

**REVISION OF THE SYSTEM OF ENVIRONMENTAL - ECONOMIC ACCOUNTS  
(SEEA)**

**United Nations Committee of Experts on Environmental Economic Accounting (UNCEEA)  
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**Chapter 5: Asset accounts**

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## 5.1 Introduction

- 5.1 Assets are considered items of value to society. In economics, assets have long been defined as stores of value that, in many situations, also provide inputs to production processes. More recently, there has been consideration of the value inherent in the components that comprise the environment and the inputs the environment provides to society. The term environmental asset has been used to denote the source of these inputs which may be considered in both physical and monetary terms.
- 5.2 One motivation for considering environmental assets is the concern that the current patterns and practices of economic activity are depleting and degrading the available environmental assets more quickly than they can regenerate themselves and hence there are concerns about sustainability. Another motivation is that current generations can be seen as “stewards” for the range of environmental assets on behalf of future generations. Overall, there is a general aim to improve the management of environmental assets taking into account the sustainable use of resources and the capacity of environmental assets to continue to provide inputs to the economy and society.
- 5.3 Combined, these motivations are a key driver for the development of the SEEA and in particular for the measurement of assets and the compilation of asset accounts. In this context, the aim of asset accounting in the SEEA is to measure the quantity and value of environmental assets and to record and explain changes in those assets over time.
- 5.4 For environmental assets, the physical and monetary changes over the period include additions to the stock of environmental assets (such as additions due to natural growth and discoveries) and reductions in the stock of environmental assets (such as those reductions due to extraction and natural loss).

### *Chapter structure*

- 5.5 This chapter focuses on accounting for environmental assets. Section 5.2 provides more detail on the definition of environmental assets in the Central Framework working from the general definition of environmental assets outlined in Chapter 2. Section 5.3 describes the structure of the accounts and the accounting entries that are required to compile asset accounts including opening and closing stocks, additions to stock, reductions in stock and revaluations.
- 5.6 Section 5.4 describes two key areas in the compilation of asset accounts. First, there is description of the principles of defining depletion of environmental assets in physical terms with particular focus on the depletion of renewable environmental assets such as aquatic and timber resources. Second, in relation to monetary asset accounts, there is a discussion of approaches to the valuation of environmental assets and in particular the net present value (NPV) approach. An annex to the chapter provides additional material explaining NPV.
- 5.7 Sections 5.5 – 5.11 outline asset accounting for a range of individual environmental assets. Detail is provided on the measurement scope of each of these assets, the structure

of the relevant asset accounts and other relevant conceptual and measurement issues. While there are general principles that can be applied across all environmental assets, each environmental asset has individual characteristics that must be taken into consideration.

## **5.2 Assets in the System of Environmental and Economic Accounts**

### **5.2.1 Introduction**

5.8 As defined in Chapter 2, environmental assets are the naturally occurring living and non-living components of the Earth, together comprising the bio-physical environment, that may provide benefits to humanity. In the Central Framework, environmental assets are considered from the perspective of the individual components that comprise the environment with no account taken of the interactions between these components as part of ecosystems. A discussion on accounting for ecosystems and ecosystem services is presented in SEEA Experimental Ecosystem Accounts.

5.9 This section provides an explanation of the general measurement boundary for environmental assets in the Central Framework including a description of the Classification of Environmental Assets and articulation of the relationship between environmental and economic assets.

### **5.2.2 Environmental assets in the Central Framework**

5.10 The scope of environmental assets in the Central Framework is defined through a focus on the individual components that comprise the environment. The scope comprises those types of individual components that may provide resources for use in economic activity. Generally, the resources may be harvested, extracted or otherwise moved for direct use in economic production, consumption or accumulation. The scope includes land and other areas of a country (such as inland waters and coastal waters) that provide space for undertaking economic activity.

5.11 The individual components of the environment that are considered environmental assets in the Central Framework are mineral and energy resources, land, soil resources, timber resources, aquatic resources, other biological resources (excluding timber and aquatic resources), and water resources. These individual components have been the traditional focus for the measurement of environmental assets through the development of specific asset or resource accounts. Other sections in this chapter discuss asset accounts for these types of environmental assets and the relevant measurement boundaries in physical and monetary terms.

5.12 The coverage of individual components in the Central Framework does not extend to the individual elements that are embodied in the various natural and biological resources listed above. For example, carbon and nitrogen are not considered individual environmental assets in the Central Framework. Nonetheless, the asset accounting framework can be extended to account for these individual elements. This extension is discussed in SEEA Experimental Ecosystem Accounts.

5.13 The measurement scope of the environmental assets of a country is limited to those contained within the economic territory over which a country has control. This includes all land areas, including islands; coastal waters including waters and sea-beds within a country's Exclusive Economic Zone; and any other water or sea beds in international waters over which the country has a recognised claim. The extension of geographic scope

beyond environmental assets on land is of particular relevance in the measurement of stocks of aquatic resources and mineral and energy resources.

5.14 In physical terms the conceptual scope for each individual component is broad extending to include all of the resources that currently provide or could provide benefits to humanity. However, in monetary terms the conceptual scope is limited to those individual components that have an economic value based on the market valuation principles of the SNA. For example, all land within a country is within scope of the SEEA to allow for a full analysis of changes in land use and land cover. In the SNA only land considered to have economic value is within scope. The broader scope applied in physical terms aims to account better for the environmental characteristics of the individual components. Issues concerning the valuation of environmental assets are described in more detail in Section 5.2.3.

*Classification of environmental assets in the central framework*

5.15 Based on a focus on individual components a classification of environmental assets in the Central Framework is presented in Table 5.2.1. For each of these environmental assets a measurement boundary in physical and monetary terms must be drawn for the purposes of asset accounting. These boundaries are described in the relevant section for each asset type (see Sections 5.5 – 5.11).

**Table 5.2.1: Classification of Environmental Assets in the SEEA Central Framework**

	Mineral and energy resources
	Oil resources
	Natural gas resources
	Coal and peat resources
	Non-metallic mineral resources (excluding coal and peat resources)
	Metallic mineral resources
	Land and other areas*
	Land
	Inland waters
	Soil resources
	Timber resources
	Cultivated timber resources
	Natural timber resources
	Aquatic resources
	Cultivated aquatic resources
	Natural aquatic resources
	Other biological resources (excluding timber resources and aquatic resources)
	Water resources
	Surface water
	Groundwater
	Soil water

\* The classification of Land and other areas presented here reflects higher level categories relating to land use. Land may also be classified by type of land cover. Section 5.6 discusses the issues regarding classification of land.

5.16 The volume of water in the ocean is not considered in scope of water resources in the Central Framework because the stock of water is too large to be meaningful for analytical purposes. The exclusion of the ocean in terms of a volume of water resources does not in

any way limit the measurement of ocean-related individual components such as aquatic resources (including fish stocks on the high seas over which a country has harvesting rights) and mineral and energy resources on the ocean floor.

5.17 Although oceans and the atmosphere are excluded, the measurement of exchanges and interactions with them is of particular interest. In this context, the interactions between the economy and the oceans, and between the economy and the atmosphere, are recorded in the Central Framework in various ways. For example, measures of the abstraction of sea water are included in the asset accounts for water resources, and measures of emissions from the economy to the atmosphere and oceans are recorded in physical flow accounts.

#### *Natural resources*

5.18 Natural resources are a sub-set of environmental assets. ***Natural resources include all natural biological resources (including timber and aquatic resources), mineral and energy resources, soil resources and water resources. All cultivated biological resources and land are excluded from scope.***

#### *Land and other areas*

5.19 For most environmental assets in the central framework it is straightforward to conceptualise the supply of materials to economic activity – for example in the form of fish, timber and minerals. The exception to this is land.

5.20 The primary role of land in the SEEA is its provision of space. The land and the space it represents defines the locations within which economic and other activity is undertaken and within which assets are situated. Although not physical, this role of land is a fundamental input to economic activity and can have significant value. This is most commonly observed in the varying valuations given to similar dwellings in locations that have different characteristics in terms of landscape, access to services, etc. This conceptualisation of land can also be applied to marine areas over which a country has a recognised claim, including its Exclusive Economic Zone (EEZ).

5.21 The term “land” as applied in the SEEA also encompasses areas of inland water such as rivers and lakes. For certain measurement purposes, variations in this boundary may be appropriate, for example to consider the use of marine areas for aquaculture, conservation or other designated uses. These details are explained in Section 5.6.

5.22 A clear distinction is made between land and soil resources. The physical inputs of soil are reflected in the volume of soil and its composition in terms of nutrients, soil water and organic matter. This distinction is discussed further in sections 5.6 and 5.7.

5.23 In the valuation of land and in the context of the measurement of ecosystems, both the location of an area and its physical attributes (i.e. topography, elevation, climate, etc) are important considerations. The valuation of land is discussed in Section 5.6 and the definition and measurement of ecosystems is described in SEEA Experimental Ecosystem Accounts.

### *Timber, fish and other biological resources*

- 5.24 Biological resources include timber and fish resources and a range of other animal and plant resources such as livestock, orchards, crops and wild animals. Like most environmental assets they provide physical inputs to economic activity. However, for biological resources, a distinction is made between whether the resources are cultivated or natural. This distinction is based on the extent to which there is active management over the growth of the resource.
- 5.25 Maintaining this distinction in the central framework is important to ensure that clear links can be made to the treatment of these resources in the production accounts and asset accounts of the SNA.
- 5.26 There is a wide range of ways in which biological resources can be cultivated. In some cases the management activity is very active such as in the case of battery farming of chickens or the use of greenhouses for horticultural production. In these situations the unit undertaking the production creates a controlled environment, distinct from the broader biological and physical environment.
- 5.27 In other cases there may be relatively little active management, for example in the case of broad acre cattle farming or the growing of plantation timber. In these cases, the biological resource is exposed constantly to, and interacts as a part of, the broader biological and physical environment. Of course, there are cases between these two extremes.
- 5.28 Cultivated biological resources that are managed in such a way that they do not interact with the broader biological and physical environment should not be considered environmental assets since they do not deliver benefits from the bio-physical environment.
- 5.29 In practice, it may be difficult to distinguish between different types of cultivated biological resources by virtue of the manner of their production.
- 5.30 Many cultivated biological resources may be grown and harvested over a short period of time. Where the cultivation occurs within an accounting period then there are no opening or closing stocks of these assets to be recorded. However, depending on the time of the growing and harvesting season relative to the times of the accounting period there may be cultivated biological resources to be recorded and in these cases they should be recorded as part of environmental assets.

### *Forests*

- 5.31 In the SEEA, forests are considered a form of land cover, forestry is a category of land use and forests are a type of ecosystem. Often forests are seen predominantly in terms of timber resources, i.e. the volume of standing timber, but forests produce a wide range of other benefits and hence forests and timber resources should not be equated. It is also the case that timber resources are not found solely in forests and in many countries other types of land cover, for example, other wooded land, contain timber resources. As a result of

this distinction between forests and timber resources, and given the resource focus for environmental assets in the Central Framework, the classification of environmental assets in Table 5.2.1 includes forests within the sub-categories of land and distinguishes the timber resources located on this land as a separate environmental asset. Asset accounts for forests and other wooded land are described in Section 5.6 and asset accounts for timber resources are described in Section 5.8.

### 5.2.3 Valuation of environmental assets

5.32 In the Central Framework, consistent with the SNA, the scope of valuation is limited to valuing the benefits that accrue to economic owners. In principle, all of the benefits delivered by environmental assets can be valued in monetary terms. However, there are many complexities in undertaking these broad valuations including the quantification of the benefits themselves and the consideration of the value of benefits to society as a whole rather than only the value to individuals. These measurement issues are discussed in SEEA Experimental Ecosystem Accounts.

5.33 *An economic owner is the institutional unit entitled to claim the benefits associated with the use of an asset in the course of an economic activity by virtue of accepting the associated risks.* Further, following the SNA, *an asset is a store of value representing a benefit or series of benefits accruing to the economic owner by holding or using the entity over a period of time.*<sup>39</sup> Examples of economic assets include houses, office buildings, machines, computer software and financial assets.

5.34 The benefits underlying the definition of economic assets are economic benefits. *Economic benefits reflect a gain or positive utility arising from economic production, consumption or accumulation.* They are recorded in the accounts in the form of operating surplus from the sale of extracted natural resources and cultivated biological resources, in the form of rent earned on permitting the use or extraction of an environmental asset, or in the form of receipts when an environmental asset is sold.

5.35 Economic assets in the SNA are classified as produced assets, non-produced assets or financial assets and the relevant concepts and measurement approaches to construct these estimates are fully described in the SNA. *Produced assets are assets that have come into existence as outputs of processes that fall within the production boundary of the SNA.* Produced assets include fixed assets (e.g. buildings, machines); inventories (e.g. stores of wheat for future use); and valuables that are held as stores of value and expected to increase in value over time (e.g. artworks and precious metals).

5.36 Cultivated biological resources are a type of produced asset in the SNA and also a type of environmental asset in the SEEA. They may be either fixed assets (e.g. sheep for wool, breeding stock and orchards) or inventories (e.g. livestock for slaughter, certain trees for timber). Other types of produced asset are often relevant in the measurement of

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<sup>39</sup> 2008 SNA paragraph 10.8

economic activity related to the environment but they are not considered environmental assets.

5.37 ***Non-produced assets are assets that have come into existence in ways other than through processes of production.*** They include natural resources; contracts, leases and licences and purchased goodwill and marketing assets. In the SNA natural resources include all those assets considered to be natural resources in the SEEA and land is also considered part of natural resources.<sup>40</sup> While some contracts, leases and licences and purchased goodwill and marketing assets may be relevant in the assessment of economic activity related to the environment, none of these types of non-produced asset are also environmental assets.

5.38 Financial assets, and the corresponding financial liabilities, relate to claims to future payments, or series of payments between economic units. They are defined in detail in the SNA. While some financial assets may be relevant to assessment of economic activity related to the environment, no financial assets are also environmental assets.

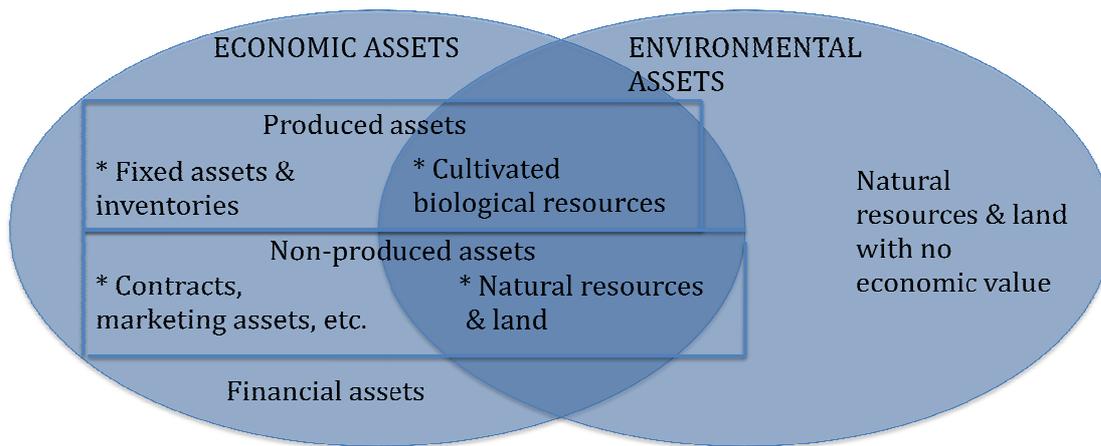
#### *Relationship between environmental and economic assets*

5.39 Many environmental assets are also economic assets. In particular, natural resources and land are considered non-produced assets, and cultivated biological resources may be either fixed assets or inventories depending on their role in production. Figure 5.2.1 shows the relationship between the classes of environmental assets and the high level asset classes within the SNA. All environmental assets that are classed as cultivated must be recorded as either fixed assets or inventories.

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<sup>40</sup> The 2008 SNA also includes radio spectra within its scope of natural resources as the utilisation of the radio spectra generates significant income for various economic units. In the SEEA, radio spectra are not considered part of the bio-physical environment and hence are excluded from the scope of environmental assets.

**Figure 5.2.1 Relationship between environmental and economic assets**



5.40 In physical terms, the scope of environmental assets measured in the Central Framework may be greater than the scope of environmental assets measured in monetary terms following the SNA definition of economic assets. This is because there is no requirement in physical terms that environmental assets must deliver benefits to an economic owner. For example, remote land and timber resources should be included within the scope of the environmental assets of a country even if they do not currently or are not expected to deliver benefits to an economic owner.

5.41 Consequently, there may be environmental assets that are recorded in the Central Framework in physical terms but which have zero value in monetary terms and hence are excluded from environmental assets measured in monetary terms. Where such assets are recorded in physical terms, the quantities should be separately recorded from quantities of environmental assets that do deliver benefits to economic owners.

*Economic assets used in activities related to the environment*

5.42 There is interest in economic assets, primarily produced assets, that have a role in activities related to the environment but are not themselves environmental assets. They include assets relevant to undertaking environmental protection and resource management activities and assets used in the extraction and harvest of natural resources such as water dams, fishing vessels, and cutting and drilling equipment for mining. A discussion of these types of assets is included in Chapter 4 primarily in the context of Environmental Protection Expenditure Accounts (EPEA). Produced assets for natural resource extraction are also important considerations in the calculation of resource rent and the valuation of environmental assets. These measurement issues are discussed in Section 5.4.

## **5.3 The structure of asset accounts**

### **5.3.1 Introduction**

5.43 The recording of flows for environmental assets takes place in asset accounts. These accounts record both the opening and closing stock of assets and the changes over the accounting period. This section outlines the basic form of asset accounts in physical and monetary terms and describes the relevant accounting entries. Sections 5.5 – 5.11 describe in more detail the relevant asset accounts for each type of environmental asset.

### **5.3.2 Conceptual form of the physical asset account**

5.44 Physical asset accounts are usually compiled for specific types of assets rather than for a range of different assets because each asset will usually be recorded in different units. This also means that aggregation across different assets in physical terms is generally not possible.<sup>41</sup> While aggregation is only broadly possible in monetary terms, the physical asset account entries are essential in the compilation of monetary estimates.

5.45 Estimates of the opening or closing stock of an asset should always be compiled with information pertaining to the reference date of the specific opening or closing stock. If information in respect of those dates is not directly available, other relevant information may need to be time-adjusted for use in compilation. From time to time, new information will arise that leads to a change in the assumptions underlying a set of estimates. When incorporating additional information it is important that the estimates continue to reflect the quantities and values that could reasonably be expected at the reference date.

5.46 The entries concerning the changes between opening and closing stocks of each asset are broadly divided into (i) additions to the stock and (ii) reductions in the stock. However, within these broad categories there are many different types of flows and often the flows are labelled differently by type of asset. For example, the term extraction is generally used in relation to mineral and energy resources, while the term abstraction is generally used for water resources. Both of them however relate to the removing environmental assets through processes of economic production.

5.47 Table 5.3.1 presents the range of accounting entries for physical asset accounts by type of asset. It gives an overview of the structure of physical asset accounts that are elaborated in detail for each asset in sections 5.5 – 5.11.

5.48 The table provides a complete listing of possible flows for each asset type. In practice, only certain flows are likely to be important and not all cells that show the possibility of an entry in Table 5.3.1 should be shown separately in the published accounts for each type of asset.

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<sup>41</sup> In a limited number of situations it is possible to aggregate across assets in physical terms, for example, physical quantities of energy resources can be aggregated using joules or similar conversion units.

**Table 5.3.1 General structure of the physical asset account for environmental assets (physical units)**

		<b>Mineral &amp; energy resources</b>	<b>Land (incl. forest land)</b>	<b>Soil resources</b>	<b>Timber resources</b>		<b>Fish resources</b>		<b>Water resources</b>
					<i>Cultivated</i>	<i>Natural</i>	<i>Cultivated</i>	<i>Natural</i>	
<b>Opening stock of resources</b>		Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
<b>Additions to stock of resources</b>									
	Growth in stock	na	Land reclamation	Soil formation Soil deposition	Natural growth	Natural growth	Growth	Growth	Precipitation Returns
	Discoveries of new stock	Yes	na	na	na	na	Yes*	Yes*	Yes*
	Upwards reappraisals	Yes	na	Yes*	Yes*	Yes*	Yes*	Yes*	Yes*
	Reclassifications	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
	<i>Total additions to stock</i>								
<b>Reductions in stock of resources</b>									
	Extractions	Extractions	na	Soil extraction	Removals	Removals	Harvest	Gross catch	Abstraction
	Normal reductions in stock	na	na	Erosion	Natural losses	Natural losses	Normal losses	Normal losses	Evaporation
	Catastrophic losses	Yes*	Yes*	Yes*	Yes	Yes	Yes	Yes	Yes*
	Downwards reappraisals	Yes	na	Yes*	Yes*	Yes*	Yes*	Yes*	Yes*
	Reclassifications	na	Yes	Yes	Yes	Yes	Yes	Yes	na
	<i>Total reductions in stock</i>								
<b>Closing stock of resources</b>		Yes	Yes	Yes		Yes		Yes	Yes

na – not applicable

\* - An asterisk indicates that this flow is not usually a significant flow for the resource or it is typically not separately identified in the source data. In practice, not all cells that show the possibility of an entry here should be shown separately in the published accounts for each type of resource.

