debt, for example) either by selling shares or by selling property. If it sells shares, the operation is below the line (national accountants also say that it is "entirely financial"). This is because shares constitute a financial asset; financial assets are included in the financial account, i.e. below the line, and the money obtained is also a financial asset, treated similarly. The situation is quite different if the government sells property. The money obtained is again shown below the line, but the sale of the property is shown above the line, with the result that the

public deficit is correspondingly reduced. Exercise 6 explains this case, which is interesting in that it highlights one of the limitations of the definition of the public deficit. Why should the impact be different between a financial disposal (of shares) and a non-financial disposal (of property)? The answer is that it is based on a convention, and like any convention, the definition of the deficit has advantages and disadvantages.

Accrual accounting in general government accounts

National accounts are drawn up on what is known as the **accrual basis** (for more on accrual accounting, see appendix "Going further (3)" in Chapter 10). Here we shall merely describe the implications for the general government account. Accrual accounting is a basic accounting practice in the private sector, but it has not so far been completely accepted for public accounting except in a few countries. In France, while the social security institutions have adopted it, this is not yet true of the State Budget, which to a great extent remains on a "cash" basis, especially for income. However, in the recent years, France has developed an accrual system for the State (so-called "comptabilité generale d'exercice"). However, because these accounts are recent, INSEE, the French statistical office continues to use the cash accounts, thus recording the tax payments received and not the tax due. It is therefore obliged to transform the budgetary data in certain cases, notably for VAT (Value-Added Tax). In practice, VAT generated and collected by firms during a given month is received by the government only six weeks later. INSEE therefore brings forward the VAT recovery by these six weeks (see Exercise 9 at the end of this chapter). For certain other taxes, INSEE records tax assessments instead of tax payments and therefore has to introduce an adjustment item called "assessed but unlikely to be collected" (see Exercise 5). INSEE is also obliged to make significant modifications in the amount of interest paid by government in order better conform to the accrual concept. For example, some government bonds are "zero-coupon", meaning that interest is not paid annually but in a lump sum at the end of the bond's maturity. INSEE spreads out the interest over the life of the bond in order to give a truer account of government's actual annual charges.

Exercises for Chapter 9

Exercise 1. Updating the first table

The figures in this chapter are extracted from the old SNA 93 system of accounts. Go to the INSEE web site, *www.insee.fr*. Using the pages devoted to the annual national accounts for general government, find the amounts in million euros in recent years for the following: general government net lending/borrowing (B9A); the public debt; public expenditure; taxes and compulsory contributions. Also find GDP at current prices. Using these figures, update the four indicators in Table 9.1 of this chapter and adapt them to the new SNA 2008.

Exercise 2. MCQ: Are the following propositions true or false?

a) The "deficit" is the same as "net lending".

b) All output of general government is non-market.

c) Social benefits are financed out of social contributions.

d) The convention in the national accounts is that general government consumes its non-market output.

e) B9A is the official code of the net lending/net borrowing item.

f) The sum of the B9A items of the institutional units making up general government is less than the B9A of general government.

g) In France, the state monopoly generating electricity (EDF) is an institutional unit forming part of general government.

h) Non-market output is sold at economically significant prices.

i) The gross operating surplus of general government is zero.

Exercise 3. Identifying general government expenditure in the general government account (a tricky exercise)

The following table shows INSEE's calculation of total French general government expenditure in 2011. On the basis of this model, find the principal elements of this calculation (those in bold type), using the full set of general government accounts included in the text and other information. Explain why

total final consumption expenditure of general government is not included in the expenditure figure, despite being the largest "use" item of general government. Explain why the consumption of fixed capital is not included.

Table of government expenditure

2011

Intermediate consumption (P2)	**109.6**
Compensation of employees (D1)	**262.7**
of which: Employers' imputed social contributions (D122)	39.1
Other taxes on production (D29)	9.5
Property income excluding interest (D4 except D41)	0.1
Current taxes on income, wealth, etc. (D5)	0.1
Interest (D41)	52.6
Social benefits other than social transfers in kind (D62)	**388.7**
Social transfers benefits in kind of market goods and services (D63 – part)	**122.0**
Subsidies (D3)	29.5
Other current transfers (D7)	64.9
Capital transfers (D9 except D995)	14.5
Gross fixed capital formation (P51)	**62.7**
Other net acquisitions of non-financial assets (P52, P53, K2)	**1.6**
Total expenditures	1 118.5

Source: Insee Databases (2013): Statistical indices and series: Macroeconomic Database: National Accounts *www.bdm.insee.fr/bdm2/index?request_locale=en*.

