CMFB

COMMITTEE ON MONETARY, FINANCIAL AND BALANCE OF PAYMENTS STATISTICS

CMFB Opinion on the treatment of non-returned banknotes and coins in national accounts in the context of the cash changeover

11/06/02

Eurostat consulted the CMFB on Friday 17 May 2002 on the above-mentioned subject. The deadline for returning the questionnaire was Friday 7 June 2002. Both the procedure and the content of the consultation were agreed by the CMFB Executive Body. All fifteen (15) national statistical institutes and fifteen (15) national central banks from the Member States returned the questionnaire. A total of thirty (30) national institutions, from all Member States, thus participated in the consultation. One institution from the EEA responded that it had no comments.

The result of the consultation was as follows:

- Twenty-six (26) national institutions agreed with the treatment proposed in the reference document (provided in the annex) without reservations. Four (4) national institutions also agreed, but expressed some reservations. No national institution disagreed. All the comments have been transmitted to Eurostat.

Accordingly, the CMFB agrees with the treatment in the national accounts of non-returned banknotes and coins in the context of the cash changeover as proposed in the annexed document.

In addition to this opinion, the following has been transmitted to Eurostat and will be kept in the records of the secretariat of the CMFB: a document putting together the answers of all the institutions; a summary of the vote; and the original replies of the institutions.

STEVEN KEUNING, CMFB Chairman
Voorburg, 11 June 2002

EUROPEAN COMMISSION
EUROSTAT

Directorate B: Economic statistics and economic and monetary convergence
Unit B-4: Accounts and financial indicators, statistics for the excessive deficits procedure

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TREATMENT OF NON-RETURNED BANKNOTES AND COINS IN NATIONAL ACCOUNTS IN THE CONTEXT OF THE CASH CHANGEOVER

(This document has been written in co-operation with the European Central Bank)

1. Introduction

During the euro cash changeover banknotes and coins in circulation denominated in national currency were returned to the respective issuers, which in most cases were (respectively) the national central banks and the national governments. Part of the national currency previously in circulation will never be returned because it has been destroyed or lost, or because holders decided to keep it for collection or other reasons. The non-return of banknotes in national currency generates an accounting gain for the NCBs, which may be transferred to government, either as a separate payment or as part of the regular payment of dividends. Section 2 deals with the treatment in National Accounts of this gain. Furthermore, coins are in general a liability of governments and the question arises whether its non-return impacts government deficit/surplus and debt. Section 3 analyses this issue.

2. Non-returned banknotes

ISSUE

This document deals with the impact on government deficit and debt within the framework of the Excessive Deficit Procedure of the cases where the non-return of old banknotes leads to flows to government as part of the regular payment of dividends and taxes on profits, or as other payments made by the NCBs.

EFFECT ON GOVERNMENT DEFICIT[1]

The Eurostat Manual on Government Deficit and Debt (part II.5) contains specific provisions on the types of payment from an NCB to government that are **not** considered as government revenue in national accounts:

- If "it happens that, apart from its normal activity (…), the central bank sells a significant part of its reserve assets… and pays back part or all of the proceeds to government (…) this payment of the proceeds has to be completely recorded in the financial accounts of general government and of the central bank."
- "Capital gains have to be excluded from the distributed profits of the central bank, at least for the part, which is distributed to general government, when the bookkeeping of the central bank allows for such capital gains to be included in trading profits."

The treatment of gains arising from non-returned banknotes is not explicitly discussed in the Eurostat Manual. However, the spirit of the recommendations in the Manual indicates that such gains, which are not part of the trading profits of an NCB, should not impact government deficit. This stems from the principle that reserve assets and currency are managed by the central bank 'on behalf of the nation' and government keeps implicitly special rights over them. By analogy with assets and liabilities owned by government, holding gains or losses and other changes in the volume of them change government's net worth but not government deficit. That is, in cases where government holds equity in an NCB, the government's net worth is automatically adjusted in line with such holding gains or losses and other changes in the volume of assets. When subsequent payments are received by government the payments have to be recorded as financial transactions (a withdrawal of equity), not as a government revenue (whether dividends, taxes on profits[2] or capital transfers). The same principle applies in the exceptional cases where government does not hold equity in the NCB.