- 5.49 There are four types of additions to the stock of a resource.
- i. Growth in stock. These additions reflect increases in the amount of the stock of resources over an accounting period due to growth. For biological resources the growth may be natural or cultivated and is often estimated net of normal losses of stock. Increases in the total area of land of a country, for example through land reclamation projects, should be recorded as growth in stock.
  - ii. Discoveries of new stock. These additions concern the arrival of new resources to a stock and commonly arise through exploration and evaluation.
  - iii. Upwards reappraisals. These additions reflect changes due to the use of updated information that permits a reassessment of the size of the stock. The use of updated information may require the revision of previous estimates to ensure a continuity of time series.
  - iv. Reclassifications. Reclassifications of environmental assets will generally result from situations in which an environmental asset is used for a different purpose – for example increases in forest land due to afforestation are recorded here. An increase in one category of an asset should be offset by an equivalent decrease in another category meaning that for the environmental asset as a whole reclassifications have no impact on the total physical quantity of an individual asset type.
- 5.50 There are five types of reductions in the stock of a resource.
- i. Extraction. These are reductions in stock due to the physical removal or harvest of an environmental asset through a process of production. Extraction includes both those quantities that continue to flow through the economy as products and those quantities of stock that are immediately dispersed to the environment after extraction because they are unwanted – for example by-catch in fishing.
  - ii. Normal reductions in stock. These reductions reflect expected losses to stock during the course of an accounting period. They may be due to natural deaths of biological resources or losses due to accidental causes that are not significant enough to be considered catastrophic and might reasonably be expected to occur in most accounting periods based on past experience.
  - iii. Catastrophic losses. Losses due to catastrophic and exceptional events are recorded when large scale, discrete and recognizable events occur that may destroy a significantly large number of assets within any individual asset category. Such events will generally be easy to identify. They include major earthquakes, volcanic eruptions, tidal waves, exceptionally severe hurricanes and other natural disasters; acts of war, riots and other political events; and technological accidents such as major toxic spills or release of radioactive particles into the air. Included here are major losses such as destruction of biological resources by drought or outbreaks of disease.
  - iv. Downwards reappraisals. These reductions reflect changes due to the use of updated information that permits a reassessment of the size of the stock. The use of updated

information may require the revision of previous estimates to ensure a continuity of time series.

- v. Reclassifications. Reclassifications of environmental assets will generally result from situations in which an environmental asset is used for a different purpose – for example decreases in forest land due to permanent deforestation are recorded here. An decrease in one category of an asset should be offset by an equivalent increase in another category meaning that for the environmental asset as a whole reclassifications have no impact on the total physical quantity of an individual asset type.
- 5.51 The depletion of natural resources is related to the extraction of resources and the physical using up of the resource thus limiting the potential to extract amounts in the future. For non-renewable resources the quantity depleted is the same as the quantity extracted but this is not the case for renewable resources that can regenerate over time. The definition of depletion in physical terms is covered in detail in section 5.4.
- 5.52 It may not be possible to directly estimate all of the accounting entries outlined in the conceptual form of the physical asset account in Table 5.3.1. Consequently, some entries may need to be estimated using appropriate models or derived on the basis of other accounting entries. Depending on the particular flow and its importance in the overall accounting for changes in the stock of a resource, it may also be appropriate to combine some accounting entries for the purposes of constructing physical asset accounts for publication.
- 5.53 All of the details regarding the definition and measurement of these flows in relation to individual resources are contained in Sections 5.5-5.11.

#### *Accounting entries for institutional sector accounts*

- 5.54 The compilation of asset accounts by institutional sector may be of interest for particular types of environmental assets where the ownership of resources is of policy or analytical concern. Examples might include the attribution of mineral and energy resources between government units and extracting units and the assessment of ownership of land.
- 5.55 To construct institutional sector accounts there are two additional types of entries that are required compared to those shown in Table 5.3.1 in order to account for transactions and other exchanges between sectors. These entries are
- i. Acquisition and disposals of environmental assets. These entries are recorded when transactions take place between institutional units in different sectors. The acquisition of environmental assets represents an addition to the stock of the acquiring sector and the disposal represents a reduction in the stock of the other sector.
  - ii. Uncompensated seizures. These changes in stock occur when institutional units take possession of or remove environmental assets without providing appropriate compensation to the owner. An addition to stock is recorded for the sector that takes

ownership of the environmental asset and a corresponding reduction in stock is recorded for the sector that previously owned the asset.

- 5.56 It is also noted that reclassifications between sectors may be common entries in institutional sector accounts.
- 5.57 Although not common it is also possible that entries are required at a national level for the acquisition and disposal or uncompensated seizure of environmental assets. This would arise in the case of transactions in land between countries or in situations in which political changes lead to changes in the overall area of a country. Since these entries are not commonly required they are not incorporated into the standard form of the physical asset account presented in Table 5.3.1.

### 5.3.3 Conceptual form of the monetary asset account

- 5.58 The general form of the monetary asset account is presented in Table 5.3.2. There are close links to structure of the physical asset account.

**Table 5.3.2 Conceptual form of the monetary asset account (monetary units)**

<b>Opening stock of resources</b>		
<b>Additions to stock of resources</b>		
A1	Growth in stock	
A2	Discoveries of new stock	
A3	Upwards reappraisals	
A4	Reclassifications	
	<i>Total additions to stock</i>	
<b>Reductions in stock of resources</b>		
R1	Extractions	
R2	Normal loss of stock	
R3	Catastrophic losses	
R4	Downwards reappraisals	
R5	Reclassifications	
	<i>Total reductions in stock</i>	
<b>Revaluation of the stock of resources</b>		
<b>Closing stock of resources</b>		

- 5.59 The definitions of the flows presented in the monetary accounts align exactly with the same flows as defined in physical terms. Thus, the monetary account reflects a valuation of physical flows as recorded in the physical asset account, noting that for some environmental assets the measurement scope is broader in physical terms (e.g. timber resources not used for wood supply are included in physical terms but excluded in monetary terms). For most environmental assets it will be the case that measurement requires the estimation of the physical flows followed by estimation of the monetary flows.
- 5.60 The only additional flow recorded in the monetary asset account compared to the physical asset account concerns revaluations. Revaluations relate to changes in the value

of assets due to price changes and reflect nominal holding gains and losses on environmental assets. The nominal holding gain for environmental assets is calculated in the same way as for non-financial assets as the increase in value accruing to the owner of the asset as a result of a change in its price over a period of time.

- 5.61 As discussed in Chapter 2, changes in price should be distinguished from both changes in the quantity and changes in the quality of the relevant asset. For environmental assets, the quality of an asset (e.g. land or water resources) may change due to the effects of pollution or the treatment of previous environmental damage. Ideally, where the price of the asset changes to reflect a different quality this should be considered a change in the volume of the asset rather than as a revaluation. In effect, there has been a reclassification between different qualities of the same asset.
- 5.62 As well as the nominal holding gain, it is interesting to know how the change in value compares with the general measure of inflation. If the value of an asset rises over an accounting period at the same rate as the general inflation rate this amount of gain is referred to as a neutral holding gain. The difference between the nominal holding gain and the neutral holding gain is referred to as a real holding gain.
- 5.63 Revaluations should also incorporate changes in the monetary value of environmental assets due to changes in the assumptions made in the valuation models that are often used to estimate the value of environmental assets, in particular the Net Present Value model. The assumptions that should be taken in account are those regarding future rates of extraction and natural growth, the length of the asset/resource life and the discount rate.
- 5.64 As with physical asset accounts it may not be possible to directly estimate all of the accounting entries outlined in the conceptual form of the monetary asset account in Table 5.3.2. Consequently, some entries may need to be estimated using appropriate models or derived on the basis of other accounting entries. Depending on the particular flow and its importance in the overall accounting for changes in the stock of a resource, it may also be appropriate to combine some accounting entries for the purposes of constructing asset accounts for publication.

#### *Relationship to SNA accounting entries<sup>42</sup>*

- 5.65 Rather than a broad separation into additions and reductions in the stock, the SNA focuses on (i) changes due to transactions and (ii) other change in volume of assets. To support the links between the SEEA and the SNA, the relevant SNA entries may be appended to the monetary asset account. They can be derived directly from the information as structured in the monetary asset account. These derivations are shown in Table 5.3.3.
- 5.66 The scope of the SNA accounting entries is different depending on whether the environmental asset is produced or non-produced. In the SEEA, this distinction is

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<sup>42</sup> The detailed description of the relevant accounting entries are contained in Chapters 10, 12 and 13 of the 2008 SNA.

reflected in whether an environmental asset is cultivated (i.e. produced in SNA terms) or natural (i.e. non-produced in SNA terms). For SNA purposes a further distinction is needed for cultivated assets as to whether they are fixed assets or inventories.<sup>43</sup>

5.67 For fixed assets the relevant accounting entry is gross fixed capital formation, for inventories the relevant accounting entry is change in inventories. For natural environmental assets the relevant SNA entries are economic appearance of non-produced assets and economic disappearance of non-produced assets. There are also SNA entries related to the range of other additions and reductions in stock. These entries are defined equivalently between the monetary asset account in Table 5.3.2 and the SNA.

**Table 5.3.3 Derivation of accounting aggregates (monetary units)**

	Cultivated biological resources		Natural environmental assets
	Fixed assets	Inventories	
<b>Accounting aggregates</b>			
<i>Gross fixed capital formation</i>	A1 less R1	na	na
<i>Changes in inventories</i>	na	A1 less R1	na
<i>Economic appearance</i>	na	na	A1 + A2 + A3
<i>Economic disappearance</i>	na	na	R1 + R2 + R4

na – not applicable

A and R codes defined in Table 5.3.2

5.68 In addition to the monetary accounting entries shown in Tables 5.3.2 and 5.3.3 there are two entries, depletion and consumption of fixed capital, that relate to the physical using up of assets over time. Consumption of fixed capital relates to the using up of fixed assets and in the context of cultivated biological resources is reflected in the value of the normal losses of stock.

5.69 Depletion relates to the physical using up of natural resources through extraction. In monetary terms it represents the decline in future income that can be earned from a resource due to extraction. Details on the definition and measurement of depletion in physical and monetary terms are presented in Section 5.4.

#### *Institutional sector accounts in monetary terms*

5.70 Institutional sector asset accounts may also be compiled in monetary terms and indeed these accounts may be of particular interest since they can be connected directly to the full sequence of institutional sector accounts as presented in the SNA. A key aggregate that can be compiled from a full recording of asset accounts by institutional sector is net worth by sector.

<sup>43</sup> Also see paragraph 5.24-30.

5.71 The accounting entries required to compile monetary asset accounts by institutional sector are the same as those required to compile physical asset accounts by institutional sector with the only addition being the inclusion of entries for revaluations (as outlined in paragraph 5.55).

## 5.4 Principles of asset accounting

### 5.4.1 Introduction

5.72 Accounting for changes in the stocks of environmental assets presents some measurement challenges. The challenges commence in accurately measuring the physical stock of environmental assets which all have their own unique characteristics including, in some instances, the capacity to regenerate over time. Understanding the population dynamics is therefore important in making a reasonable assessment of certain environmental assets.

5.73 In addition to calculating estimates in physical terms, estimates of the values of environmental assets in monetary terms should also be compiled. Aside from land and soil resources, few environmental assets are actively traded before they are extracted and hence determining their *in situ* valuation is not straightforward.

5.74 Although there are challenges involved, a range of techniques and underlying concepts have developed that permit the compilation of asset accounts. Section 5.4.2 describes a key challenge in physical asset accounting – the measurement of depletion in physical terms. This is followed in section 5.4.3 by a discussion on valuation approaches and, in particular a presentation of the net present value approach. The section concludes with a discussion on the potential uses and limitation of valuation approaches and a description of the relationship between resource rent and depletion in monetary terms. The application of the various definitions and principles of asset accounting are described for each environmental asset in sections 5.5 – 5.11.

### 5.4.2 Defining depletion in physical terms

5.75 In the compilation of asset accounts the measurement of depletion is often a particular focus. The depletion of environmental assets relates to the physical using up of environmental assets through extraction and harvest by economic units, including households, such that there is a reduced availability of the resource. Depletion does not fully account for all possible changes in the stock of an asset over an accounting period and hence should not be linked directly to measures of sustainability. Assessments of the sustainability of environmental assets should take into account a broader range of factors, such as the extent of catastrophic losses or discoveries and potential changes in the demand for inputs from environmental assets.

5.76 *Depletion, in physical terms, is the decrease in the quantity of the stock of a natural resource over an accounting period that is due to the extraction of the natural resource by economic units occurring at a rate that will not permit the same quantity of resource to be extracted in all future periods.* This is a general definition that requires refinement in the case of renewable natural resources such as timber resources and aquatic resources.

5.77 *Depletion, in monetary terms, is the decline in value of a stock of a natural resource over an accounting period that is due to the extraction of the natural resource by economic units occurring at a rate that does not permit the same economic benefits to be earned from the resource in all future periods.* A measure of depletion in monetary terms must be underpinned by a measure of depletion in physical terms, i.e. if there is no reduction in the available

quantity of the resource over an accounting period due to economic activity, there can be no depletion, and instead any changes in value must be attributed to other factors.

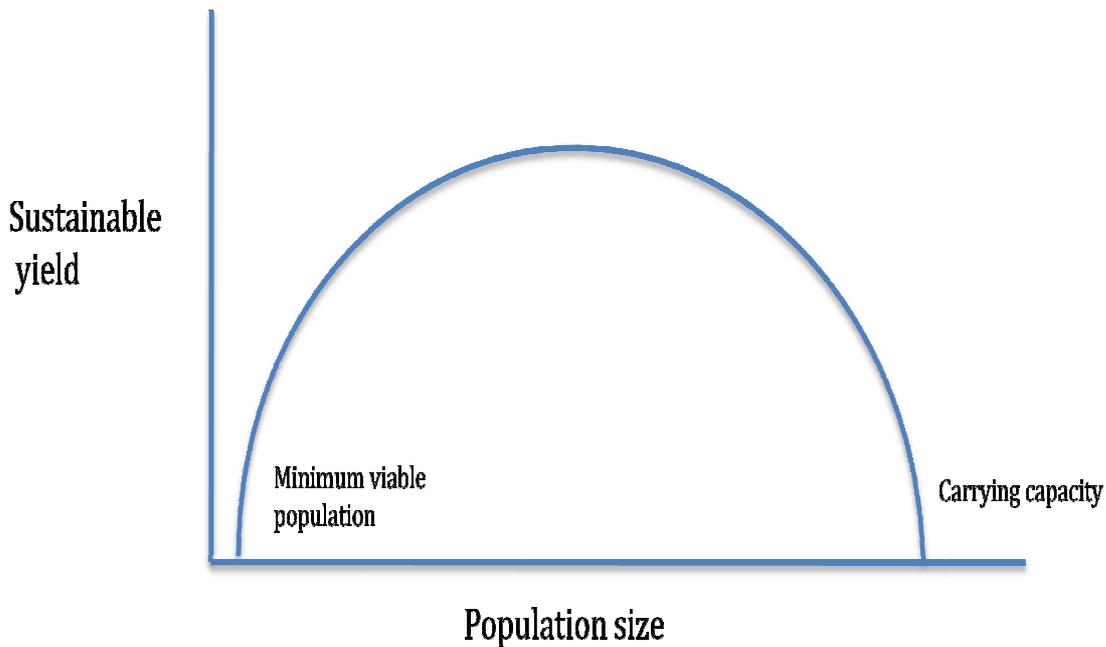
- 5.78 Depletion is not recorded when there is a reduction in the quantity of an environmental asset due to unexpected events such as losses due to extreme weather or pandemic outbreaks of disease. These reductions are recorded as catastrophic losses. Rather, depletion must be seen as a consequence of the extraction of natural resources by economic units.
- 5.79 In physical terms, the depletion of non-renewable natural resources, such as mineral and energy resources, is equal to the quantity of resource that is extracted since a given stock of resources at the beginning of a period cannot regenerate itself on human time scales.
- 5.80 For renewable natural resources such as timber resources and aquatic resources, the equality in physical terms between depletion and extraction does not hold. The ability for these resources to regenerate naturally means that under certain management and extraction situations, the quantity of resources extracted may be matched by a quantity of resources that are regenerated and there is no overall physical depletion of the environmental asset in this situation. The following paragraphs outline in more detail the measurement of depletion in physical terms for renewable natural resources.

#### *Depletion of renewable natural resources in physical terms*

- 5.81 Renewable natural resources are able to reproduce and grow over time. Thus, in the estimation of depletion, it is necessary to consider both the extraction and the regeneration of the resources. While the rates of extraction can be directly observed, measurement of the rates of regeneration requires consideration of biological models. These models have the general form that when the stock or population of the specific type of resource is small, the rate of growth will be small but, as the population increases, the rate of growth will also increase. Eventually, as the population within a given area reaches the carrying capacity of the area, i.e. the density reaches a maximum, the rate of growth in the population will return to being small.
- 5.82 Based on this general model, at any given population size, it is possible to calculate the number of animals or volume of plants that may be removed from the population without affecting the capacity of the population to remain at the current size (i.e. opening stock equals closing stock). In effect there is a quantity of “surplus” or excess animals or plants that can be harvested from the existing stock. In biological models, this surplus is known as the sustainable yield.

5.83 The level of the sustainable yield rises and falls in line with the overall size of the population. At low population levels where the growth rates are low, the sustainable yields are also low. At high population levels, i.e. near carrying capacity, sustainable yields are also low. These relationships are shown in Figure 5.4.1. It is noted that the same level of extraction will have a different relationship to the sustainable yield depending on the population size. Referring to Figure 5.4.1, a given level of extraction may be above, on or under the sustainable yield curve.

**Figure 5.4.1 Stylised sustainable yield curve**



5.84 For a given population size, if the amount of extraction is less than the sustainable yield, i.e. points under the curve in Figure 5.4.1, no depletion should be recorded. In this situation, assuming no catastrophic losses or other changes, it would be expected that the stock would increase over the accounting period and that extraction by economic units will not reduce the potential for the same quantity of resources to be extracted in the future.

5.85 In principle, depletion should be measured wherever the amount of extraction is greater than the sustainable yield corresponding to the population size. This corresponds to points above the curve in Figure 5.4.1 and reflects quantities of extraction being greater than the growth in the population that is achievable at the given population size.

5.86 However, for most populations of natural biological resources, the estimation of sustainable yield is difficult as the natural processes of growth and death, the relationship to other species (including predators) and the impact of extraction are usually non-linear, variable (for example due to variations in climatic conditions) and often not fully understood in scientific terms. Thus it is recommended that some year on year variation around an estimate of sustainable yield be considered as normal. Consequently, in practice, depletion should be recorded when extraction is beyond the normal variation in sustainable yield for a particular population size.

5.87 The estimation of the required variables will involve the use of biological models and assumptions regarding the growth, death and other changes in population. If such models are unavailable other indicators of stock size and changes in stock size may be used. Possible methods are discussed in relation to timber resources in Section 5.8 and aquatic resources in Section 5.9.

*The relationship between depletion and degradation*

5.88 The focus in measuring depletion is on the availability of individual environmental assets in the future and changes in the availability due to extraction and harvest by economic units. There is particular focus on the provisioning services of individual environmental assets and the capacity of the extraction of the resources to generate income for the extractor.

5.89 Degradation considers the broader capacity of environmental assets to deliver the full suite of ecosystem services and the extent to which this capacity may be reduced through the action of economic units, including households. In this sense, since depletion relates to one type of ecosystem service, it can be considered as a specific form of degradation.

5.90 The measurement of degradation is complicated because the capacity of environmental assets to deliver ecosystem services is not completely attributable to individual assets and also that individual assets may deliver a number of different ecosystem services. Further, while individual environmental assets, such as water and soil resources, may have been degraded over time, separating the extent of degradation of the individual asset from the broader degradation of the related ecosystem may not be straightforward.

