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**GENERAL GOVERNMENT: MEASUREMENT PROBLEMS**

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## Introduction

The first chapter of ESA95 lists eight characteristics of ESA concepts. The fifth characteristic is the following: the concepts are different from most administrative concepts. One of the most serious consequences of this characteristic is that the grouping of producers in ESA95 differs from the legal concepts used in the economy and in the administrative registers.

In ESA 95 we can find a couple of rules according to the sector classification. One of them is the so-called 50% criterion, which is the clearest rule of ESA95. If the sales cover more than 50% of the production cost, the institutional unit is a market producer. Market units can not be classified into general government sector. Unfortunately the other rules relating to the classification issue are less definite and clear than this criterion.

Because the economy is in transition the institutional system is in transition as well. To follow the classification of units is more difficult task in our countries than in a market economy. That is why I would like to devote my presentation to the classification problems in the general government sector.

The first problem I would like to raise is the classification of the traditional budgetary institutions fulfilling the above mentioned 50% criterion.

## Budgetary institutions

In Hungary the central government and the local government sector in legal terms consists of budgetary institutions. Ministries, most of the schools, health care and cultural institutions are traditionally budgetary institutions.

Budgetary institutions prepare their budget according to their founder 's directives. Their budget makes part of the budget of the ministry or local government they belong to, and this budget should be approved by the parliament or by the local councils. The management of these institutions is appointed by the minister or by the local government. It means they do not have autonomy of decision. On the other hand they keep a full set of accounts including balance sheet. In theory they are clearly non-profit institutions controlled by the government.

The problem raises when these institutions start to engage in market activity as well.

This happened to several of them in Hungary in the last years of the planned economy. The institutions were encouraged to sell their services in the market, services that were sometimes far from their principal function. For example budgetary institutions responsible for cleaning and maintenance of the governmental buildings were engaged in construction. Several institutions fulfilled the 50% criterion. The question was: shall we classify them out of the general government sector? Regarding their restricted autonomy two types of units could be considered:

a. Quasi corporations. In this case they should have been classified into the non-financial corporation sector.

b. Local kind of activity units. In this case they could be kept inside the general government but their output should have been measured as market output.

The Hungarian Statistical Office chose the second solution. We took into account that the economic behaviour in exercising their principal function is different from that of the corporations. The original function was considered as principal function. What were the consequences of this decision?

Every budgetary institution by legal form was considered local KAU of the central or local government. In other words: the central government in legal terms forms one single institutional unit in Hungarian national accounts. Similarly every local government with its budgetary institutions is one institutional unit. Ministries, schools, cultural or health care institutions and so on are treated as local KAUs.

Every entity which belongs to the general government by legal form is classified into the general government accounts irrespective of the market /non-market distinction, only the valuation of the output differs.

### **Public hospitals**

The above idea was challenged two years ago when EUROSTAT experts initiated an inquiry on classifying the public hospitals. The conclusion of this inquiry was that the public hospitals (budgetary institutions) are properly classified into the general government. But the reasoning of this decision was completely different from the one I described above.

EUROSTAT examined the way of financing. It concluded that public and private, market and non-market health care institutions compete in the market. The social security fund finances them in the same way, and the payments have an explicit link with the output. EUROSTAT raised the question, whether these payments should be considered as sales. Applying the example worked out in ESA95 for the public schools. At last it concluded that the payments should not be regarded as sales because the output is subject to negotiation with the government. What is the logic behind this reasoning?

- EUROSTAT experts regarded the budgetary institutions as institutional units.
- It applied the 50% criterion.
- Before applying the market/non-market distinction it classified the payments financing the activity.

This reasoning undermined our classification policy concerning the budgetary institutions. Fortunately in the mean time the legislation according to budgetary institutions restricted the market activity of these entities, and the ministries and local governments are encouraged to transform their institutions into non-financial corporations or non-profit institutions other than budgetary institutions. We still have to treat this problem, but to a lesser extent than before.

While the transformation of budgetary institutions into non-financial companies made our job easier because the market activities were mostly cleared out of the sector, the appearance of new type of non-profit institutions raised new problems. As they are legal entities all of them are identified as institutional units. We apply the 50% rule to separate the market units from the non-market ones. As we have seen in the example cited above, this can be complicated as well.

## Road maintenance institutions

The best example is the case of road maintenance institutions. There is a road maintenance institution responsible for the maintenance of the state road in every county. These entities used to be in Hungary budgetary institutions of the central government. In 1996 they were transformed into so called public utilities. Public utilities are non-profit institutions according to the national legislation. They are institutional units and we have three options for classifying them: general government; non-profit institutions serving households sector and non-financial corporation sector.

Before using the 50% criterion we had to examine the nature of the payments received by the institutions from the central budget. We found out that they had two kinds of activities: road maintenance including smaller renovation works, and road construction. Concerning the first activity the institutions do not compete with each other because each of them works in its own county. The ministry does not hire private units for the maintenance of the state road. Concerning the road construction, the situation is the opposite - the contractors are chosen by public competition. In addition, the road maintenance corporations can sell their services in the market if they have free capacity.