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1 While the note applies the ESA 95 national accounts terminology, throughout the document the term 'accounting' is used to indicate that the word it qualifies should be understood in a bookkeeping (and not in an ESA 95 national accounts) sense.

2 Similarly to dividends, also amounts paid to government as taxes on profits arising from non-returned banknotes (at least when the amounts are big) should be recorded as withdrawal of equity - i.e. not recognised as taxes in national accounts. This is in line with the treatment put forward in the Eurostat Manual on Government Deficit and Debt (see part II.1.2, paragraph 1) regarding taxes on profits made by NCBs on revaluation of foreign assets, and by public holding companies relating to privatisation.

One of two situations may arise depending on the bookkeeping practices of the NCBs. In some NCBs the proceeds from non-returned banknotes may be regularly transferred to the profit and loss account and channeled to government indirectly via (accounting) dividends. Other NCBs may make one or several direct payments to government on the account of non-returned banknotes, perhaps even before they are definitively written-off in the accounting balance sheet. However, irrespective of the way in which government receives the proceeds in the different countries, the treatment in national accounts should lead to the same impact on government deficit and debt.

The detailed treatment in national accounts in the typical case where government holds equity in the NCB is as follows. Given that the non-returned banknotes having ceased to be legal tender can still be exchanged for legal tender banknotes during a certain period, it is necessary to reclassify them in national accounts from "currency" to "other accounts payable". This reclassification is recorded in the "other changes in volume of assets" account[3]. At the time of the writing-off of the banknotes, government's equity in the NCB is increased involving the "other changes in the volume of assets account" (while the NCB's net worth is unchanged similarly to the case of reserve assets). Money subsequently flowing to government on account of this writing-off is treated as a financial transaction in (withdrawal of) other equity.[4] In cases where the NCB makes payments to government in anticipation of the writing-off of the banknotes from the central bank's balance sheet, the payments are treated in national accounts as advance payments (AF.7) which are reversed against the withdrawal of equity when the writing-off takes place.

If government does not hold equity in the NCB but is entitled by legislation to receive the proceeds from non-returned banknotes, government deficit should likewise not be affected. In these cases treatment in the national accounts recognises that government keeps special rights in the proceeds arising from non-returned banknotes, reflecting the fact that government receives benefits as normally accorded to legal owners (see Eurostat's decision 05/98).

3. Non-returned coins

Coins in circulation appear in the balance sheet of government under the category "currency" and are part of the definition of government debt relevant for the excessive deficit procedure

3 Banknotes which have ceased to be legal tender but remain on the balance sheet of the NCB should not continue to be classified in national accounts under the category "currency" where only legal tender is recorded. In practice, consistency with money and banking statistics (and the monetary aggregates) may need to be preserved, so that the reclassification could take place a little time after the legal tender was suppressed.

4 When the payment is part of accounting dividends, the amount relating to non-returned banknotes should be identified, reclassified as a financial transaction, and excluded from national accounts dividends.

('Maastricht debt'). Similarly to the banknotes, old coins have to be moved to "other accounts payable" once they lost their legal tender status, but can still be exchanged. This means that in the euro cash changeover the old coins were taken out from the stock of debt outstanding when they were returned or, those non-returned, when they lost the legal tender status, since the category "other accounts payable" is not part of the 'Maastricht' debt. Of course these coins were replaced for a large part by euro coins so that the stock of government debt relating to coins remained roughly unchanged.

Like with the banknotes, the writing-off of the non-returned coins in government's balance sheet takes place when they are no more exchanged by the issuer (after which those that were not destroyed or lost become valuables). This should be recorded in national accounts as a writing-off proper (as opposed to cancellation[5]), through "other changes in volume", increasing government's net worth but leaving the net lending/net borrowing unchanged.

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5 In national accounts, debt cancellation differs from writing-off in that the former presupposes mutual agreement between debtor and creditor (debt forgiveness). Contrary to the writing-off, cancellation requires the recording of a capital transfer from the creditor to the debtor. The holders of the non-returned coins keep them for collection or other reasons (a financial asset is "transformed" into a non-financial one - valuables), not because they want to forgive the debt of government. Forgiveness would occur if the holders gave the coins back without receiving anything in return. Furthermore part of the non-returned coins were simply destroyed or lost, which in national accounts is treated under "other changes in volume".