5.91 The measurement of degradation in physical terms is also complicated as it generally relies on a detailed assessment of the internal characteristics of environmental assets rather than the relatively simpler quantities of an environmental asset that are used in the estimation of asset accounts in physical terms and in the estimation of depletion. For example, to assess whether a body of water has been degraded assessments might be made of the amounts of various pollutants in the water. While individual accounting for each of these pollutants might be undertaken it will not be directly related to the volume of water in cubic metres that is used to account for water resources in an asset account.

5.92 Although separately identifying degradation in physical terms is complex, implicitly, the monetary value of individual environmental assets that have been degraded will be affected by the changing quality of the asset. Ideally, where the price of the asset changes to reflect a different quality this should be considered a change in the volume of the asset rather than as a revaluation. However, isolating the price change due to degradation from other causes of price change is likely to be very difficult in practice.

5.93 For these reasons the direct measurement of degradation in physical and monetary terms is not pursued in the central framework. Rather it is considered as part of SEEA Experimental Ecosystem Accounts. However, measures of the pressures leading to degradation are recorded, for example emissions to air and water.

### 5.4.3 Principles of asset valuation

- 5.94 One general advantage of applying valuation approaches is that different environmental assets can be compared using a common numéraire, a comparison that cannot be made using purely physical data. Further, environmental assets can be compared against other assets in order to assess relative returns, national wealth and other similar types of analysis. Since it is commonly the case that governments have a high degree of ownership or influence over the extraction of environmental assets, valuation of resources in monetary terms may be a useful approach to assessing future streams of income for government, for example in the estimation of future government revenue from the extraction of oil and natural gas.
- 5.95 It is also the case that in business accounts, enterprises involved in extraction make assessments in terms of their future income streams and it is relevant to be able to place these individual enterprise based valuations in a broader, national perspective. There is also increasing use of market based mechanisms, such as quotas, to allocate access rights to environmental assets. These mechanisms may relate directly to aggregate valuations for environmental assets.
- 5.96 Since many environmental assets are not purchased in a market place and have not been produced in a manner like buildings and equipment there are generally no observable prices for the value of the opening and closing stock of environmental assets or for the flows between these two dates.
- 5.97 It should be recognised that where market prices do not exist the estimation of values requires the use of assumptions and models. Overall, these models have proved to be sound tools to the development of meaningful valuations for produced assets. At the same time, there are complexities in the application of these models to the valuation of environmental assets that compilers and users should be aware of before applying the models in practice.
- 5.98 The following parts explain the principles for the valuation of assets and outline the approaches that can be used to estimate the values in monetary terms<sup>44</sup>. Specific measurement issues relevant to individual environmental assets are addressed in later sections of this chapter.

#### *General principles of valuation*

- 5.99 The prices at which assets may be bought or sold on markets are a basis of decisions by investors, producers, consumers and other economic agents. Market prices are assessed by investors and producers in relation to their expectations of the flows of income they can derive from the assets. For example, investors in renewable energy infrastructure assets (such as wind turbines) and environmental assets (such as land) make decisions in respect of acquisitions and disposals of these assets in the light of their values in the market relative to the income they expect the assets to generate over time.

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<sup>44</sup> The principles of valuation explained here align fully to the SNA. See the 2008 SNA paragraphs 13.16-13.25

- 5.100 Ideally, observable market prices should be used to value all assets and every item should be valued as if it were being acquired on the date to which the estimate of the stock relates. These two recommendations enable the values of different types of assets, including environmental, financial and other economic assets to be compared in meaningful ways and allows the formation of opening and closing values of stocks that can be used to assess national and sector based estimates of wealth in monetary terms.
- 5.101 At the same time, market based estimates of asset values will commonly not account for all aspects that may be considered to be relevant in forming a valuation for an asset. For example, the value of a second-hand car in the market place will often be less than the value that the current owner places on the utility and flexibility of car ownership. At the same time, the car's value may not reflect the impact of emissions from operating the car on the environment. Thus while the use of market prices allows comparison across asset types they may not reflect the full value of the asset from an individual or society's perspective. This limitation of market based prices is often referred to in respect of the valuation of environmental assets.
- 5.102 An additional and important consideration in the application of general principles of valuation to environmental assets is that the objective is to estimate the value of the asset *in situ* rather than after its removal.
- 5.103 The approaches described in the SEEA, in particular the Net Present Value approach, provide reasonable proxies for observable market prices but do not take into account the full range of benefits (and costs) that might be considered relevant. The potential uses and limitations of NPV approaches are outlined later in this section.

#### *Approaches to the valuation of assets*

- 5.104 The ideal source of price observations for assets are values observed in markets in which each asset traded is completely homogeneous, is often traded in considerable volume and has its market price listed at regular intervals. Such markets yield data on prices that can be multiplied by indicators of quantity in order to compute the total market value of different classes of assets. These types of price observation are available for most financial assets, newly purchased produced assets including many types of transport equipment (such as cars and trucks) and livestock.
- 5.105 In addition to providing direct observations on the prices of assets actually traded, information from such markets may also be used to price similar assets that are not traded. For example, information on house and land sales may be used to estimate the value of houses and land that have not been sold.
- 5.106 When there are no observable prices because the items in question have not been purchased or sold on the market in the recent past, an attempt has to be made to estimate what the prices would be if a market existed and the assets were to be traded on the date to which the estimate of the stock relates.
- 5.107 One approach to a lack of information on relevant market prices is to use values obtained by accumulating and revaluing transactions. Most non-financial assets change in

value year by year reflecting changes in market prices. In most cases the value of an asset will decline over time as the initial acquisition cost is reduced by consumption of fixed capital (more commonly referred to as depreciation) over the asset's expected life. Furthermore, the acquisition prices of equivalent new assets will change. Thus, in theory, the value of an asset at any given point in its life is equal to the current acquisition price of an equivalent new asset less the accumulated consumption of fixed capital over its life. This valuation is sometimes referred to as the "written-down replacement cost". When reliable, directly observed prices for used assets are not available, this procedure gives a reasonable approximation of what the market price would be were the asset to be offered for sale.

- 5.108 In the context of environmental assets, this approach may be applied to estimate the value of the stock of cultivated biological resources that are fixed assets, for example, orchards.
- 5.109 A second approach is to use the discounted value of future returns. For many environmental assets there are no relevant market transactions that would permit the use of the previous two approaches. Thus, although market prices can be found to value the output from extraction or harvest of an environmental asset, no values for the overall asset itself, in situ, are available.
- 5.110 The discounted value of future returns approach, commonly referred to as the Net Present Value approach – or NPV – uses projections of the future rate of extraction of the asset together with projections of its price to generate a time series of expected returns. Typically these projections are based on the history of returns earned from the use of the environmental asset. Assuming that returns earned in the current period is worth more to the extractor than returns earned in the future, the stream of expected returns is discounted to reflect values in the current period.
- 5.111 The next section outlines the key components of the NPV approach followed by a discussion of the uses and limitations of the approach for environmental accounting. Additional detail, including the relevant mathematical derivations related to the NPV approach, is contained in an annex to the chapter.

#### **5.4.4 The Net Present Value (NPV) approach**

- 5.112 There are five key aspects of NPV that require explanation: the measurement of returns on environmental assets, the determination of the expected pattern of resource rents based on expected extraction profiles and prices, the estimation of the asset life, the selection of a rate of return on produced assets and the choice of discount rate.

##### *The measurement of returns on environmental assets*

- 5.113 In the SEEA returns are defined using the concept of economic rent. Economic rent is best considered as the surplus value accruing to the extractor or user of an asset calculated after all costs and normal returns have been taken into account.

- 5.114 The surplus value, referred to as resource rent in the context of environmental assets, can be considered as the return attributable to the asset itself. The logic of NPV requires estimating the stream of resource rents that are expected to be earned in the future and then discounting these resource rents back to the present accounting period. This provides an estimate of the value of the asset at that point in time.<sup>45</sup>
- 5.115 One common aspect in the definition of resource rent is that the amount of rent is always derived relative to the returns earned by other firms on average over time – i.e. normal returns. It is also observed that resource rent, as a residual may be positive or negative. Economic theory would suggest that over the long term resource rents should not be negative.
- 5.116 The framework for the derivation of resource rent is based on the idea that environmental assets can be considered to generate a return to an enterprise in the same way as produced assets. Thus the operating surplus earned by an enterprise is considered to reflect both a return for the investment in produced assets and a return to the environmental assets used in production.
- 5.117 The relationship between operating surplus, returns to produced assets and returns to environmental assets is shown in Table 5.4.1. It is based on some key national accounts variables. The table shows that gross operating surplus is composed of two key parts – resource rent and the user cost of produced assets which is the terms used to describe the rent attributable to the use of produced assets. In turn, each of these rents can be decomposed into a portion that accounts for the cost of using up the assets (and hence reducing future potential income) and a portion that reflects the return to the assets after deducting these costs.<sup>46</sup>

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<sup>45</sup> There are a number of different theories concerning what factors drive the generation of resource rent accruing to the extractor or user of an asset. Examples of sources of resource rent include differential rent, scarcity rent and entrepreneurial rent. Different sources of resource rent are not mutually exclusive and, consequently, the estimates of resource rent that underpin the NPV estimates in the SEEA should not be considered as emerging from any particular source of resource rent.

<sup>46</sup> Another common national accounting aggregate, Net Operating Surplus (NOS), can also be formed in this framework. It is calculated as Gross Operating Surplus less Consumption of fixed capital, or equivalently the sum of Resource rent and the Return to produced assets.

**Table 5.4.1 Relationships between different flows and income components**

Output (sales of extracted environmental assets)			
<i>Less</i> Operating costs			
Intermediate consumption (input costs of goods and services)			
Compensation of employees (input costs for labour)			
<b><i>Equals</i> Gross Operating Surplus (a)</b>			
User cost of produced assets		Resource rent	
Consumption of fixed capital	Return to produced assets	Depletion	Return to environmental assets (b)

(a) Strictly this accounting identity also includes Gross Mixed Income (the surplus earned by unincorporated enterprises) and should be adjusted for net taxes and subsidies on production. These details do not affect the logic of the explanation here.

(b) In principle the return to environmental assets derived here also incorporates a return to other non-produced assets (e.g. marketing assets and brands) as these assets also play a role in generating the operating surplus. These returns are ignored in the formulation described here.

5.118 Estimates of resource rent can be derived residually based on knowledge of all of the other variables and very often a residual approach is used to estimate resource rent. However, direct estimation methods are also available working within the same national accounts based framework.

#### Approaches to estimating resource rent

5.119 In practice, there are three main approaches to estimating resource rent: the residual value method, the appropriation method and the market price method.

5.120 The most commonly applied method is the residual value method. Under this method resource rent is estimated by deducting user costs of produced assets from gross operating surplus.

5.121 Estimates of the value of gross operating surplus may be obtained from national accounts datasets. Estimates of the user costs of produced assets are not generally available and must be constructed so as to obtain each period's resource rent. Estimates of the user costs of produced assets are composed of two variables – the consumption of fixed capital of produced assets; and the normal return on produced assets. Both variables may be estimated within national accounts models designed to estimate the value of the fixed capital stock and related variables for various purposes including productivity analysis. If such models have not been developed then each variable may be estimated using assumptions regarding depreciation rates, asset lives and rates of return on produced assets. A full description of relevant considerations and approaches to the measurement of user costs is presented in the OECD manual, *Measuring Capital*.

5.122 One difficulty in estimating resource rents using these methods is that it is rare for the source information, particularly national accounts data, to be able to isolate only the extraction or

harvesting activity, and in certain circumstances, multiple resources may be extracted at the same time, particularly in mining. Generally, data on GOS for industries that extract and harvest environmental assets will capture some downstream processing, refinement or other value added activity also undertaken by the extractor before sale. Since all of these additional activities require inputs of labour and capital, partitioning a firm's GOS into pure extraction activity relating to a single resource is not always straightforward. Nonetheless, all efforts should be made to isolate the specific GOS for the extraction activity of individual resources in the underlying data.

- 5.123 Estimates of resource rent may also be affected by the receipt of subsidies by the extracting or harvesting enterprise. Subsidies should be deducted in the derivation of resource rent. Even though the receipts provide support to continue the activity of extraction, the receipts do not relate to the income attributable to the underlying environmental asset.
- 5.124 There may be concern that in situations of overexploitation of resources the resulting gross operating surplus will generate a higher estimate of resource rent than can be sustained over the longer term. While this observation is correct it does not invalidate the measurement approach. The aim of the valuation approach is not to measure what might or should happen under ideal circumstances but to account for expected behaviour in respect of the environmental asset. Thus if overexploitation continues it should be reflected in a shorter asset life and in a greater amount of depletion (as a component of the higher resource rent) than might otherwise be the case.
- 5.125 The appropriation method estimates the resource rent using the actual payments made to owners of environmental assets. In many countries, governments are the legal owners of environmental assets on behalf of the country. As legal owners, governments could in theory collect the entire resource rent derived from extraction of the resources they own. This amount would, in principle be equal to GOS less user costs of produced assets of the extractor, as defined.
- 5.126 The collection of resource rent is generally undertaken by governments through mechanisms such as fees, taxes and royalties. In practice, the fees, taxes and royalties collected tend to understate total resource rent as the rates may be set with other priorities in mind, for example encouraging investment and employment in extracting industries. These alternative motivations should be considered before adoption of the appropriation method.
- 5.127 The market price method is based on the fact that access to resources may be controlled through the purchase of licences and quotas – commonly observed in the forestry and fishing industries. When these resource access rights are freely traded it is possible to estimate the value of the relevant environmental asset from the market prices of the rights. The economic logic parallels the residual value method since it is expected that in a free market the value of the rights should be equivalent to the future returns from the asset (after deducting all costs including user costs of produced assets).
- 5.128 Where the resource access rights that are purchased provide a very long term or indefinite access to the assets, the market value of the rights should provide a direct estimate of the total value of the asset rather than simply an estimate of the resource rent. In this case no discounting of future flows of resource rent is needed. If the rights are for a more limited

period, say entitlements for one year, this can provide a direct estimate of the resource rent for that year.

- 5.129 In practice, in many cases the government give the rights direct to extractors for free or do so at a price less than the true market value and trading of the rights may be restricted or prohibited. In these cases there is no directly observable market valuation.

#### Summary of approaches to estimating resource rent

- 5.130 While in theory all of these methods will generate the same estimates of resource rent it is the case that the application of the appropriation and market price method are more heavily influenced by institutional arrangements in a country. For these reasons, the compilation of estimates of resource rent based on the residual value method should be compiled and, where possible, reconciled with estimates obtained using the other methods. Indeed, there may be particular analytical interest in comparing the estimates of resource rent based on the different methods.

#### *Determination of the expected pattern of resource rents*

- 5.131 The critical factor in the valuation of assets is not the past or current returns but the expected returns. An asset with no expected returns has no value in economic terms. Expected returns are, by definition, not observed and hence assumptions concerning these flows must be made.
- 5.132 The starting point is generally the estimates of resource rent in the current or immediate past periods. In the absence of any additional information on future price changes or likely changes in extraction rates, it is recommended that estimates of expected resource rent should be set equal to current estimates of resource rent thus assuming no price changes beyond the general level of inflation and a realistic rate of resource extraction.
- 5.133 In general, there is too much volatility in unit resource prices for meaningful assumptions about future resource price changes to be incorporated. Also, in the absence of other information, it may be reasonable to assume that extraction will continue at the same rate as in the past since this is the extraction rate for which an appropriate amount of produced assets have been acquired. At the same time, if it was known that the majority of the expected resource rent was to be earned in years 5 to 10 over a total asset life of 30 years, then this should be taken into account.
- 5.134 Special consideration is needed in situations where the extraction rates in any particular period fall to zero, or close to zero. In practice this is possible in any given accounting period for example, if economic circumstances change such that extraction is no longer cost effective, if natural disasters make the resource inaccessible or un-harvestable, or if access to resources is restricted to allow the recovery of stocks.
- 5.135 If changes in the expected extraction schedule that underpin the NPV estimates occur, the resulting NPV estimates may produce results that are difficult to interpret. However, this only highlights that when the expected extraction schedule changes, for any reason including simply the receipt of additional information, the NPV estimates must be re-estimated since it reflects a

valuation based on all of the information available at that point in time.

#### *Estimates of the asset life*

- 5.136 Estimates of the asset life must be based on consideration of the physical stock of the asset and assumed rates of extraction and growth, in the case of renewable resources. In a very simple case the asset life may be calculated as the existing physical stock divided by the excess of expected annual extractions over expected annual growth. However, especially for renewable resources such as fish resources, it is necessary to consider biological models and associated sustainable yields of renewable resources such that the impact of changing age and sex structures is taken into account in the determination of the asset life. A description of relevant considerations is contained in section 5.4.2.
- 5.137 It may be that, through the use of biological and economic models, optimal extraction paths can be calculated that effectively determine the asset life through alignment between the available stock and rates of extraction. Often implicit in the determination of such extraction paths, particularly for renewable natural resources, are assumptions regarding the sustainability of the resource – for example that future management of fish stocks will ensure extraction does not exceed growth.
- 5.138 For the SEEA making such assumptions regarding sustainability is problematic as it may imply the adoption of behaviour that may not have been evidenced in the past. Unless there is evidence the contrary, it is recommended that estimates of asset life be based on rates of extraction and growth that have occurred in the recent past rather than through the use of general assumptions on sustainability or intended management practice.
- 5.139 Estimates of the asset life are required to provide the time frame over which the NPV approach is applied. In practice, depending on the choice of discount rate, if asset lives are longer than around 20 years, the NPV estimates are relatively stable. That is, the values of the expected returns in later years are relatively small. The sensitivity of the NPV estimates to the choice of discount rate over varying asset lives is shown in Annex A5.1.

#### *Rate of return on produced assets*

- 5.140 An expected rate of return on produced assets is required to estimate the user cost of the produced assets used in the extraction of the asset. If this cost is not deducted the resulting estimates of resource rent will be overstated.
- 5.141 Two approaches can be taken to estimating rates of return on produced assets – an endogenous approach and an exogenous approach. The endogenous approach sets the rate equal to the net operating surplus (gross operating surplus less consumption of fixed capital) divided by the value of the stock of produced assets. This approach implicitly assumes that there is no return attributable to non-produced assets, including environmental assets and hence is not recommended. It should, however, form an upper bound on the estimated rate of return on produced assets.
- 5.142 The exogenous approach is recommended in the SEEA. This approach assumes that the

expected rate of return on produced assets is equal to an external (exogenous) rate of return. Ideally, the expected rate of return should take into account activity or industry specific returns thus implicitly taking into account risks in investing in particular activities. However, in many cases financial markets may not be sufficiently developed to provide robust estimates of these specific rates of return.

5.143 For this reason a realistic approach is to use an economy wide rate of return perhaps based on government bond rates where these exist.<sup>47</sup> In all cases a real rate of return should be used. While exogenous rates of return are unlikely to be perfect proxies for rates of return on individual produced assets, it is likely that they provide a reasonable reflection of normal returns for the derivation of estimates using the NPV approach.

#### *Choice of discount rate*

5.144 Discount rates are required to convert the expected stream of resource rents into a current period estimate of the overall value. A discount rate expresses a time preference – the preference for the owner of an asset to receive income now rather than in the future. It also reflects the owner’s attitude to risk. In general, individuals and businesses will have higher rates of time preference than governments. That is, individuals and businesses will tend to demand a quicker return from ownership of an asset than will governments. Higher rates of time preference translate into higher discount rates.

5.145 The use of a discount rate in NPV calculations can be interpreted as an expected rate of return on the non-produced assets. In an enterprise where all assets are identified and measured accurately, and where conditions of perfect competition prevail, the discount rate and the rate of return on produced assets should be equal. This is because the enterprise should only invest if the rate of return is aligned to its own time and risk preferences for receiving income.

5.146 To ensure a valuation basis that is aligned to the general concept of market prices, it is recommended that a market-based discount rate should be used equal to the assumed rate of return on produced assets (see above).

5.147 At the same time, there is also support for the use of social discount rates in the valuation of environmental assets. The rationale is that environmental assets are of broad and long term value to society as a whole and should be valued in that light rather than solely in relation to their value to a present day extractor.

5.148 One of the main arguments supporting the use of social discount rates is that generally, social discount rates are lower than market-based discount rates and lower rates will place higher relative importance on income earned by future generations. From this it is often implied that estimates of NPV that use market-based discount rates do not value future generations and the total values obtained are too small since they do not place sufficient value on these future incomes.