We found also that in the case of road maintenance activity the output is subject to negotiations between the ministry and the institutions. So we did not record these payments as sales. On this basis most of the institutions did not fulfil anymore the 50% criterion. From our point of view, we wanted to classify these units in as simple way as possible, this was a complete failure. We could not classify this unit into the non-financial corporation sector.

And now comes the more difficult part of our job: we should have decided whether the unit belonged to the general government. This part of the work also has two steps. The first one is the examination of financing. As the road maintenance activity is financed by the budget the answer was unambiguous.

The second step is the examination whether they are controlled by the general government. It is a very troublesome job. I will show you an example, but first I would like to close the road maintenance institution case. A simplification was introduced. Having recognised that their output should be recorded as collective consumption and taking into account that by convention the non-profit institution sector can not provide goods and services for collective consumption, we classified the road maintenance institutions into the general government sector. We also have to apply this simplified rule when classifying other newly established non-profit institutions (fire brigades for example)

This is not the proper way of classifying the non-profit institutions, according to ESA95 rules. One should examine whether the activity is financed and controlled by the government rather than the type of service provided by the unit. But as the notion “controlling” is quite difficult to be justified, this looked a comfortable and reasonable solution. But it is still difficult to find out if:

- a unit is a non-market producer
- the level of control practised by the general government is sufficient
- the output is for collective consumption

How should this unit be classified in the ESA95 framework?

## The media case

My last example concerns the difficulties in examining the controlling activity of the general government. This is the media case. You will not be very surprised if I tell you that the radio and television used to be budgetary institutions in the old times. In the last two years private producers entered into the market and the situation was completely changed.

- The radio and television budgetary institutions were transformed into three companies.
- Three foundations were established: the exclusive owners of these companies. They were established by the Hungarian parliament. These are non-profit institutions.
- A supervisory body was established to supervise not only the public service TVs/radios, but all the participants of the TV/radio media market. It conducts competition for the channels, it decides on the competitors for the free frequencies and contracts with the winner. This is a budgetary institution by legal form, but special one which is not controlled by the government but by the parliament. It is responsible for the distribution of the payments made by the government as well.

The TV and radio companies were classified into the corporation sector. This classification had some difficulties, because their receipts consist of:

- Market activity (advertising)
- Subsidies from the general government via the supervisory body and the foundation
- The operation fee paid by the consumers but distributed via the supervisory body and the foundation.

The result of the 50% criterion depended on the classification of the operating fee paid by the consumers, that is why first we classified the transaction rather than the units. We classified these payments as final consumption expenditure of households rather than a tax, despite of the fact that this fee arrives to the companies via two other institutions. It followed that the units met the 50% criterion, and could be kept inside the non-financial corporation sector.

The classification of the foundations was more difficult. They are established and owned by the Parliament. They play political role in the system: they isolate the companies from the political influence of the government in power. The foundations themselves are controlled by the parties of the parliament (in ESA95 parties are classified into non-financial institutions serving households sector) and by other non-profit institutions. They receive the payments (subsidies, operating fee) from the government via the supervisory body and they transfer them to the foundations. They act as mailmen.

The operating costs of the foundations are covered by 1% of the operating fee. As the operating fee is regarded as consumption expenditure by households, this made the situation even more ambiguous: foundations with clearly regulatory functions financed by sales.

As the supervisory body is a budgetary institution by legal form and also financed by the operating fee, we looked for a solution to solve this contradiction. This was the rerouting of the transaction. Rerouting is one of the rearrangement techniques of ESA95. It means that a transaction, which takes place directly between two units, is recorded as two transactions taking place indirectly through a third unit.

The whole amount of the operating fee was recorded as sales revenue of the companies. The part kept by the supervisory body and the foundations was recorded as tax on production paid by the companies themselves. This way we could ensure that they were financed by the government.

Finally we classified the supervisory body and the foundations into the government sector despite of the fact that they are controlled by parties and other non-profit institutions. Comparing the significance of parties in the controlling the foundations with that of other non-profit institutions we found out that the parties play more important role. Every party of the parliament is involved. That is why we could say that they are controlled by the parliament itself. The parliament is a government institution. This solution is justified by the fact that this is the only way to record their output as collective consumption.

This last example shows how difficult can be to recognise the boundary between the general government sector and the non-profit institutions serving household. Hundreds of theatres, cultural and health care institutions are nowadays non-profit institutions by legal status founded and mostly financed by the central or local budgets. In the case of large national institutions founded by the government the deed of foundation is published in the Official Journal and the information on the control is accessible by the statisticians. However, in the case of local institutions we do not have the necessary information.

It is not possible to classify such a mass of institutions on individual basis. Uniform and straightforward rules should be established and applied in the future.

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