Exercise 4. Moving from expenditure to revenue

Total expenditure was shown in the previous exercise (EUR 1 118.5 billion). How can the figure for revenue be very easily obtained from the general government account?

Exercise 5. Moving from revenue to compulsory levies (a tricky exercise)

Compulsory levies are the sums raised by government from households and firms in the form of taxes and compulsory social contributions. They therefore correspond to government revenue. This exercise consists of attempting to move from the general government revenue (shown below) to total compulsory levies in the case of France, using subsidiary information. Use two principles: (1) do not include imputed social contributions; (2) include taxes paid to the European institutions. The result you are looking for is EUR 875.4 billion.

Revenue of general government

2011

Market output and residual sales (P11)	58.0
Output for own final use (P12)	1.4
Partial payments of households (P13 – partly)	8.9
Other subsidies on production (D39)	3.1
Interest (D41)	3.6
Property income excluding interest (D4 except D41)	12.6
Taxes on production and imports (D2)	305.2
Current taxes on income, wealth, etc. (D5)	224.6
Capital taxes (D91)	10.3
Social contributions (D61)*	375.6
Taxes and social contributions assessed but unlikely to be collected (D995)	-6.2
Other current transfers (D7 except D73)	14.3
Capital transfers (D9 except D91, D995)	1.2
Total receipts	1 012.7
For information:	
* *of which:* Imputed social contributions (D612)	39.1
Actual compulsory levies received by institutions of the European Union	5.0

Source: Source Insee Databases (2013): Statistical indices and series: Macroeconomic Database: National Accounts *www.bdm.insee.fr/bdm2/index?request_locale=en.*

Exercise 6. Deficit and debt as recorded in the T-shaped accounts

The object of this exercise is to illustrate the difference between "above the line" and "below the line" transactions. This exercise is training in the use of T-shaped accounts, which are an excellent instrument that any national accountant should use before replying to what is a difficult question.

Let us first suppose that the State sells shares worth EUR 10 billion in order to pay off part of its debt. Show that this has no impact on the deficit, by completing the non-financial and financial T-shaped accounts below.

Non-financial account of general government

Uses	Resources
	B9A Net lending/net borrowing

Financial account of general government

Changes in assets	Changes in liabilities
Currency and deposits	Currency and deposits
Securities other than shares	Securities other than shares
Shares and other equity	
	B9B Balance on the financial account

Show, using the same accounts, that the sale of property for EUR 10 billion, again for the purpose of reducing the debt, has an impact on B9A. Draw conclusions.

Exercise 7. (A follow-up to 6, but slightly more complicated)

The object of this exercise is to complete the T-shaped tables below with the following information. The government sells property for EUR 5 billion and equities for EUR 3 billion, issues long-term Treasury notes for EUR 30 billion and buys in short-term Treasury notes for EUR 10 billion. By how much will its deficit be reduced? How will its debt change? Recapitulate the variation in general government net worth.

Non-financial account of general government

Uses	Resources
GFCF	
	B9A Net lending/net borrowing

Financial account of general government

Changes in assets	Changes in liabilities
Currency and deposits	Currency and deposits
Short-term securities	Short-term securities
Long-term securities	Long-term securities
Shares and other equity	
	B9B Balance of the financial account

Exercise 8. Calculation of tax revenue on an accrual basis

The following table shows a quarterly series for the receipts of VAT (Value-Added Tax) by the Treasury. Calculate the amount of VAT as recorded in the national accounts for the year, remembering that it is assumed that there is a lag of six weeks between the generation of the VAT (the purchases by households) and receipt by the Treasury. Suppose that the government raises the VAT rate by 2 percentage points at the beginning of November. Show why the series on an accrual basis is more useful in macroeconomic terms than the series on a cash basis.

Q1	Q2	Q3	Q4	Q1	Q2
15 420	16 658	14 548	16 510	18 540	19 870

The solutions to these exercises are available at:
http://dx.doi.org/10.1787/9789264214637-27-en