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<sup>47</sup> It is also the case for technical reasons that a general rate of return is appropriate. If an industry specific rate of return is used it is also necessary to include industry specific expectations in the derivation of the revaluation term in the NPV formula and in doing this the impact of using industry specific rates of return is offset.

5.149 Annex A5.2 presents an extended discussion on discount rates and their application, including a table showing the sensitivity of valuations based on NPV to the choice of discount rate.

*Calculation of Net Present Values*

5.150 Using these various elements estimates of the value of an environmental asset are obtained using the following basic steps assuming the use of the residual value method to calculate resource rent.

- i. Estimates of GOS and the user cost of produced assets for the extractive activity are obtained from relevant sources, most likely based on national accounts data, relevant activity specific information and assumptions regarding rates of return on produced assets.
- ii. Estimate Resource rent as GOS less User cost of produced assets.
- iii. Estimate the asset life based on physical assessment of the stock and projected rates of extraction and growth.
- iv. Project the estimate of Resource rent over the life of the asset taking into account any expected changes in extraction pattern.
- v. Apply the NPV formula using an appropriate discount rate

$$V = \sum_{t=1}^T \frac{RR_t}{(1+r)^t}$$

5.151 Where possible, compilers are encouraged to compare results of NPV calculations that would be obtained using different estimates of the discount rate and also, different approaches to the estimation of resource rent. This may be possible where tradable access rights are in existence or where payments of rent are recorded. These alternative estimates of resource rent may be substituted into the general NPV formulation to derive alternative valuations.

5.152 Wherever actual market prices are available, for example on the basis of actual transactions in environmental assets, this information should be used in preference to NPV based valuations. In incorporating this information, appropriate adjustments for the scope and coverage of the transactions compared to the scope of the estimation based on NPV need to be made.

5.153 Ideally, calculation of NPV estimates should be undertaken for individual stocks, for example for a specific mineral deposit or fish stock. At this level of detail changes in the stock can be more accurately considered and assumptions evaluated. More generally, all efforts should be made to test assumptions used in the formulation of NPV valuations and, wherever possible additional information about specific individual stocks should be taken into account, for example for large discoveries of mineral and energy resources or catastrophic losses of timber resources due to exceptional weather events.

5.154 A complete articulation of the derivation and application of the NPV approach is presented in Annex A5.1.

#### **5.4.5 Accounting for change between NPV estimates**

5.155 Accounting for the change in the value of assets over an accounting period is a core part of asset accounting. As with the assessment of the value of an asset at the beginning and end of a period, the valuation of changes in the stock, such as discoveries and catastrophic losses, is also dependent on the impact that these changes have on expected incomes. Since these changes are not usually evidenced by transactions in the assets themselves, their valuation requires the use of the NPV approach to ensure alignment between stock valuations and valuations of the changes in the stock. A complete accounting for these changes within the NPV framework is presented in Annex A5.1. The following paragraphs focus on the interpretation of depletion, a key indicator of the change in value of an environmental asset.

##### *Relationship between resource rent and depletion*

5.156 Table 5.4.1 shows that the estimate of resource rent can be decomposed into depletion and the return to environmental assets. The ability to decompose resource rent in this way is an important conceptual relationship as it permits the development of estimates of depletion adjusted operating surplus and other related aggregates within the framework of the traditional national accounts.

5.157 These paragraphs describe the nature of the relationship between resource rent and depletion. Section 5.4.2, explains the basis for measuring depletion in physical terms which underpins the monetary estimates discussed in this section. Annex A5.1 explains in detail how monetary estimates of depletion can be derived within the NPV approach. Chapter 6 describes the full sequence of accounts including adjustments for depletion.

5.158 The gross operating surplus of an enterprise represents the benefit accruing to the owner of using all assets in the year in question. It can equally be described as the value of the flow of services rendered by the assets, referred to as capital services, in the same period plus a possible residual profit or loss. The value of all assets can, in principle, be estimated by calculating the NPV of the gross operating surplus (or capital services) to be generated for all future years in which the assets will be still in service.

5.159 The value of capital services is composed of two elements. First, there is an element that reflects the change in the value of the assets due to the using up of the assets over an accounting period. In effect, after each accounting period there are fewer capital services available to be delivered by the assets. Second, there is an income element, or return on assets, that reflects the fact that the owner receives a net benefit from undertaking investment in the assets. If there was no income element the owner should have invested in an alternative asset.

5.160 In relation to produced assets, the cost of using up the asset's capital services is referred to as consumption of fixed capital in the SNA. More generally it is referred to as depreciation. The difference between gross operating surplus and consumption of fixed capital is net operating surplus. Net operating surplus incorporates the return on produced assets and the full value of capital services provided by non-produced assets.

- 5.161 For environmental assets a similar logic can be applied. The value of capital services provided by environmental assets is referred to as resource rent and can be partitioned into two components. The first component, depletion, reflects the decline in the value of the asset due to the physical extraction of the asset. The second component, the return to environmental assets, reflects the income accruing to the extractor of the asset through the use of the extracted resource in production.
- 5.162 If an environmental asset has characteristics such that no amount of use of the asset in production over a year leads to a decline in its value, then there is no depletion and the entire value of the capital service represents a return to the environmental asset and is considered income. This situation can only arise if (i) the natural growth of the asset always keeps pace with extraction/harvesting; or (ii) the asset is sufficiently abundant as to render it free, with no cost arising from using up the asset.
- 5.163 In the case of non-renewable resources, which by definition have a finite life (even if quite long in some instances), the recognition of a depletion element is relatively straightforward since each year the total amount of income that can be earned from the resource in the future reduces due to the physical extraction of the resource.
- 5.164 In the case of renewable resources the recognition of depletion is less obvious. It is quite possible that the amount extracted is replaced through natural growth of the environmental asset such that the income that can be earned from the asset in the future is unchanged despite the physical extraction.
- 5.165 Where the amount extracted does not impact on the long term viability of the environmental asset then estimated depletion is zero and all resource rent should be considered as a return to the extractor of the environmental asset. Where the amount extracted does impact on the long term viability of the asset then depletion should be estimated. The relevant considerations and measurement approaches are explained in detail in Section 5.4.2 and also in Annex A5.1.
- 5.166 Where growth in the environmental asset is greater than extraction leading to an overall increase in the availability of the asset at the end of the period then this should be recorded as an addition to the stock of the environmental asset in the asset account.

#### **5.4.6 Measurement of environmental assets in volume terms**

- 5.167 As explained in Chapter 2, volume measures of assets are not measures of quantities but rather are estimates of changes in the value of assets after removing the effects of price change. Thus, volume measures comprise changes due to changes in quantities and changes in quality.
- 5.168 Volume measures of environmental assets are compiled to assist in the analysis of the changes in environmental assets over time. Removing the effect of price change may be undertaken for two primary purposes. First, the effect of price change may be removed to provide an indicator of the purchasing power of environmental assets, i.e. an estimate of the capacity of a set of environmental assets to be used to acquire a given set of goods and services. Second, the effect of price change may be removed to assess whether there has been a change in the underlying aggregate physical stock of a number of environmental assets. Both

of these rationales may be important considerations when undertaking an aggregate analysis of the wealth of a country and considering the relative importance of environmental assets compared to other economic and social assets.

- 5.169 To estimate the purchasing power of a set of environmental assets, the volume measure is equal to the total value of environmental assets divided by an estimate of the general rate of inflation, for example the consumer price index.
- 5.170 To estimate changes in the aggregate physical stock, a rough assessment may be completed through analysis of the change in the physical stock of each type of environmental asset. However, this approach does not permit aggregation across assets since each will be measured in different physical units, for example hectares of land and tonnes of coal.
- 5.171 In order to provide a volume measure reflecting the aggregate physical stock a number of different measurement approaches can be considered. First, a volume measure can be compiled that is the aggregation of the changes in physical stocks of each asset weighted by their relative values at a given point in time. The point in time is often the beginning or end of the accounting period but the relative values may also be calculated based on an average of beginning and end of period values.
- 5.172 A second approach to the compilation of the volume of the aggregate physical stock can be applied in cases where the NPV formula has been used. The approach is to re-estimate the NPV at the end of the period, for each environmental asset, using the same unit resource rent as was used at the beginning of the period. The sum of these re-estimated NPVs provides an estimate of the volume of environmental assets at the end of the period. This estimate can be compared to the value of the environmental assets at the beginning of the period to provide an estimate of the change in volume. In effect the physical stocks at the beginning and end of the period are all valued using the same set of prices and hence any change reflects the volume change in environmental assets.
- 5.173 It is possible, using a time series of asset values, to use the unit resource rent from one reference period to re-estimate the assets at all other periods. This provides a time series of asset values at constant unit resource rents. However, the use of a single reference unit resource rent may hide changes in resource rent due to changing technology and extraction costs. Hence it is preferable to calculate the changes in volume between each period using unit resource rents relevant to that period and then link the consecutive estimates of the changes in volume together to form a single time series.
- 5.174 A third approach to deriving asset volumes is to divide the individual asset values at the end of the period by an asset specific price index. In many cases this may be a price index relating to the sales of extracted products (e.g. a price index for coal used to deflate the value of stocks of coal). However, a more accurate result is obtained if the price index reflects changes in the unit resource rent. This requires taking into account not only the changing prices of the extracted products but also in the changing costs of extraction. As for the second approach, the price index reflecting the changing costs of production should assume a constant technology such that these changes are captured in the volume change.

## **5.5 Asset accounts for mineral and energy resources**

### **5.5.1 Introduction**

- 5.175 Mineral and energy resources represent a unique type of environmental asset in that they can be extracted and used through economic activity but cannot be renewed on any human time scale. Since they cannot be renewed there is particular interest in understanding the rate at which these assets are being extracted and depleted, the overall availability of these assets and the sustainability of the industries that exploit them.
- 5.176 Asset accounts for mineral and energy resources organise relevant information including the levels and values of stocks of the resources and the changes in these over accounting periods. Flows of extraction, depletion and discoveries are central to the asset account and in turn these can provide valuable information regarding the sustainability of individual resources.
- 5.177 The capacity to value stocks and flows of mineral and energy resources allows important links to be made to monetary estimates of the value added and operating surplus of the extracting industries such as the derivation of depletion adjusted value added measures. Such measures provide a more holistic view of extraction activity recognising a more complete set of production costs. Monetary estimates of these assets may also be of interest in the determination of government taxation and royalty settings given that in many countries the government is the collective owner of these assets on behalf of the community.
- 5.178 This section defines mineral and energy resources and the relevant measurement boundary for the central framework. It then presents asset accounts in physical and monetary terms including a discussion on the estimation of resource rent. A final part of this section discusses two specific measurement issues related to mineral and energy resources – (i) the allocation of income from the extraction of mineral and energy resources, and (ii) the recording of stocks and flows for energy from renewable sources.

### **5.5.2 The definition and categorisation of mineral and energy resources**

- 5.179 Mineral and energy resources include deposits of oil resources, natural gas resources, coal & peat resources, non-metallic minerals and metallic minerals. Since the resources are generally found under the ground (and hence commonly referred to as subsoil assets) it is often not known with a great deal of precision the quantity of resources that might be reasonably extracted. Consequently, a key factor in the measurement of mineral and energy resources is the concentration and quality of the minerals and energy resources in the deposit, since this will influence the likelihood and cost of extraction and the degree of confidence that exists regarding the quantity that can be extracted in the future.
- 5.180 *Mineral and energy resources are defined as known deposits of oil resources, natural gas resources, coal & peat resources, non-metallic minerals and metallic minerals.*

- 5.181 The framework used to define the scope of known deposits is the United Nations Framework Classification for Fossil Energy and Mineral Reserves and Resources 2009 (UNFC-2009). The UNFC-2009 is a generic and flexible scheme for classifying and evaluating quantities of fossil energy and mineral resources.
- 5.182 The UNFC-2009 categorizes mineral and energy resources by looking at whether, and to what extent, projects for the extraction or exploration of the resources have been confirmed, developed or planned. Based on the maturity of the projects the underlying natural resources are classified. The UNFC-2009 is based on a breakdown of the resources according to three criteria affecting their extraction:
- Economic and social viability (E)
  - Field project status and feasibility (F)
  - Geological knowledge (G)
- 5.183 The first criteria (E) designates the degree of favourability of economic and social conditions in establishing the commercial viability of the project. The second criteria (F) designates the maturity of studies and commitments necessary to implement mining plans or development projects. These extend from early exploration efforts before a deposit or accumulation has been confirmed to exist through to a project that is extracting and selling a product. The third criteria (G) designates the level of certainty in the geological knowledge and potential recoverability of the quantities.
- 5.184 Known deposits are categorised into three classes each defined according to combinations of criteria from the UNFC-2009.
- i. Class A: Commercially Recoverable Resources. This class includes deposits for projects that fall in the categories E1 and F1 and where the level of confidence in the geological knowledge is either high (G1), moderate (G2) or low (G3).
  - ii. Class B: Potentially Commercially Recoverable Resources This class includes deposits for those projects that fall in the category E2 (or eventually E1) and at the same time in F2.1 or F2.2 and where the level of confidence in the geological knowledge is either high (G1) moderate (G2) or low (G3).
  - iii. Class C: Non-Commercial and Other Known Deposits are resources for those projects that fall in E3 and for which the feasibility is categorised as F2.2, F2.3 or F4 and where the level of confidence in the geological knowledge is either high (G1), moderate (G2) or low (G3).
- 5.185 Known deposits exclude potential deposits where there is no expectation of the deposits becoming economically viable and there is a lack of information to determine feasibility of extraction or to have confidence in the geological knowledge. Table 5.5.1 gives an overview of how the classes of resources are defined based on the UNFC criteria. The UNFC is explained in more detail in Annex A5.3.
- 5.186 The scope of known deposits is broader than the scope of deposits that underpins the measurement of mineral and energy resources in the SNA. In the SNA the scope is limited to

deposits that are commercially exploitable given current technology and relative prices.<sup>48</sup> The broader scope of known deposits is applied in the SEEA to ensure that as broad an understanding as possible is obtained on the availability of the stock of mineral and energy resources. Issues associated with the scope of the valuation of mineral and energy resources are discussed in section 5.5.4.

**Table 5.5.1: Categorization of Mineral and Energy Resources**

	SEEA Classes	Corresponding UNFC-2009 project categories		
		<b>E Economic and social viability</b>	<b>F Field project status and feasibility</b>	<b>G Geological knowledge</b>
<b>Known deposits</b>	<b>Class A: Commercially Recoverable Resources<sup>1</sup></b>	E1. Extraction and sale has been confirmed to be economically viable	F1. Feasibility of extraction by a defined development project or mining operation has been confirmed	Quantities associated with a known deposit that can be estimated with a high (G1), moderate (G2) or low (G3) level of confidence
	<b>Class B: Potentially Commercially Recoverable Resources<sup>2</sup></b>	E2. Extraction and sale is expected to become economically viable in the foreseeable future <sup>3</sup>	F2.1 Project activities are ongoing to justify development in the foreseeable future Or F2.2 Project activities are on hold and/or where justification as a commercial development may be subject to significant delay	
	<b>Class C: Non-Commercial and other known deposits<sup>4</sup></b>	E3. Extraction and sale is not expected to become economically viable in the foreseeable future or evaluation is at too early a stage to determine economic viability	F2.2 Project activities are on hold and/or where justification as a commercial development may be subject to significant delay Or F2.3 There are no current plans to develop or to acquire additional data at the time due to limited potential Or F4. No development project or mining operation has been identified	
Potential deposits (not included in SEEA)	Exploration projects Additional quantities in place	E3. Extraction and sale is not expected to become economically viable in the foreseeable future or evaluation is at too early a stage to determine economic viability	F3. Feasibility of extraction by a defined development project or mining operation cannot be evaluated due to limited technical data Or F4. No development project or mining operation has been identified	Estimated quantities associated with a potential deposit, based primarily on indirect evidence (G4)
Notes				
1. Includes on-production projects, projects approved for development and projects justified for development				
2. Includes economic and marginal development projects pending and development projects on hold				
3. Potential Commercial Projects may also satisfy the requirements for E1.				
4. Includes unclarified development projects, non-viable development projects, and additional quantities in place				
Source: UNFC-2009, Figures 2 and 3				

<sup>48</sup> See 2008 SNA, paragraph 10.179.

### *Classification of mineral and energy resources*

5.187 There are a number of different types of mineral and energy resources such as oil, natural gas, coal and peat resources, non-metallic minerals and metallic minerals, but there is no internationally agreed detailed classification for mineral and energy resources suitable for statistical purposes.

#### **5.5.3 Physical asset accounts for mineral and energy resources**

5.188 Physical asset accounts for mineral and energy resources should be compiled by type of resource and include estimates of the opening and closing stock of mineral and energy resource and changes in the stock over the accounting period.

5.189 The units used to compile and present the relevant information will vary by type of resource. They are likely to be in tonnes, cubic metres, or barrels. For accounting purposes the same unit should be retained for a single resource to record the opening and closing stocks and the changes in the stocks over an accounting period.

5.190 It is noted that a total for each class of deposit across different resource types cannot be meaningfully estimated due to the use of different physical unit for different resources. For certain sub-sets of resources, for example energy resources, an aggregate across certain resource types may be possible using a common unit such as joules or other energy units.

### *Measurement of opening and closing stocks*

5.191 Ideally, opening and closing stocks of each mineral and energy resource should be classified by class of resource – i.e. Class A: Commercially Recoverable Resources, Class B: Potentially Commercially Recoverable Resources, or Class C: Non-commercial and other known deposits – following the structure in Table 5.5.2.

5.192 It is not recommended that totals across all classes of individual types of resources be compiled. Because each class has a different likelihood of extraction, simple summation of the available resources for a specific resource (e.g. coal) may give a misleading indication of total available resources.

5.193 In this framework it is important to clarify those resources for which a monetary valuation is to be established. If this distinction is not made a subsequent comparison between physical and monetary accounts for individual resources may provide misleading indicators of average prices and relative availability of individual resources.

**Table 5.5.2 Stocks of mineral and energy resources (physical units\*)**

		Class of known deposit		
		Class A: Commercially recoverable resources	Class B: Potentially commercially recoverable resources	Class C: Non-commercial and other known deposits
Type of mineral and energy resource				
	Oil resources			
	Natural gas resources			
	Coal & peat resources			
	Non-metallic minerals			
	Metallic minerals			

\* Different physical units (e.g. tonnes, cubic metres, barrels) will be used for different types of resources

*Physical asset account for mineral and energy resources*

5.194 A basic physical asset account for mineral and energy resources is shown in Table 5.5.3.

**Table 5.5.3 Mineral and energy resource account (physical units\*)**

		Type of mineral and energy resource (by class)				
		Oil resources	Natural gas resources	Coal & peat resources	Non-metallic minerals	Metallic minerals
Opening stock of mineral and energy resources						
Additions to stock						
	Discoveries					
	Upwards reappraisals					
	Reclassifications					
	<i>Total additions to stock</i>					
Reductions in stock						
	Extractions					
	Downwards reappraisals					
	Reclassifications					
	<i>Total reductions in stock</i>					
Closing stock of mineral and energy resources						

\* Different physical units (e.g. tonnes, cubic metres, barrels) will be used for different types of resources

*Additions to and reductions in the stock of mineral and energy resources*

5.195 The changes in the stock in physical terms should consider the following types of changes.

- i. Discoveries. Discoveries should incorporate estimates of the quantity of new deposits found during an accounting period. To be regarded as a discovery the new deposit must be a known deposit – i.e. in Class A, B or C. In situations in which a quantity of potential deposits becomes known to a higher degree of confidence, this increase should be treated as discoveries. Discoveries should be recorded by type of resource and by category of resource.
- ii. Reappraisals. Reappraisals may be upwards or downwards. They should only pertain to known deposits. In general, reappraisals will relate to either additions or reductions in the estimated available stock of a specific deposit or to changes in the categorization of specific deposits between Class A, B or C based on changes in geological information, technology, resource price or a combination of these factors.
- iii. Extraction. Estimates of extraction should reflect the quantity of the resource physically removed from the deposit. It should exclude mining overburden, i.e. the quantity of soil and other material moved in order to extract the resource. As well the quantity should be estimated before any refinement or processing of the resource is undertaken.  

Estimates of extraction should include estimates of illegal extraction, either by residents or non-residents, as these amounts reduce the availability of the resource. It is noted that for the extraction of natural gas the measurement of the quantity extracted may be more difficult due to the nature of the extraction process for some deposits. In cases where natural gas is found with oil, it is the pressure exerted by the natural gas that causes the oil (and some natural gas) to be expelled from the oil well. Some of the natural gas that is expelled may be flared rather than being put to direct use. Some natural gas, especially after extraction has been continuing for some time, may be re-injected to increase the pressure on the remaining oil and so allow more oil to be expelled. In such cases, if the natural gas associated with the oil is being accounted for, an allowance must be made for the decrease in the amount of natural gas available for other uses due to flaring and re-injection.
- iv. Catastrophic losses. Catastrophic losses are rare in relation to most mineral and energy resources. Flooding and collapsing of mines does occur but the deposits continue to exist and can, in principle, be recovered and the issue is one of economic viability of extraction rather than actual loss of the resource itself. An exception to this general principle concerns oil wells that can be destroyed by fire or become unstable for other reasons leading to significant losses of oil resources. Losses of oil and related resources in this situation should be considered catastrophic losses.
- v. Reclassifications. Reclassifications may occur if certain deposits are opened or closed to mining operations due to government decision concerning the access rights to a deposit. All other changes in the quantity of known deposits should be treated as

reappraisals. Reclassifications may also be recorded if asset accounts for mineral and energy resources are being compiled by institutional sector.

5.196 Increasingly there is interest in the capacity to supply various metals and other minerals through the recycling of produced goods. The implied stock of relevant metals and minerals within an economy is not within the scope of the asset accounts presented here. Nonetheless, depending on the extent of recycling undertaken in a country, information on recycled metals and other minerals may be compiled to provide a more complete picture of the availability of these resources and hence on the demands for the extraction of these resources from the environment.

#### 5.5.4 Monetary asset accounts for mineral and energy resources

5.197 Asset accounts in monetary terms for mineral and energy resources are based on the availability of information on the physical stock of resources. The structure of the monetary asset accounts therefore largely parallels the structure of the physical asset accounts. The basic structure is shown in Table 5.5.4.

**Table 5.5.4 Mineral and energy asset account (monetary unit)**

	Type of mineral and energy resource (Class A: Commercially recoverable resources)				
	Oil resources	Natural gas resources	Coal & peat resources	Non-metallic minerals	Metallic minerals
<b>Opening value of stock of resources</b>					
<b>Additions to value of stock</b>					
Discoveries					
Upwards reappraisals					
Reclassifications					
<i>Total additions to stock</i>					
<b>Reductions in value of stock</b>					
Extractions					
Downwards reappraisals					
Catastrophic losses					
Reclassifications					
<i>Total reductions in stock</i>					
<b>Revaluations</b>					
<b>Closing value of stock of resources</b>					

5.198 The additional entry in the monetary asset account relates to the recording of revaluations which occur either due to changes in resource prices over the accounting

period or due to changes to assumptions underlying the NPV approaches that are typically used to value mineral and energy resources.

- 5.199 While the measurement boundary extends to all known deposits in physical terms, it may not be possible to value all of these deposits in monetary terms due to degrees of uncertainty regarding expected extraction profiles and incomes. Consequently, the resource rents for deposits in Classes B and C cannot be determined with confidence. Therefore, it is recommended that valuation only be undertaken for deposits in Class A: Commercially Recoverable Resources. If valuation of deposits in Classes B and C is undertaken, the values for each class should be clearly distinguished. In valuing deposits in each class it is important that the likelihood and timing of extraction be taken into account in determining expected patterns of extraction and income.

#### *Valuation of stocks of mineral and energy resources*

- 5.200 Because there are few transactions in mineral and energy resources the valuation of these assets requires the use of NPV approaches as introduced in Section 5.4. The calculations should be undertaken at the level of an individual resource type, ideally for specific deposits of a resource, and then summed over the range of different resources in order to obtain a total value of mineral and energy resources.
- 5.201 Application of NPV approaches to the valuation of mineral and energy resources requires consideration of a number of specific factors most pertaining to the estimation of the resource rent.

#### Estimation of resource rent

- 5.202 In general the resource rent will be estimated based on information about the income and operating costs for the extraction industry. The aim is to define a resource rent that is specific to a given resource type, for example coal. In meeting this aim several factors should be borne in mind
- 5.203 Scope of operations: Consistent with the definition of quantities extracted, the scope of the income and operating costs to be considered in the derivation of resource rent should be limited to the extraction process itself and should not include any additional income earned or costs incurred through further refinement and processing of the extracted resource. The extraction process is considered to include the activity of mineral exploration and evaluation and these costs should be deducted in the derivation of resource rent.
- 5.204 For some mineral and energy resources, a single deposit may contain several types of resources. For example, often an oil well contains gas and, frequently silver, lead and zinc can only be extracted together. In these situations, the resource rent used in the calculation of the value of the resources should be allocated by commodity. However, since data are generally only available for a single extracting unit derivation of estimates of resource rent by type of resource based on known extraction costs for each type of

resource may not be possible except by using detailed industry knowledge or general rules of thumb to allocate total extraction costs.

- 5.205 Price fluctuations: While operating costs for extracting resources may not fluctuate significantly, it is likely that income earned from sales of extracted resources will fluctuate. Consequently, the resource rent (which is derived as a residual), may be a quite volatile time series. In addition the aggregate amount of resource rent in any one period may be affected by extraction rates that in turn may be affected by one-off events, eg mine collapse. Since the objective is to define a resource rent which can be forecast it is recommended first, that unit resource rents be derived by dividing total resource rent for an individual resource by quantities extracted in a period and second, that, in the absence of other information on future resource prices, a moving average of unit resource rents be used as the basis for the estimation of future resource rents.
- 5.206 Treatment of mineral exploration and evaluation: Mineral exploration is undertaken in order to discover new deposits of minerals and energy resources that may be exploited commercially. Such exploration may be undertaken on own account by enterprises engaged in mining activities. Alternatively, specialized enterprises may carry out exploration either for their own purposes or for fees. The information obtained from exploration and evaluation influences the production activities of those who obtain it over a number of years. Hence, the expenditures are considered to be a form of gross fixed capital formation resulting in the production of an intellectual property product, a type of produced asset.
- 5.207 Mineral exploration and evaluation consists of the value of expenditures on exploration for petroleum and natural gas and for non-petroleum deposits and subsequent evaluation of the discoveries made.<sup>49</sup>
- 5.208 These expenditures include prelicence costs, licence and acquisition costs, appraisal costs and the costs of actual test drilling and boring, as well as the costs of aerial and other surveys, transportation costs, etc, incurred to make it possible to carry out the tests. Re-evaluations may take place after commercial exploitation of the resource has started and the cost of these re-evaluations is also included.
- 5.209 Consumption of fixed capital should be calculated for this asset, potentially using average service lives similar to those used by mining or oil corporations in the own accounts.
- 5.210 For the purpose of estimating resource rent it is necessary to deduct the user costs of produced assets including both the consumption of fixed capital and a return to the produced asset.
- 5.211 It is recognized that an outcome from mineral exploration is the discovery of mineral and energy resources and hence the value of mineral and energy resources on the balance sheet may in part be considered to be due to mineral exploration. The deduction of the user costs of mineral exploration and evaluation in the derivation of resource rent ensures

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<sup>49</sup> See 2008 SNA paragraph 10.106

that the recorded value of the mineral and energy resources reflects only the value of the non-produced environmental resource.

- 5.212 Mine and rig decommissioning costs: Consistent with the treatment in the 2008 SNA it is recognized that in many cases costs are incurred by extractors at the end of the productive life of a deposit, generally to restore the natural environment around the extraction site. These costs, where they can be reasonably anticipated or estimated, should be considered to reduce the resource rent earned by the extractor over the operating life of the extraction site even though the actual expenditure is likely to take place at the end of the operation of the assets. Details on accounting for these costs are discussed in Chapter 4.
- 5.213 Aggregation of the same resource over different deposits: In the discussion so far, it has been implicitly assumed that the mineral and energy resources constitute a single deposit, so that any extractions and discoveries affect the resource life of all resources available to a country. In practice, of course, this is not the case: some oil fields will be exhausted in a relatively short time frame and extractors will then move to another.
- 5.214 Many reappraisals apply to established fields where extraction is already in progress. Upward revisions in quantities will extend the life of the resources and the addition to value will largely reflect the change between the previous and new resource lives since without additional investment the extraction rate is likely to remain steady.
- 5.215 A somewhat different situation holds for a completely new discovery. Suppose a deposit is discovered with an expected life of, say, 20 years, equal by itself to the existing reserves of a country. It is not realistic to automatically assume that the resource in the new deposit will necessarily be extracted in years 21 to 40. On the other hand, neither is it realistic to automatically assume that it will be extracted in years 1 to 20 and thus double the total extractions in these years. For these reasons, it is desirable, if at all possible, to make projections of the impacts of discoveries and reappraisals separately and ideally, on a deposit by deposit basis.

#### Extraction rate

- 5.216 Independent of assumptions about the unit resource rent, an assumption must be made about the pattern of extraction to be followed in the future. The assumption most often used is that the extraction rate will stay constant in physical terms, but there is no reason why this should necessarily be so. As resources approach extinction, there may be a decline in output as some deposits become completely exhausted if there are no new deposits to take their place. Alternatively, an enterprise could adjust the rate of extraction to give the same total income every year, or could reduce the amount extracted as the resource diminishes, assuming that the price increased at the same time. There may be information available from government or from enterprises on projected levels of extraction that could be used, although these often tend to be based on conservative projections of the likely level of new discoveries and reappraisals.

5.217 In the absence of more precise information, a reasonable assumption is that the rate of extraction is kept constant in physical terms which effectively assumes that the efficiency of extraction process remains steady and the stock of extraction related assets remains steady in proportion to the available stock of the resource.

#### Resource life

5.218 At any point in time, the life of a resource is equal to the stock at that time divided by the average extraction rate. In the course of a year, the resource life will diminish by one year due to extractions and will change by the quantity of discoveries and reappraisals during the period divided by the average extraction rate. If, on balance, there are more downward reappraisals than upward reappraisals and discoveries, then the life is further reduced.

5.219 The quantity of the stock used to calculate the resource life must be consistent with the quantity to be valued. Since only Class A resources are to be valued, then the resource's life must be calculated based only on Class A resources and not on total known deposits for the resource (i.e. including also Class B and C resources).

#### *Valuation of flows of mineral and energy resources*

##### Value of discoveries, reappraisals, extractions, depletion and catastrophic losses

5.220 The value of additions and reductions in the stock should be calculated using the average prices of the resource over the period multiplied by the quantity discovered, reappraised, extracted, depleted or lost. This is consistent with the approach outlined in section 5.4 and explained in detail in Annex A5.1.

5.221 Of importance is the valuation of extractions which, as explained in Section 5.4, is comprised of a depletion component and an income component. While the distinction between income and depletion is not shown in the asset account, the estimation of both components is important for use in the generation and allocation of income accounts to adjust measures of operating surplus and rent for the cost of depletion.

##### Acquisitions and disposals of mineral and energy resources

5.222 These transactions are likely to be rare but when they occur they should be recorded. Estimates of the value of these transactions should take into account the costs of ownership transfer that should be recorded as the purchase of a produced asset – costs of ownership transfer on non-produced assets. On the balance sheet this produced asset is considered to be incorporated into the value of the underlying mineral and energy resource.

### **5.5.5 Other issues in the measurement of mineral and energy resources**

#### *Allocation of income from the extraction of mineral and energy resources*

- 5.223 A general characteristic of mineral and energy resources is that the income earned from the extraction of the resources is shared between economic units. Most commonly, part of the income accrues to the extractor of the resources in the form of operating surplus and part of the income accrues to the government in the form of rent. The government earns this income, on behalf of the society, by allowing access to the resources.
- 5.224 Depending on the nature of the arrangements, often both the extractor and the government will have substantial assets in the form of expected future incomes from the extraction of the resources. Following the description in Section 5.4 the expected incomes (which are equal in total to the resource rent) can be separated into depletion and return to environmental assets components. Changes in the value of the assets for each unit will reflect declines due to depletion, while the return to environmental assets will be reflected in the generation and allocation of income accounts.
- 5.225 Within the SEEA, a specific objective is to show, within the general national accounts framework, how the incomes earned from the extraction of natural resources are impacted by the cost of depletion. In particular, the SEEA aims to define depletion adjusted estimates of operating surplus, value added and saving at both an economy wide level and for institutional sectors. Since there is only one amount of depletion for a given mineral and energy resource it must be allocated between the relevant units within the accounting framework.<sup>50</sup>
- 5.226 In the circumstances outlined, accounting for these incomes and the associated depletion is problematic in the standard national accounts framework for two main reasons. First, the incomes flows are recorded in different accounts with the value added and operating surplus of the extractor recorded in the production and generation of income accounts and the rent earned by the government recorded in the allocation of primary income account. Second, no cost of depletion is recorded against the income earned in the structure of the standard accounts (unlike for the cost of produced assets which is recorded as consumption of fixed capital). Instead, in the SNA depletion is recorded in the other changes in volume of assets account.
- 5.227 The following accounting treatment is recommended for the SEEA.
- i. Record the total cost of depletion in the production and generation of income accounts of the extractor as deductions from value added and operating surplus. This ensures that the analysis of extractive activity and economy wide aggregates of operating surplus and value added fully account for the cost of depletion. Further, since the government has no operating surplus in regard to the extraction activity, not recording depletion in the production account of the government ensures that

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<sup>50</sup> Note that in cases where a government owned unit undertakes extraction it should be treated as a non-financial corporation distinct from the general government who remains the legal owner.

estimates of government output (which are calculated based on input costs) are not increased due to depletion.

- ii. Record the payment of rent from the extractor to the government in the allocation of primary income account. This entry is the standard national accounts entry.
- iii. Record an entry for the allocation of depletion in the allocation of primary income accounts. This entry recognises (a) that the rent earned by the government includes the government's share of total depletion which must be deducted from the estimate of rent; and (b) that the saving of the extractor would be understated if the total amount of depletion were deducted in the derivation of their depletion adjusted saving. Implicitly, the payment of rent is being partitioned such that the flow to the government is, in net terms, equal to a depletion-adjusted rent.

5.228 These entries are shown in Table 5.5.5. Importantly, they ensure that the sum of the institutional sector entries for depletion adjusted aggregates is equal to the same aggregates calculated at the economy wide level.

5.229 The values of depletion shown for each unit should be consistent with the change in net worth of each unit in relation to the mineral and energy resources (assuming no other changes in the stock of resources such as discoveries). The relevant balance sheet entries may be made in different ways depending on the nature of the analysis and on the institutional arrangements within a country. In any presentation, the allocation of assets and the resulting estimates of institutional sector net worth should reflect the expected future income streams for each sector from the extraction of the resources.

**Table 5.5.5: Entries to allocate the income and depletion of mineral and energy resources**

Transaction	Government		Extractor	
	Resources/ assets	Uses/ Liabil.	Resources/ assets	Uses/ Liabil.
<i>Production account</i>				
Output – sales from extraction			1000	
Intermediate consumption				500
Gross Value Added			500	
Consumption of fixed capital			-150	
Net Value Added			350	
Depletion			-61	
Depletion adjusted Net Value Added			289	
<i>Generation of income account</i>				
Compensation of employees				200
Gross operating surplus			300	
Consumption of fixed capital			-150	
Net operating surplus			150	
Depletion			-61	
Depletion adjusted operating surplus			89	
<i>Allocation of primary income account</i>				
Rent	56			56
Allocation of depletion		34	34	
Depletion adjusted saving		22		67

5.230 This approach to the allocation of income and depletion from the extraction of mineral and energy resources can also be applied to other natural resources subject to depletion.

*Treatment of energy from renewable sources*

5.231 Energy from renewable sources (renewable energy) has been an important source of energy in many countries and increasingly is being seen as an alternative source of energy for those countries that have primarily used energy from non-renewable sources. Renewable energy can be produced in various ways, including but not limited to wind energy, hydropower energy (including run of river resources), solar energy, biomass including wood, and geothermal energy.

5.232 Setting aside energy sourced from the use of timber resources, other renewable energy sources cannot be exhausted in a manner akin to fossil energy resources and neither are they regenerated as is the case with biological resources. Thus in an accounting sense there is no physical stock of these other renewable energy resources that can be used up or sold.

5.233 Therefore, the measurement scope of SEEA in relation to these resources relates to the amount of energy that is produced given current levels of fixed assets and associated technology. Excluded from scope are potential amounts of energy that could be produced using available renewable energy sources if investment and technology were to increase in the future.

5.234 The presence of investments in renewable energy capture facilities and equipment impacts on the value of the land (including inland waters) associated with those facilities. For example, the land in a particularly windy area would be priced more highly than similar land in a non-windy area if investment was made to construct windmills to capture the energy from the wind resource. Thus, opportunities to earn resource rent based on resources like wind, solar radiation and geothermal energy are expected to be reflected in the price of land.

5.235 In situations where the only income generated from the relevant land is from the generation of renewable energy, the value of the area will, in theory, be equal to the net present value of the future income stream. However, it is also possible that other income is earned from the same area – for example agriculture may take place under wind farms and fishing may be undertaken in water used for generating hydropower. In these cases the valuation of the area must also take into account the income generated from other activities in the same area.

5.236 Nonetheless, where possible, the value of the land (including inland waters) should be partitioned to provide an estimate of the value of the land that is attributable to income arising from the generation of renewable energy.

5.237 These accounting treatments do not apply in the case of energy sourced from timber and other biomass resources. Unlike other renewable energy sources a stock of timber resources can be observed and measured. In concept the volume and value of timber resources (considered in detail in Section 5.8) encompasses all possible uses of the timber including its use as an energy source.

## 5.6 Asset accounts for land

### 5.6.1 Introduction

5.238 The consideration of land is central to economic and environmental accounting.

Beyond an assessment of the ownership and use of land as part of economic production, some of the issues that can be considered in the context of land accounts include the impacts of urbanisation, the intensity of crop and animal production, afforestation and deforestation, the use of water resources and other direct and indirect uses of land.

5.239 While broad assessment of the changing shares of different land use and land cover within a country may provide useful indicators of change, increasingly the power of land accounts is reflected in the use of mapping technologies that can pin-point areas of change. The classifications and structures outlined in this section are designed to support work of this type.

5.240 Land also constitutes an important component in the assessment of national and institutional sector wealth. Land is bought and sold in combination with the physical characteristics (buildings, soil, trees) and the composite value will incorporate a value of the space itself (the location) as well as a value for the physical characteristics.

5.241 This section is structured to define the scope of land accounts and define two primary views of land for environmental accounting purposes - land use and land cover. Categories and classes for the organisation of data on land use and land cover are presented followed by a description of land accounts in physical terms. A particular focus is placed on physical land accounts for forest and other wooded land which complement the asset accounts for timber resources discussed in section 5.8. Land accounts in monetary terms are described next. The potential extension of land accounts towards ecosystem accounts building on the definitions of the land cover classes is discussed at the end of this section.

### 5.6.2 Definition and classification of land

5.242 Land is a unique environmental asset that delineates the space in which economic activities and environmental processes take place and within which environmental assets and economic assets are located.

5.243 While land is commonly meant to refer only to terrestrial areas, in the SEEA the term land may also apply to areas covered by water. Thus the SEEA land accounts encompass areas covered by inland water resources such as rivers and lakes and, in certain applications, the land accounts may be extended to include areas of coastal water and a country's EEZ. Together the areas of land, inland water and coastal water comprise the area of a country. The total country area should be defined as the area enclosed by all inland borders and, if applicable, the normal baselines (low-water mark) and straight baselines on the seaward side.<sup>51</sup>

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<sup>51</sup> The boundaries between the land and the sea vary considerably between countries depending on the different geographical features of a country. The conventions by which country area is determined, in

- 5.244 Land area is analysed in many different ways. Most often, statistical analysis will be conducted by compiling data for administratively defined regions within a country. From a more specifically economic view point there may be interest in knowing the area of land owned by different institutional sectors, such as areas of government land, and regarding data on land used by different industries.
- 5.245 From the perspective of environmental and economic accounting there are several other views which are of interest including topography (e.g. mountains, plains), elevation and land zoning (e.g. residential, industrial, conservation). The most important additional views in the SEEA are land use and land cover. Classifications for land use and land cover are described in this section. Particularly for statistics organised on land cover, traditional administrative boundaries become less relevant and more interest is in the relationship of the different features of the environment and the interaction between these features and the economy and society.
- 5.246 Countries will have considerably different patterns of land use and land cover types. For example, forest land may be of major or minor importance for a particular country and some land types, for example deserts, may not be present in all countries. Consequently, the categorizations reflected in the SEEA may require more details to be added for national purposes in order to highlight particular features and meet information requirements.
- 5.247 A particular feature of statistics on land use and land cover is the means by which data are collected. Broadly, two methods are used – field surveys and satellite images. Field surveys are important as they can provide a high level of specificity regarding the land cover and in particular the land use in a particular area. Satellite images are important as they enable a broader assessment of all areas in a country and, over time, more detailed resolutions of the images are permitting new forms of analysis. Increasingly, data based on combinations of field surveys and satellite images are being compiled. In the SEEA, the classifications and accounting structures are defined and described independently of the means by which relevant data are collected. However, in practice, the type of data and the level of detail that can be compiled may depend on the means by which data have been collected.

#### Land use classification

- 5.248 Estimates of area classified by type of land use may be of considerable interest in understanding issues of agricultural production, forestry management and the spread of built up areas. Additional benefit is gained through analysis of changes in land use over time.
- 5.249 ***Land use reflects both (i) the activities undertaken and (ii) the institutional arrangements put in place; for a given area for the purposes of economic production, or the maintenance and restoration of environmental functions.*** In effect, an area that is “used” implies the existence of some human intervention or management. Land in use therefore includes areas, for example protected areas, that are under the active

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particular the definition of baselines, focus on the boundary between land and sea and have been agreed internationally in the United Nations Convention on the Law of the Sea (UNCLOS).

management of institutional units of a country for the purpose of excluding human activity from that area.

- 5.250 Not all land in a country is used following the definition above. Some areas are “not in use” although they may have a use in supporting ecosystems and biodiversity. In order to provide a complete accounting for land use within a country both land in use and land not in use must be included.
- 5.251 The scope of land use accounts comprises areas of land and inland water. For some analytical purposes, and depending on the composition of a country’s economic territory, the measurement boundary for land use may be extended to include coastal waters and areas within a country’s EEZ.<sup>52</sup> Such a broader boundary is likely to be of relevance in the management of fishing rights, offshore mining and exploration, the protection of coral reefs and the understanding of other marine issues. Particularly where the area of a country’s coastal water and EEZ is a large part of its economic territory, the extension of the analysis of land use is appropriate.
- 5.252 The SEEA land use classification is shown in Table 5.6.1. At its highest level it is classified by the primary types of surfaces: land and inland water. The classification by type of surface reflects the primary use of the classification as a means of comparing alternative uses. Generally, the types of uses of inland water areas and land areas are quite distinct and these different areas are likely to be managed in different ways.
- 5.253 For land, the classification consists of seven main categories of land use: Agriculture, Forestry, Land used for Aquaculture, Use of built-up and related areas, Land used for maintenance and restoration of environmental functions, Other uses of land n.e.c., and Land not in use. For inland water there are four main categories: Inland water used for aquaculture or holding facilities; Inland water used for maintenance and restoration of environmental functions; other uses of inland water n.e.c.; and Inland water not in use. Various sub-categories and classes are listed in Annex A5.4, including a listing of classes relevant for extended analysis of coastal waters and the EEZ.
- 5.254 Within each type of area the classification comprises various categories of use. The categories are not defined on the basis of economic activity but rather on consideration of the general purpose and role of the user of the area. In many cases this will align with the scope of the economic activity but in some cases, particularly for forestry, the area considered to be in use may be larger than the area being used for economic production.
- 5.255 At the same time, for areas of forest not intended to be used for economic production (e.g. for strict nature reserves where there is no intention to harvest timber) then their primary use is more likely to be for maintenance and restoration of environmental functions or land not in use depending on the relevant designations associated with the area.
- 5.256 In some cases an area may support multiple uses at the same time or, over an accounting period the same area may be used for different uses at different times and there

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<sup>52</sup> Following the UN Convention on the Law of the Sea a country’s EEZ may extend up to 200 nautical miles from the country’s normal baseline.

may be interest in recording all uses for particular areas. In general, however, the principle of primary or dominant use should be used to ensure that all of the area has been attributed.

5.257 There may be strong analytical interest in understanding the range of multiple uses and compilers should take this interest into account in developing accounts for land. In such cases it may be possible to define smaller areas that are used for particular purposes. For example, if trees are planted in defined areas on a farm to reduce water erosion or improve water quality (e.g. on river banks) then, rather than assigning the entire farm area to agriculture, the smaller area could be classified as an area used for the maintenance and restoration of environmental functions.

5.258 In some areas, particularly in areas covered by water, there may be no clearly defined use for a given area such that a primary or dominant use can be identified. For example, areas within harbours may be used to provide areas for recreation, passenger and freight transport and fishing. In order to be defined as an area in use there must be a significant degree of persistence in the use of the area. In general, areas of water will only be considered “used” where the area has been clearly zoned or delimited for a specific use.

**Table 5.6.1 Land Use Classification**

<b>Land</b>	
	Agriculture
	Forestry
	Land used for aquaculture
	Use of built up and related areas
	Land used for maintenance and restoration of environmental functions
	Other uses of land n.e.c.
	Land not in use
<b>Inland waters</b>	
	Inland waters used for aquaculture or holding facilities
	Inland waters used for maintenance and restoration of environmental functions
	Other uses of inland waters n.e.c.
	Inland waters not in use
	EEZ areas used for aquaculture or holding facilities
	EEZ areas used for maintenance and restoration of environmental functions n.e.c.
	Other uses of EEZ areas n.e.c.
	EEZ areas not in use

#### Land cover classes

5.259 Land cover refers to the observed physical and biological cover of the Earth’s surface and includes natural vegetation and abiotic (non-living) surfaces. At its most basic level it is comprised of all of the individual features that cover the area within a country. For the

purposes of land cover statistics the relevant country area includes only land and inland waters. The area of coastal waters is excluded.

- 5.260 The UN Food and Agriculture Organisation (FAO) has developed an international standard classification system, the Land Cover Classification System (LCCS 3)<sup>5354</sup>, that can be used to systematically record the biophysical characteristics of all areas of land within any territory.
- 5.261 Current land cover is a function of natural changes in the environment and of previous and current land use, particularly in agricultural and forestry areas. Although vegetation characteristics (such as natural or cultivated) influence the land cover within an area, they are not inherent features of the land cover. Thus, a clear and systematic description of classes of land cover allows the land cover classification to be compared to types of land use, while maintaining pure land cover criteria. The FAO LCCS provides a theoretical basis for this approach.
- 5.262 There are an enormous number of different land cover features that can be created with the LCCS approach. For the purposes of standardisation and harmonisation across statistical data sets a classification comprised of 14 classes is described, as presented in Table 5.6.2.
- 5.263 The 14 classes provide a comprehensive set of land cover types with clear boundaries based on definitions from the LCCS that are mutually exclusive and unambiguous. This set of land cover types can be used at all scales, independently from the method of observation, thus allowing cross referencing of local and regional maps with continental and global maps without loss of information.
- 5.264 The set of land cover types is complemented with a set of basic rules of classification to allow translation of national data sets. These rules are set out in Annex A5.4. The rules reflect the logical structure of the LCCS and determine, as the first step, the main object (the “basic object”) to be considered when undertaking a translation of data. The basic objects are simple and intuitive elements of land cover (such as trees, shrubs, buildings, etc) and the descriptions are supplemented by the inclusion information on the

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<sup>53</sup> The LCCS provides a basis for any piece of land to be defined and classified with a rigorous syntax and clear classification criteria, starting from a set of basic objects identified purely through physiognomic criteria, i.e. on their overall appearance. When the land is vegetated, the basic objects described are the plants (divided into trees, shrubs and herbaceous vegetation). When the land has a non-vegetal cover, or no cover at all, the basic objects can be water, ice and snow, or the abiotic or artificial surface. This information in the LCCS can be supplemented with information on properties and characteristics of the basic objects. Properties are further physiognomic characterisations of basic objects such as height and cover. Characteristics are descriptive elements of the basic objects not directly related to its physiognomic aspects and distinguishing, for example, whether the area is intended for agricultural purposes or if it is natural.

<sup>54</sup> A higher level abstraction of the basic objects that compose land cover classes, as used in LCCS, called the “LCML” (for Land Cover Meta Language) has also been developed for use as a framework to classify land cover and compare systems internationally. This meta language allows the existing well established national and regional land cover systems to remain in place, while still allowing the data to be integrated into common world level data sets following a common land cover standard. LCML is currently undergoing the approval process to become an ISO standard as a framework to classify land cover and compare systems internationally.

“properties” (such as height, cover, etc) and “characteristics” (such as natural, cultivated, etc) of the basic objects.

**Table 5.6.2 Land Cover Types**

<b>Code</b>	<b>Category</b>
	Artificial surfaces (including urban and associated areas)
	Herbaceous crop
	Woody crops
	Multiple or layered crops
	Grassland
	Tree covered area
	Mangroves
	Shrub covered area
	Shrubs and/or herbaceous vegetation, aquatic or regularly flooded
	Sparsely natural vegetated areas
	Terrestrial barren land
	Permanent snow and glaciers
	Inland water bodies
	Coastal water bodies and inter-tidal areas

### **5.6.3 Physical asset accounts for land**

5.265 The objective of land accounts in physical terms is to describe the area of land and changes in the area of land over an accounting period. A range of different physical land accounts can be envisaged – for example, accounts for land use, land cover or land ownership (by industry or institutional sector). The measurement units of land in physical terms are units of area such as hectares or square metres.

5.266 Generally the total area of land for a country will remain unchanged from one period to the next. Hence the changes between the opening and closing stock of land in physical terms will be primarily comprised of changes between different classes of land, for example classes relating to land ownership, land use or land cover.

5.267 However, there are situations where the area of land for a country may change. It may increase, for example due to reclamation of land through the construction of dykes and other barriers. It may also decrease, for example due to land subsidence or higher water levels.

5.268 As well, changes in the total area of land may occur due to political factors. For example, the total area may increase or decrease due to war and associated events and there are commonly areas of disputed territory. The area that is within scope of land cover and land use statistics should be clearly defined to avoid confusion.

### *Types of physical land accounts*

- 5.269 In the first instance it is recommended that countries develop estimates of the total land area classified by land use and by land cover at the beginning and end of each accounting period.
- 5.270 With data structured in this way it is possible to construct tables showing land use by land cover and matrices showing the changes in land cover (or land use) over an accounting period. In assessing land cover and land use change it may be useful to determine the proportion of the opening stock of land whose cover or use has remained unchanged. To undertake this type of analysis the data must be based on spatially referenced data sources.
- 5.271 An additional step might be the construction of tables showing reasons for land cover change. For example, changes in land cover might be classified to show whether the change relates to urban growth and development of infrastructures (through conversion of agriculture and natural land), intensification and industrialisation of agriculture (through conversion of family farming and mosaic landscapes), extension of agriculture in general (through conversion of forest land), drainage of wetlands, deforestation (for timber production and or agriculture development), and desertification (at the expense of formerly vegetated areas).

### **5.6.4 Physical asset accounts for forest and other wooded land**

#### *Introduction*

- 5.272 For particular land uses or types of land cover it is also possible to construct basic physical asset accounts as established for other resources. The most developed example of this is for forest and other wooded land. Often the compilation of physical asset accounts for forest and other wooded land is undertaken in conjunction with the compilation of asset accounts for timber resources as described in Section 5.8. However, in principle, accounts for forest and other wooded land are a type of land account.
- 5.273 A key distinction between the physical asset account for forest and other wooded land and the asset account for timber resources is that the scope of timber resources is not limited to timber from forest and other wooded land. Thus, for example, depending on their significance, orchards would fall within scope of timber resources but are not considered areas of forest and other wooded land.
- 5.274 Another key distinction is that the asset account for timber resources is focused on the volume of timber resources rather than the area of land covered by forests and other wooded land. Thus, the focus of the forest and other wooded land account is on changes in the area of land, for example, due to deforestation and afforestation, rather than on the quantity and value of timber removed from areas of forest and other wooded land.
- 5.275 Notwithstanding these clear distinctions in purpose and scope, there are strong connections between asset accounts for timber resources and asset accounts for forest and other wooded land. This is because the majority of timber resources are found in areas of

forest and other wooded land. Consequently, there are links between the two sets of accounts that should be considered in their compilation.

#### *Scope of the forest and other wooded land account*

5.276 The scope of the forest and other wooded land account is defined consistently with the definition of in the FAO Forest Resource Assessment 2010.<sup>55</sup> Forest land is defined as land spanning more than 0.5 hectares with trees higher than 5 metres and a canopy cover of more than 10 percent, or trees able to reach these thresholds *in situ*. It does not include land that is predominantly under agricultural or urban land use.

5.277 Forest land is classified according to different types of forest. The primary distinction is between naturally regenerated forest and planted forest. Naturally regenerated forest is forest predominantly composed of trees established through natural regeneration. In this context, predominantly means that the trees established through natural regeneration are expected to constitute more than 50% of the growing stock at maturity.

5.278 Two broad types of naturally regenerated forest are distinguished:

- i. Primary forest is naturally regenerated forest of native species, where there are no clearly visible indications of human activities and the ecological processes are not significantly disturbed. Key characteristics of primary forests are that (a) they show natural forest dynamics, such as natural tree species composition, occurrence of dead wood, natural age structure and natural regeneration processes; (b) the area is large enough to maintain its natural characteristics; and (c) there has been no known significant human intervention or the last significant human intervention was long enough ago to have allowed the natural species composition and processes to have become re-established.
- ii. Other naturally regenerated forest is naturally regenerated forest with clearly visible indications of human activities. These include (a) selectively logged-over areas, areas regenerating following agricultural land use and areas recovering from human-induced fires, etc; (b) forests where it is not possible to distinguish whether they are planted or naturally regenerated; (c) forests with a mix of naturally regenerated trees and planted/seeded trees and where the naturally regenerated trees are expected to constitute more than 50% of the growing stock at stand maturity; (d) coppice from trees established through natural regeneration; and (e) naturally regenerated trees of introduced species.

5.279 Planted forests are predominantly composed of trees established through planting and/or deliberate seeding. Planted/seeded trees are expected to constitute more than 50% of the growing stock at maturity, including coppice from trees that were originally planted or seeded.

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<sup>55</sup> The following definitions are sourced or adapted from the Global Forest Resources Assessment 2010: Specification of National Reporting Tables for FRA 2010. Forestry Department, Food and Agriculture Organization of the United Nations. Forest Resources Assessment Programme Working paper 135, Rome 2007

5.280 Other wooded land is land not classified as forest land, spanning more than 0.5 hectares; with trees higher than 5 metres and a canopy cover of 5-10 percent, or trees able to reach these thresholds in situ; or with a combined cover of shrubs, bushes and trees above 10 percent. It does not include land that is predominantly under agricultural or urban land use.

5.281 Where possible accounts should be compiled using these distinctions between types of forest and other wooded land. In addition, countries may be interested to compile accounts based on the total area of different species of tree.

5.282 A physical asset account for forests is presented in Table 5.6.6. It shows the opening and closing stock by area and changes in the area of forest and other wooded land. The area of forest and other wooded land should be measured inclusive of relevant access roads, rivers and streams.

**Table 5.6.6 Physical asset account for forest and other wooded land (hectares)**

	Type of forest and other wooded land				Total
	Primary forest	Other naturally regenerated forest	Planted forest	Other wooded land	
<b>Opening stock of forest and other wooded land</b>					
<b>Additions to stock</b>					
Afforestation					
Natural expansion					
<i>Total additions to stock</i>					
<b>Reductions in stock</b>					
Deforestation					
Natural regression					
<i>Total reductions in stock</i>					
<b>Closing stock of forest and other wooded land</b>					

*Additions to and reductions in the stock*

5.283 All changes in the area of forest and other wooded land are reclassifications either between different types of forest and other wooded land or where there are changes in the area of land between forest and other wooded land and other land types, such as agricultural land. Following are the definitions of the particular types of reclassification that apply in the case of forest and other wooded land.

5.284 Afforestation represents an increase in the stock of forest and other wooded land due to either the establishment of new forest on land that was previously not classified as forests or as

a result of silvicultural measures such as planting and seeding. In particular, land previously classified as other wooded land may be converted to forest land as a result of silvicultural measures or natural restoration.

- 5.285 Natural expansion is an increase in area resulting from natural seeding, sprouting, suckering or layering.
- 5.286 Forest reforestation by natural or silvicultural measures after clear-cutting does not qualify as an increase in forest land. This land remains classified as forest land except when clear-cutting is preliminary to putting the land to an alternative use such as agriculture or construction.
- 5.287 Deforestation represents a decrease in the stock of forest and other wooded land due to the complete loss of tree cover and transfer of forest land to other uses (as agricultural land, land under buildings, roads etc.) or to no identifiable use. Removals of standing timber do not lead to decreases in forest and other wooded land if the use of the land does not change after felling.
- 5.288 Natural regression should be recorded when the stock of forest and other wooded land reduces for natural reasons.
- 5.289 Monetary asset accounts for forest and other wooded land are not separately described but are covered as part of the monetary asset accounts for land in the next part.

#### **5.6.5 Monetary asset accounts for land**

- 5.290 The monetary asset account for land follows the structure outlined in Table 5.6.7. Changes in the overall value of land will relate primarily to the revaluation of land since the total area of land will remain largely unchanged. However, since at a more detailed level there will be changes in the purposes for which land is used (often due to purchases and sales of land between economic units), there are likely to be notable changes in the value of different types of land due to transactions and reclassifications.
- 5.291 Table 5.6.7 shows the value of land by type of land use. It may also be of interest to estimate the total value of land by institutional sector of ownership. In this case, transactions and reclassifications between sectors are likely to be important accounting entries.

**Table 5.6.7 Monetary asset account for land (monetary unit)**

	Type of land use								Total
	Agriculture	Forestry	Land used for aquaculture	Use of built up and related areas	Land used for maintenance & restoration of environmental functions	Other uses of land n.e.c.	Land not in use	Inland water	
<b>Additions to stock</b>									
Acquisitions of land									
Reclassifications									
<i>Total additions to stock</i>									
<b>Reductions in stock</b>									
Disposals of land									
Reclassifications									
<i>Total reductions in stock</i>									
<b>Revaluations</b>									
<b>Closing value of stock of land</b>									

### *Valuation of land*

5.292 Unlike most environmental assets there is, in most countries, an active market in the purchase and sale of land of all types, including residential, industrial and agricultural land. However, determining the value of the land itself is a complex task.

5.293 Generally, the market values of land encompass the value of the location, the value of the physical attributes of the land and the produced assets that may be located on the land (e.g. buildings). Separating these different components may be difficult. Further, although there is a market in land, relatively little land changes hands in any year and thus observed prices may not be representative. Therefore, a comprehensive set of prices to cover all land types in all locations is seldom if ever available. Finally, some land will never be exchanged on the market. This may include designated public areas, land under traditional patterns of common ownership, and remote and inhospitable areas.

### Composite assets

5.294 Several common situations in which assets are bundled with land need to be described and relevant accounting treatments defined.

- 5.295 Soil resources. Although land and soil are distinguished as separate environmental assets, in terms of valuation, land and soil are always considered jointly. Thus the value of all land, especially agricultural land, implicitly includes the value of any associated soil.
- 5.296 Buildings and structures. The opening and closing values of the stock of land should be recorded excluding the value of buildings and structures on the land.
- 5.297 For land underlying buildings, the market will, in some instances, furnish data directly on the value of the land. More typically however, such data are not available and a more usual method is to calculate ratios of the value of the site to the value of the structure (often using administrative data) and to deduce the value of the land from the replacement cost of the buildings or from the value on the market of the combined land and buildings. Another approach is to use estimates of the depreciated value of the stock of dwellings and other buildings and structures that is often compiled for the purposes of the core national accounts and deduct this amount from the value of the composite asset.
- 5.298 When the value of the land cannot be separated from the building or structure on it, the composite asset should be classified to the asset category representing the greater part of its value.
- 5.299 Land improvements. In addition to buildings and structures, there may be improvements to land due to activities such as land clearance, land contouring or the creation of wells and watering holes for agriculture that are integral to the land in question. These activities, collectively referred to as “land improvements” are characterised by the outcome that they lead to major improvements in the productivity of a given area of land, potentially through the prevention of a deterioration in the quality of land. In principle, the value of land improvements should be recorded as a separate produced asset distinct from the value of the land as it existed before improvement.
- 5.300 If the value of the land improvements cannot be separated from the value of land in its natural state, the value of the land may be allocated to one category or the other depending on which is assumed to represent the greater part of the value. (For details regarding the full accounting treatment for land improvements refer to the 2008 SNA.)
- 5.301 Biological resources. As with the treatment of buildings and structures the value of these environmental assets should, in principle, be separated from the land on which they are grown. For land under forests, the separation should be based on the value of the stock of timber resources (for details see section 5.8) For cultivated biological resources other than timber resources, the range of techniques for making this distinction outlined for buildings and structures are also relevant for these assets.
- 5.302 Land under roads and public land. In principle the land under roads, railways and other transportation routes should be valued in the same way as for other land. However, given the shared characteristics of these assets, determining appropriate valuations may be difficult.
- 5.303 It is recommended that the valuations adopted for the purposes of government finance statistics be used to value land under roads and public land more generally. The value of the roads and rail lines, etc should be determined separately, possibly on the basis of

construction costs as required for the purposes of capital stock estimation in the national accounts.

5.304 Renewable energy sources. As described in Section 5.5, for some land and inland water the value may be influenced by the income generated from the generation of renewable energy. Examples include the value of land on which wind farms are based and the value of areas used for hydropower generation. The value arises due to the scarcity of the sites used for energy generation. Where possible, the value of the land (including inland waters) should be partitioned to provide an estimate of the value of the land that is attributable to income arising from the generation of renewable energy.

#### Changes in value due to changes in the quality of land

5.305 Changes in the value of land may be due to many factors including changes in the quality of land. At times there may be catastrophic losses in land quality for example as a result of contamination by radioactive waste or major flooding. Changes in the quality of land that lead to changes in the value of the land should not be recorded as revaluations even though the area of land does not change. Rather, the changes in value should be recorded as reclassifications (where the land use changes), reappraisals (where the land use remains the same) or catastrophic losses as most appropriate.

5.306 It is also noted that changes in the quality of land implicitly reflect the capacity for a given area of land to provide ecosystem services and the associated values of land will take this capacity into account.

#### *Accounting for transactions in land*

5.307 Generally, all transactions in land are between resident economic units. In situations in which a non-resident purchases land, the accounting convention is to establish a notional resident unit that purchases the land and the non-resident is shown as having the full financial ownership of the notional unit. There are at times exceptions to this treatment such as when governments may purchase land from other countries. These should be recorded as acquisition and disposals between countries.

#### *The treatment of costs of ownership transfer*

5.308 Whenever land is sold, there are transaction costs involved, arising, typically, from the involvement of the lawyers registering the change of ownership of the land and of the estate agents who bring the buyer and seller together. There may also be taxes payable in connection with the land purchase. The SNA refers to these expenses as the “costs of ownership transfer”. These costs are not recoverable by the new owner; any further sale will cover the underlying value of the land itself plus a new set of costs of ownership transfer. As a transaction, the costs to the purchaser of the land are treated as the purchase of a fixed asset and they are written off over time by means of consumption of fixed capital.

- 5.309 In general, because they are treated as a separate asset the costs of ownership transfer on land are not included in the valuation of land in the asset account. However, some refinements on this general position need to be clarified. Where the transaction involves only land and land improvements (for example where the sale of buildings, forests, is not involved), the cost of ownership transfer are allocated to the produced asset land improvements. Where the transaction involves land and other fixed assets (such as buildings or cultivated biological resources) the costs are allocated to the specific fixed asset involved. In both of these situations the costs are also recorded against the opening and closing stock values for the relevant produced asset.
- 5.310 It is also noted that where the costs of ownership transfer relate to a non-produced asset other than land (such as when related to the sale of mineral and energy resources or natural timber resources) the costs are capitalised against the item “costs of ownership transfer on non-produced assets” but they are recorded on the balance sheet against the non-produced asset in question.

#### **5.6.6 Links to ecosystem accounting**

- 5.311 Ecosystem accounts are founded on consideration of the capacity of the environment to deliver ecosystem services as described in Chapter 2. Importantly, it is the interactions between different environmental assets within a given area that generates ecosystem services.
- 5.312 To the extent that meaningful groupings of land cover areas can be defined, these areas of land are effectively statistical units in the context of ecosystem accounts in the same way as establishments are statistical units in economic accounts. SEEA Experimental Ecosystem Accounts develops these ideas in detail to provide a framework for assessing the capacity of ecosystems to deliver ecosystem services.

## 5.7 Accounting for soil resources

### 5.7.1 Introduction

- 5.313 Soil resources are a fundamental part of the environment. They provide the physical base to support the production and cycling of biological resources, are the source of nutrients and water for agriculture and forestry systems, provide a habitat for diverse organisms, and fulfil a complex buffering role against environmental variability (ranging from dampening diurnal and seasonal change in temperature and water supply to the storage and binding of a range of chemical and biological agents).
- 5.314 Accounting for soil resources therefore has many dimensions. At one level, accounting for soil resources can provide information on the area and volume of soil resources lost due to soil erosion, or made unavailable by changes in land cover (e.g. soil covered by buildings or roads) and other causes (e.g. changes in soil structure due to compaction, acidity or salinity). More broadly, accounting for soil resources in terms of their types, nutrient content, carbon content and other characteristics is relevant for more detailed examination of the health of soil systems, and the connections between soil resources and production in agriculture and forestry.
- 5.315 The focus of asset accounting for soil resources in the SEEA is on the top layers (horizons) of soil that form a biological system. Thus, quantities of soil that are extracted for construction, land reclamation, engineering and similar purposes are not considered, except to the extent that such extraction reduces the area and volume of soil resources available to operate as a biological system. Quantities of soil extracted for landscaping and similar purposes where the soil continues to operate as a biological system are considered within the accounting framework.
- 5.316 Research into the quantity and quality of soil has been a longstanding undertaking in many countries. At an international level, there has been substantial effort to create harmonised systems for recording information on different soils and more recently there has been work to more completely record information on soils in all countries in recognition of the fundamental role that soil resources play in environmental and economic systems.<sup>56</sup>
- 5.317 At the same time, there have been few pieces of research that relate the changes in the physical volume and characteristics of soil to measures of economic activity using accounting frameworks like the SEEA. Work is advancing from a scientific perspective on considering changes in soil resources from a natural capital perspective<sup>57</sup> but until now this work has not been translated into the SEEA framework.

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<sup>56</sup> See, for example, the *Harmonised World Soil Database* developed jointly by the Food and Agriculture Organisation of the UN, the International Institute for Applied Systems Analysis, ISRIC – World Soil Information, the Institute of Soil Science – Chinese Academy of Sciences and the Joint Research Centre of the European Commission - and, at finer scale, the GlobalSoilMap initiative overseen by a consortium of major soil information institutions ([www.globalsoilmap.net](http://www.globalsoilmap.net))

<sup>57</sup> For material examining this issue from a soil science perspective see, for example, Dominati et al, 2010, “A framework for classifying and quantifying the natural capital and ecosystem services of soils”, *Ecological Economics*, Vol 69.

5.318 Some aspects of accounting for soil resources fit easily into the broader asset accounting framework that is described in the Central Framework. Also, some of the physical flows associated with soil resources, for example, flows of nutrients, are within the framework of physical flows described in Chapter 3. More broadly, accounting for soil resources as a system providing multiple benefits is a part of the broader subject of ecosystem accounting and is described in SEEA Experimental Ecosystem Accounts.

5.319 This section presents a brief characterisation of soil resources and the associated information on soil. It then describes how the volume and area of soil resources can be accounted for within the asset accounts of the Central Framework. The final part of the section introduces the aspects of soil measurement that can be taken into consideration in other parts of the SEEA, including aspects such as nutrient balances and measuring soil resources as a system.

### **5.7.2 Characterisation of soil resources**

5.320 Different types of soil are defined in reference to their components and properties. Soil components reflect the biogeochemical composition of the soil, the minerals, liquids, gases and organic matter that are present in the soil. Soil properties reflect the physical, chemical and biological characteristics of the soil – e.g. porosity, texture, pH level, microbial biomass.

5.321 Various soil types can be defined using information on different combinations of soil components and properties. It is these various soil types (groupings) that can provide the basis for a generalised accounting for soil resources not because soil types change, but because soils have different baselines and potentials. Soil types are necessary categories to understand the importance of measured change and the potential for improvement. The Harmonised World Soil Database describes 28 major soil groupings that can be used to categorise and map soils at a broad global scale. Various national and regional groupings of soil types may be appropriate for national and sub-national measurement.

5.322 Soil resources are measured through a series of inventory processes – known collectively as a soil survey. Typically, a soil survey produces maps of soil types, soil suitability for various purposes, hazard and degradation potential and, in some cases, maps of specific soil properties. Other important and complementary activities for soil resource accounting include site or area based measures of soil loss or erosion processes, and simulation modelling of the way in which soil types relate to various climate and land use settings.

5.323 Measures of soil quality or soil value can also be developed using a range of approaches. In most cases, the soil suitability for specific purposes is assessed through a standardised indexing procedure. Most countries and regions have similar procedures optimised for their approach to soil mapping and soil classification. Soils are generally ranked in terms of their productive capacity (e.g. for agriculture) and/or their tendency for degradation. Simulation models can then be used to extrapolate from well-studied sites across the landscape to produce quantitative measures of yield, runoff and soil erosion.

5.324 The availability of this suite of measurements varies between and within countries. Overall, while most soil information has not been placed into an accounting framework, there

is a strong potential for aggregate accounting frameworks to be populated using the data available.

### 5.7.3 Accounting for the area and volume of soil resources

5.325 A first stage of accounting for soil resources is to measure the area of different soil types within a country. This type of accounting is an extension of the land accounts described in Section 5.6. An example of how an asset account for the area of soil resources can be structured is presented in Table 5.7.1. It shows the opening and closing stock of soil resources by type of soil and the additions and reductions in area of soil resources. In order to focus on soil resources that are available as a biological system the scope of this account should be restricted to land used for agriculture and forestry and also volumes of soil extracted to be used as a biological system. In certain circumstances there may be a focus on particular landscapes or land use systems that are under pressure.

5.326 In terms of accounting entries, the focus is on the area of different soil types at the beginning and end of an accounting period and on changes in the availability of different soil types. A distinction is made between changes in land cover (e.g. loss of soil resources for agriculture due to urban expansion – also known as soil alienation); and those due to changes in soil function (e.g. compaction or acidification) and the soil environment (e.g. due to desertification or land clearing). In practice distinguishing between these different types of changes may be difficult and the structure of the account should be based on highlighting the primary reasons and the changes of most environmental, economic or social interest.

**Table 5.7.1 Physical asset account for area of soil resources (hectares)**

		Type of soil resource				Total area
<b>Opening stock of soil resources</b>						
<b>Additions to stock</b>						
	Due to changes in land cover					
	Due to changes in soil function					
	Due to changes in soil environment					
	<i>Total additions to stock</i>					
<b>Reductions in stock</b>						
	Due to changes in land use					
	Due to changes in soil function					
	Due to changes in soil environment					
	<i>Total reductions in stock</i>					
<b>Closing stock of soil resources</b>						

- 5.327 In addition to an asset account such as in Table 5.7.1, there may be interest in tabulating types of soil resources by type of land use or land cover at a particular point time. Such information may help in analysis of whether various types of land use are being undertaken on high quality or marginal soil and hence provide a basis for assessment of alternative land uses. Considerable analytical benefits would also be gained through mapping information on soil types, land use and land cover using data that are spatially referenced.
- 5.328 A second stage in accounting for soil resources is to measure the volume of soil resources. Accounting for changing volumes of soil may enable assessment of the extent of erosion and the impact of major disasters such as flooding or drought, as well as providing information relevant to the assessment of soil depletion, i.e. the loss of soil resources due to economic activity.
- 5.329 An asset account for the volume of soil resources is shown in Table 5.7.2. It is structured to show the opening and closing volumes of soil and the changes in the volume of soil. Increases in the volume of soil by natural processes (soil formation) are assumed to be very slow and in this sense soil may be considered a non-renewable resource. However, the movement of soil through natural means (e.g. wind and water) may mean that soil lost from one area of a country may be deposited in another area or in another country, or in the sea and ocean. The deposition is often deleterious (e.g. covering infrastructure or polluting coral reefs) but there are situations where a region benefits from sediment movement. Where benefits from soil deposition can be established the flow should be considered part of the additions to stock while at the same time soil erosion is considered a reduction in stock.
- 5.330 The soil resources in Table 5.7.2 are classified by type of soil but it may also be meaningful to structure the changes in the volume of soil resources by geographic region or by type of land use or land cover. It is likely that different regions and land uses will have different impacts on and be differently impacted by soil erosion and soil deposition.
- 5.331 Changes in the volume of soil resources should also be recorded when soil are excavated and moved for various reasons. For example, soil may be excavated to build levies and dykes, for land reclamation, for road and other construction. Since the intent of the soil resources account is to recorded changes in the volume of soil resources that can operate as a biological system, the loss of the top layers of soil resource due to this extraction should be recorded as permanent reductions in soil resources unless the purpose is to create new biological soil systems in other locations. Losses in the accessibility of soil resources due to changing land cover (e.g. due to urban expansion or permanent flooding as is the case in the creation of artificial reservoirs) should be recorded as extractions.

**Table 5.7.2 Physical asset account for volume of soil resources (cubic metres)**

		Type of soil resource				
<b>Opening stock of soil resources</b>						
<b>Additions to stock</b>						
	Soil formation and deposition					
	Upwards reappraisals					
	Reclassifications					
	<i>Total additions to stock</i>					
<b>Reductions in stock</b>						
	Extractions					
	Soil erosion					
	Catastrophic losses					
	Downwards reappraisals					
	Reclassifications					
	<i>Total reductions in stock</i>					
<b>Closing stock of soil resources</b>						

5.332 Catastrophic losses of soil resources may take place in cases of major floods and other severe weather events. This may also lead to soil deposition depending on the quality of soil transferred. Reappraisals of soil volume should be recorded when additional information is available as for reappraisals of other environmental assets.

#### **5.7.4 Other aspects in accounting for soil resources**

5.333 In addition to the physical asset accounts proposed in this section, soil resources are accounted for in the physical supply and use tables (PSUT) described in Chapter 3. There are two main aspects to the PSUT entries for soil resources. First, the movement of soil resources for construction, land reclamation, landscaping and other such uses in the economy should be recorded as a natural resource input of soil resources from the environment to the economy. These entries should also record soil moved as part of dredging operations in rivers and ports and movements of contaminated soil for treatment or disposal.

5.334 Second, the flows of individual elements in the soil, such as soil carbon and soil nutrients (Nitrogen (N), Phosphorous (P) and Potassium (K)), can be recorded as part of material flow accounting. An introduction to net nutrient balances in the context of the SEEA is described in Section 3.6.

5.335 The recording of nutrient balances starts to consider issues related to the overall functioning of soil resources as a biological system and further, to the issue of valuing soil resources and associated measures of soil depletion and soil degradation. However, the accounting framework presented in the Central Framework does not fully describe the overall

state or condition of soil resources, changes in the health of soil resources, or their capacity to continue to provide the benefits that soil resources generate.

5.336 In the Central Framework the value of soil resources is tied directly to the value of land as described in Section 5.6. In this context connections may be made between changes in the combined value of land and soil and changes in the associated income earned from use of the soil resources.

## **5.8 Asset accounts for timber resources**

### **5.8.1 Introduction**

5.337 Timber resources are important environmental assets in many countries. They provide inputs for construction and the production of paper and other products, they are a source of fuel and they are an important sink for carbon.

5.338 The compilation of timber resource asset accounts is one measurement tool in providing information to assess and manage changes in timber resources and the services they provide. For a complete assessment of timber resources it is also relevant to construct asset accounts regarding the stock of land associated with timber resources, primarily forest and other wooded land. The changes in the stock of forest and other wooded land due to afforestation and deforestation may be of particular interest. These asset accounts are described in Section 5.6: Asset accounts for land.

5.339 This section is structured to provide details on the definitions of timber resources and associated classification and boundary issues including the relationship between timber resources and forest and other wooded land. An important aspect is the delineation between cultivated and natural timber resources. The section then presents a physical asset account and a monetary asset account for timber resources. The final part of this section outlines a physical asset account for carbon in timber resources. This is a simple extension of the physical asset accounting for timber resources.

### **5.8.2 Scope and definition of timber resources**

5.340 Timber resources may be found in a wide variety of places and may or may not be available to be felled and used as wood supply - i.e. to produce timber products or as fuelwood. Where timber resources are not available for wood supply this may be due to the trees being in areas in which logging operations are restricted or prohibited, the trees being in areas that are inaccessible or remote and hence logging is not economically viable or, from a biological perspective, the trees may not be commercially useful species.

5.341 While the timber resources that are not available for wood supply do not have an economic value, these timber resources remain in scope of timber resources in the SEEA in physical terms, as they fulfil the definition of environmental assets and may provide benefits. However, since these timber resources do not have an economic value, they are not recorded in the asset accounts for timber resources in monetary terms. Consequently, the volume of these timber resources in physical terms should be clearly identified such that appropriate alignment can occur between asset accounts in physical and monetary terms.

5.342 Most commonly timber resources are found in areas of forest land or other wooded land and the area of forest and other wooded land may often provide a good starting point for the compilation of data on timber resources. The areas that are classified as forest land and other wooded land for the purposes of measuring timber resources should be defined

consistently with those same areas in the physical asset accounts for forest and other wooded land described in Section 5.6.4.

5.343 Timber resources are also found in other areas such as in orchards, rubber plantations, along roadsides and train tracks, and in city parks. Conceptually, the timber resources in all of these areas are also within the measurement scope of the SEEA. In practice, countries should determine the scope of their timber resource accounts depending on the relative importance of the types of areas that provide timber resources.

5.344 Within the relevant areas, ***timber resources are defined by the volume of trees, living or dead, and include all trees regardless of diameter, tops of stems, large branches and dead trees lying on the ground that can still be used for timber or fuel.*** The volume should be measured as the stem volume over bark at a minimum breast height from the ground level or stump height up to a top. Excluded are smaller branches, twigs, foliage, flowers, seeds and roots.<sup>58</sup>

5.345 The thresholds for minimum breast height, tops of stem and branches may vary across countries. <sup>This variation</sup> reflects the variety of species, growing conditions and forestry management and harvesting practices that take place in different parts of the world. For example, the precise specification of the volume of a tree will vary between a conifer in northern Europe and a teak tree in a tropical rainforest. The general principle that should be considered in determining the volume of timber resources is the volume that is commercially usable. All estimates of timber resources, including estimates of the monetary value of timber resources need to take into account country specific conditions and practices.

5.346 The volume of timber resources is often referred to as the volume of standing timber. This definition includes trees on the ground either because they have been felled, but not yet removed from the area, or because they have fallen through natural causes (e.g. disease or lightning strike) but are still useful for timber products or fuel. The volume of standing timber also includes dead trees that remaining standing. The volume of standing timber should be distinguished from the growing stock which relates to living trees and forms the basis for the calculation of the natural growth in timber resources over a period.

#### *The boundary between cultivated and natural timber resources*

5.347 The determination as to whether timber resources are cultivated or natural is important in the application of the appropriate accounting treatment. The growth in cultivated timber resources is considered to be a process under the direct control, responsibility and management of institutional units. Consequently, the growth is recorded as occurring within the production boundary on an ongoing basis as an increase in inventories of those establishments undertaking the cultivation. (The removal of cultivated timber resources is recorded as a decrease in inventories of timber resources and an equivalent amount of

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<sup>58</sup> See Global Forest Resources Assessment 2010: Specification of National Reporting Tables for FRA 2010. Forestry Department, Food and Agriculture Organization of the United Nations. Forest Resources Assessment Programme Working paper 135, Rome 2007

sales.) The growth of natural timber resources, on the other hand, is not considered to take place within the production boundary and is recorded as entering the production boundary only at the time the tree is removed from the forest or other land area.

5.348 The treatment of timber resources as either cultivated or natural depends on the management practices applied to the areas in which timber resources are found. The key consideration is that the processes involved in cultivation must constitute a process of economic production. This is likely to include activities such as (a) control of regeneration, for example, seeding, planting of saplings, thinning of young stands; and (b) regular and frequent supervision of trees to remove weeds or parasites, or to attend to disease. The level of these types of activity should be significant relative to the value of the timber resources and should be directly connected with the growth of the timber resources in question.

5.349 In practice, a common starting point for the determination of whether timber resources are cultivated or natural is the type of land on which the timber resources are found. For example, for forest land, those timber resources within primary forests would generally be considered natural timber resources, whereas those timber resources in plantations are generally considered cultivated timber resources.

5.350 However, the rules by which different areas of forest land are differentiated may not align neatly to the production boundary of the SEEA or SNA. For example, when applying the definitions of different forest land as presented in Section 5.6.4, primary forest, as soon as it is logged for the first time, becomes other naturally regenerated forest and hence falls into a category of forest land that is likely to be a mixture of forest land that is under active management and control, and land in which human intervention is relatively infrequent. Also, in some countries there are large areas of planted forests that are not managed directly or frequently and the trees are left to grow until ready to harvest. These trees would be considered natural timber resources following the SEEA production boundary even though the term “planted forests” may immediately suggest a high level of economic activity.

5.351 Given the potential for forestry management practices to vary considerably across countries, it is recommended that countries determine the status of their timber resources as being either natural or cultivated based on application of the production boundary considerations listed above. This process is likely to require assessment by type of area in which timber resources are found, including forest land, other wooded land and other land with wood supply.

### **5.8.3 Physical asset accounts for timber resources**

5.352 The physical asset account for timber resources records the volume of timber resources at the beginning and end of an accounting period and the change in this stock over the accounting period. Of particular interest is the analysis of the rate of natural growth of timber resources compared to the rate of removals.

5.353 A basic structure for a physical asset account for timber resources is presented in Table 5.8.2. The asset account should distinguish between the type of timber resource, most importantly between cultivated timber resources and natural timber resources. For natural timber resources a distinction should be made between those timber resources available for wood supply and those not available for wood supply to ensure that the different scope of the asset accounts in physical and monetary terms can be reconciled. Depending on the purpose of analysis and available data, accounts by species of tree may be compiled.

5.354 The focus of the asset accounts presented in the SEEA is on the timber resources found in areas of forest and other wooded land. There may be interest however, in developing estimates of the volume of timber resources in other areas depending on country circumstance.

**Table 5.8.2 Physical asset account for timber resources (cubic metres over bark)**

	Type of timber resource		
	Cultivated timber resources	Natural timber resources	
		Available for wood supply	Not available for wood supply
<b>Opening stock of timber resources</b>			
<b>Additions to stock</b>			
Natural growth			
Reclassifications			
<i>Total additions to stock</i>			
<b>Reductions in stock</b>			
Removals			
Natural losses			
Catastrophic losses			
Reclassification			
<i>Total reductions in stock</i>			
<b>Closing stock of timber resources</b>			
<b>Supplementary information</b>			
<i>Fellings</i>			
<i>Felling residues</i>			

#### *Additions to the stock*

5.355 The stock of timber resources will increase due to natural growth. This is measured in terms of the gross annual increment i.e. the volume of increment over the reference period of all trees with no minimum diameter.

5.356 The calculation of natural growth should be based on the timber resources available at the beginning of the accounting period. Increases in the area of forest land, other wooded

land and other areas of land that lead to increases in the volume of available timber resources should not be considered as natural growth but instead should be recorded as reclassifications. Reclassifications may also occur due to changes in management practice that shifts timber resources from cultivated to natural or vice versa.

### *Reductions in the stock*

- 5.357 The stock of standing timber will decrease over an accounting period through the removal of timber resources and natural losses. Removals are estimated as the volume of timber resources removed from forest land, other wooded land and other land areas during the accounting period. They include removals of trees felled in earlier periods and the removal of trees killed or damaged by natural causes. Removals may be recorded by type of product – e.g. industrial roundwood and fuelwood or by species of tree – eg coniferous, broadleaved.
- 5.358 Removals is the relevant variable for measuring the extraction of timber resources because the definition of the stock of timber resources includes trees that have been felled and are on the ground but not yet removed.
- 5.359 Natural losses are the losses to the growing stock (i.e. living, standing trees) during an accounting period due to mortality from causes other than felling. Examples include losses due to natural mortality, insect attack, fire, wind throw or other physical damages.
- 5.360 Natural losses should only include those losses that would reasonably be expected when considering the timber resources as a whole. Exceptional and significant losses due to natural causes should be accounted for as catastrophic losses.
- 5.361 The volume of natural losses and catastrophic losses should only be recorded against these categories when there is no possibility that the timber resource can be removed.

### *Depletion*

- 5.362 Following the general definition of depletion, the depletion of natural timber resources is related to the sustainable yield of timber resources from the forest land, other wooded land and other land on which natural timber resources are found. More precisely, the sustainable yield of timber resources is the quantity of timber that can be harvested at the same rate into the future while ensuring that the productive potential is maintained. The sustainable yield will be a function of the structure of the growing stock and needs to take into account both the expected natural growth and the natural losses of trees. Various biological and forestry models will need to be taken into account in estimating sustainable yield.
- 5.363 Depletion of natural timber resources, in physical terms, is equal to extractions less sustainable yield. As explained in Section 5.4, some variation from year to year is to be expected in the relationship between estimates of sustainable yield and actual quantities of natural growth (less natural losses). Hence, depletion should only be recorded when extractions are beyond normal year on year variations in quantities of natural growth.

### *Fellings and felling residues*

- 5.364 While these entries fully account for the change in the volume of timber resources over an accounting period there may be specific interest in the volume of trees felled during the period relative to the volume of timber resources removed. Annual fellings are equal to the volume of standing timber that is felled during an accounting period. Fellings include silvicultural and pre-commercial thinnings and cleanings.
- 5.365 In addition there may be interest in the volume of fellings that are not removed, i.e. felling residues. These residues arise because, at the time of felling, a certain volume of standing timber is rotten, damaged or excess in terms of the size requirements. Felling residues exclude small branches and other parts of the tree that are also excluded from the scope of standing timber. Estimates of felling residues may provide important information on the nature of forestry practice and for the compilation of carbon accounts (see Section 5.8.5).
- 5.366 Where available estimates of the volume of fellings and felling residues may be added as supplementary information in the physical asset account.

### *Timber resources as a renewable energy source*

- 5.367 A broader discussion on renewable energy sources is presented in Section 5.5. It is noted that unlike other renewable energy sources, a stock of timber resources can be observed and measured. Thus, in concept the volume and value of timber resources will encompass all possible uses of the timber including its use as an energy source.

## **5.8.4 Monetary asset accounts for timber resources**

- 5.368 Monetary asset accounts for timber resources consist of measuring the value of the opening and closing stock of timber resources and the changes in the value of the stock over an accounting period. The monetary asset account for timber resources is presented in Table 5.8.3.
- 5.369 Most of the changes in the stock relate directly to changes recorded in the physical asset account but there are also entries relating to the revaluation of timber resources which are recorded when the prices for timber change during an accounting period.
- 5.370 It may be that because of forest legislation and/or environmental and economic reasons not all timber resources are available for harvest. It is recommended that the volume of timber resources that cannot be harvested be separately identified and should not form a part of the overall calculations of the value of timber resources.
- 5.371 Estimates are made for the value of natural growth and the value of removals. For cultivated timber resources the natural growth is considered an increase in inventories and the removal of trees is treated as a decrease in inventories. Following the SNA only the

change in inventories would normally be recorded but the entries are recorded on a gross basis in the SEEA.

5.372 For natural timber resources the natural growth is not considered an increase in inventories since the growth in the trees is not considered as part of a production process. The removal of the timber resources represents the point at which the timber resources enter the economy and output is recorded at that point.

**Table 5.8.3 Monetary asset account for timber resources (monetary unit)**

	Type of timber resource		
	Cultivated timber resources	Natural timber resources	Total
<b>Opening stock of timber resources</b>			
<b>Additions to stock</b>			
Natural growth			
Reclassification			
<i>Total additions to stock</i>			
<b>Reductions in stock</b>			
Removals			
Natural losses			
Catastrophic losses			
Reclassification			
<i>Total reductions in stock</i>			
<b>Revaluations</b>			
<b>Closing stock of timber resources</b>			

#### *Valuing the stock of timber resources*

5.373 In line with the general definition of resource rent (see Section 5.4), resource rent on timber resources is derived as the gross operating surplus from the harvest of timber resources less the value of the user cost of produced assets used in the harvesting process.

5.374 Defined in this way the resource rent will implicitly includes a share that should be attributed to the land on which the timber stands. This reflects the composite nature of the overall asset as discussed in section 5.6. In many cases due to the location of the land and the quality of the soil, the return to the land may not be large compared to the return to the timber resource but where relevant (for example, where the land may be potentially of value for other purposes) an estimate of the resource rent attributable to land should be deducted to derive the estimate of resource rent for timber resources.

5.375 Estimates of resource rent may be also be estimated more directly by using estimates of the stumpage price which is the amount paid per cubic metre of timber by the harvester to the owner of the forest. The stumpage price itself, may also be derived by deducting various harvesting costs from roadside pickup prices (also called wood-in-the-rough or

raw wood prices). The costs should include costs of thinning (net of any receipts), other management costs and rent on land. For natural timber resources, these additional costs may be very low or even zero. Where timber resources are sold prior to felling, relevant contract prices may also be used, if available, with appropriate adjustments for the scope and coverage of the prices to align with the concept of resource rent.

- 5.376 Stumpage prices can then be multiplied by estimates of the volume of standing timber per hectare at the expected harvesting age to give estimates of future receipts. These receipts are then discounted to estimate a value per hectare for each age class and, in turn, these values are multiplied by the total area of each age class and added to give the value of the total stock of standing timber. This approach should ensure that trees harvested after reaching maturity are separately accounted for.
- 5.377 A slightly simplified approach is to consider the current age structure and assume that each tree of a particular age grows to maturity and is harvested at maturity. Then the application of age specific prices generates an income flow for each age of tree that can be discounted back to the current period.
- 5.378 The primary difficulty in applying these NPV approaches is the extent to which information is available on the age structure of the trees and how these trees will mature into the future. Where the necessary detail is available these NPV approaches should be used taking into account modelling of future timber resources.
- 5.379 If detailed information on the future age structure is not available two methods are commonly applied. The stumpage value method requires information on an average stumpage price across all maturities of felling and an estimate of the current volume of timber. The consumption value method, requires information on the current age structure of the timber resources and stumpage prices for different maturities of standing timber.
- 5.380 While these two methods are variants of the basic NPV approaches, the assumptions underpinning them may be restrictive particularly in the case of a changing age structure of timber resources due to either overexploitation or active afforestation.
- 5.381 Other sources for the price of timber resources may also be available for comparison. For young forests, there may be good valuations for insurance purposes since at a young age there is a higher likelihood that forests are destroyed. Also, in some countries there are well developed markets in the acquisition and disposal of forests. In these situations pricing models have been established to provide appropriate valuations taking into account the location, type and age structure of the trees, etc. Care should be taken in using these pricing models for the purpose of valuing timber resources as the value of the forest may include estimates of the value of alternative land uses rather than only the future income stream from the timber resources.

### *Valuation of depletion, natural growth, removals and other flows*

- 5.382 In general terms, the valuation of flows of timber resources should be undertaken using the same assumptions underlying the valuation of the opening and closing stock of timber resources. The relevant approaches are described in detail in Annex A5.1.
- 5.383 The value of removals is always given by the stumpage value of the timber removed from the forest. When the stumpage prices are not available, harvesting costs must be deducted from the value of the wood in the rough.
- 5.384 With respect to catastrophic losses, for example due to wind throw or forest fire, when a catastrophic event does not fully destroy the wood, it is necessary to take into account the value of the wood that will be salvaged. The stumpage value of the salvaged timber has to be accounted for in the value of the stock for the period until its removal from the forest, which, in some cases, may take a number of years.
- 5.385 It is noted that there may also be revaluation effects following large catastrophic events. Prices may rise following a destruction of timber resources due to fire or may fall if trees are killed but not destroyed in storms. The price changes will reflect the changes in the pattern of timber available to be supplied.
- 5.386 Other changes that affect the value of stocks of standing timber as a resource for the logging industry are changes in use or status, occurring, for example, when forests are protected and logging is prohibited. In this case, the value of the standing timber, in terms of income from the sale of timber resources, is reduced to zero.

#### **5.8.5 Carbon accounts for timber resources**

- 5.387 The assessment of carbon binding is an increasingly important consideration. Estimates of the amount of carbon bound in timber resources and the changes in these amounts over an accounting period can be derived from information on opening and closing volume of standing timber and the changes in volume by applying relevant average coefficients for both the relationship between the volume of standing timber and the total biomass (including above and below ground biomass) and the relationship between the biomass and the quantity of carbon. These coefficients will vary with the species of the tree and other factors.<sup>59</sup>
- 5.388 A carbon account for timber resources can be developed based on the structure of the physical asset account for timber resources (Table 5.8.2).
- 5.389 It is noted that references to reductions in the stock of carbon in timber resources, for example due to removals, does not imply that carbon has been released to the atmosphere. In general, carbon will remain bound in timber until the timber is burnt or decomposes naturally.
- 5.390 A complete articulation of carbon accounting, including for example carbon binding in soils, is beyond the scope of the central framework but will be discussed in SEEA Experimental Ecosystem Accounts. This is mainly because calculation methods are still

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<sup>59</sup>See Intergovernmental Panel on Climate Change (IPCC): Good Practice Guidance for LULUCF and UNFCCC Guidelines on annual inventories.

developing and are not mature enough to provide sufficiently reliable information. At the same time it is noted that the underlying accounting models such as asset accounting and physical flow accounting are sufficiently well developed to be able to used for carbon accounting purposes.

## **5.9 Asset accounts for aquatic resources**

### **5.9.1 Introduction**

- 5.391 Aquatic resources are an important biological resource. They are subject to harvest for commercial reasons as well as part of recreational and subsistence fishing activities. The abundance and health of natural aquatic resources in inland and marine waters are also increasingly affected by water pollution and by the degradation of habitats through the damming and diversion of rivers, restricted water release from reservoirs to rivers, clearance of mangroves, sedimentation, coral mining, deforestation in the hinterland, urbanisation, and other activities. The dual impacts of excessive exploitation levels and habitat degradation result in the loss, or reduction, of the economic value of the goods and services provided by the aquatic ecosystems and a loss of biodiversity and genetic resources.
- 5.392 In most parts of the world, fishing capacity has reached a level where unrestricted fishing will result in overexploitation and lead to smaller catches and economic benefits than would be possible if the catch was managed in a way to prevent overexploitation. In extreme cases, there is the risk of commercial extinction of some aquatic resources with attendant impacts on the aquatic ecosystem.
- 5.393 Asset accounts for aquatic resources aim to organise information on the stocks and changes in stocks of the quantity and value of aquatic resources within a country's economic territory including stocks within a country's EEZ or on the high seas over which the country holds ownership rights. In principle, all aquatic resources are in scope of the asset accounts in the Central Framework but, in practice, the scope is limited to those aquatic resources that are subject to commercial activity. Asset accounts cover both cultivated aquatic resources and natural aquatic resources thus enabling a comparison of trends in both resources.
- 5.394 The asset accounts presented in this section do not cover the assessment of general aquatic ecosystems that support the various resources and which provide a wide range of ecosystem services. The measurement of ecosystems is described in SEEA Experimental Ecosystem Accounts.
- 5.395 This section provides a definition and classification of aquatic resources including discussion of the boundary between cultivated and natural aquatic resources. Then a physical asset account is described with a particular focus on the measurement of resources of natural aquatic resources. Finally a monetary asset account is presented incorporating discussion on the role of quotas and licences in estimating the value of aquatic resources.

### **5.9.2 Definition and classification of aquatic resources**

- 5.396 The aquatic resources for a given country comprise those resources that are considered to live within the Exclusive Economic Zone (EEZ) of a country throughout their lifecycles, both coastal and inland fisheries. Migrating and straddling fish stocks are considered to belong to a given country during the period when those stocks inhabit its EEZ.

5.397 When exploitation control over migrating and straddling fish stocks and fish stocks that complete their life cycle in international waters (high seas) has been established and the access rights of a country to them are defined in international agreements, the portion of agreed access rights of those aquatic resources can be considered to belong to the country.

5.398 In some cases, international agreements specify explicitly the share of total catches that should be allocated to each country. When this is the case, each country’s share of the stock of the common aquatic resource can be determined on the same basis. In the absence of specific information about the share of the common aquatic resource, the realised catch by a given country can be used as an indicator of the country’s share.

5.399 This measurement boundary is defined with reference to the United Nations Convention on the Law of the Sea (see United Nations, 1997a), in particular the Agreement for the Implementation of the Provision of the United Nations Convention on the Law of the Sea of 10 December 1982 relating to the Conservation and Management of Straddling Fish Stocks and Highly Migratory Fish Stocks (United Nations, 1998, sect. I; see also A/CONF.164/37) and the Code of Conduct for Responsible Fisheries of the FAO (ibid., sect. III). Together these agreements create a legal framework for international fisheries management.

*Classification of aquatic resources*

5.400 Aquatic resources include fish, crustaceans, molluscs, shellfish and other aquatic organisms such as sponges and seaweed, as well as aquatic mammals such as whales. The high level classification of aquatic resources is shown in Table 5.9.1.

**Table 5.9.1 Classification of aquatic resources**

	Aquatic resources		
		Cultivated aquatic resources	
			For harvest (inventories)
			For breeding (fixed assets)
		Natural aquatic resources	

5.401 The Food and Agriculture Organisation of the United Nations (FAO) and other fishery and aquaculture related institutions have collected capture and aquaculture production of aquatic resources, itemized at species level as much as possible. The data includes harvests of freshwater, brackish-water and marine species of fish, crustaceans, molluscs and other aquatic animals and plants, for all commercial, industrial, recreational and subsistence purposes.

5.402 The Aquatic Sciences and Fisheries Information System (ASFIS) list of species contains over 11,500 species, and is commonly used as the standard reference for fisheries production. It is linked to the FAO International Standard Classification for Aquatic Animals and Plants

(ISCAAP) which divides commercial species into 50 groups on the basis of their taxonomic, ecological and economic characteristics.<sup>60</sup>

5.403 Aquatic resources can be further grouped into the following nine divisions.

1. Freshwater fishes
2. Diadromous fishes
3. Marine fishes
4. Crustaceans
5. Molluscs
6. Whales, seals and other aquatic mammals
7. Miscellaneous aquatic animals
8. Miscellaneous aquatic animal products
9. Aquatic plants.

5.404 Diadromous fish are either those that normally live in salt water and spawn in freshwater (for example, salmon) or those that normally live in freshwater and spawn in the sea (for example, eels). Miscellaneous aquatic animal products encompass pearls, mother-of-pearl, shells, corals and sponges.

#### *Harvesting aquatic resources and the production boundary*

5.405 Aquatic resources may be either cultivated or natural biological resources. The treatment depends on the degree to which the growth and regeneration of the biological resource is under the direct control, responsibility and management of an institutional unit.

5.406 The production boundary includes all activities carried out under the responsibility, control and management of a resident institutional unit in which labour and assets are used to transform inputs of goods and services into outputs of other goods and services. In the case of aquatic resources, the growth of fish in fish farms and other aquaculture facilities is treated as a process of production.

5.407 Aquaculture is defined by FAO as follows:

“Aquaculture is the farming of aquatic organisms, including fish, molluscs, crustaceans and aquatic plants. Farming implies some form of intervention in the rearing process to enhance production, such as regular stocking, feeding, protection from predators etc. Farming also implies individual or corporate ownership of the stock being cultivated. For statistical purposes, aquatic organisms that are harvested by an individual or corporate body that has owned them throughout their rearing period contribute to aquaculture, while aquatic organisms that are exploitable by the public as a common property resource, with or without appropriate licences, are the harvest of the fisheries”.

5.408 Following the FAO definition of aquaculture, all aquatic resources produced within aquaculture facilities are considered cultivated biological resources. All other aquatic resources harvested as part of capture production processes are considered natural biological resources.

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<sup>60</sup> The ISCAAP is maintained by the Co-ordinating Working Party on Fisheries Statistics (CWP). Details on CWP and ASFIS are available at [www.fao.org/fishery](http://www.fao.org/fishery)

In some cases the life cycle of aquatic resources may start in an aquaculture establishment before transfer to the wild. In other cases fish are captured in the wild for further growth in aquaculture facilities. Following standard methods, the proportion of growth in the wild and in aquaculture facilities should be separated and classified appropriately.

5.409 While all aquatic resources in aquaculture facilities are cultivated biological resources, not all aquaculture is undertaken in the same way. Some aquaculture is undertaken using netted areas in rivers or off-shore and there is an interaction between the fish and the aquatic environment in which it is situated. Other forms of aquaculture involve raising fish in tanks where the fish are entirely removed from the natural environment. Therefore, it may be the case that some cultivated aquatic resources should not be considered environmental assets following the principles outlined in Section 5.2. Information on this distinction between types of cultivated aquatic resources would be useful given that the interactions between the environment and the economy are likely to be quite different. In practice, it may not be possible to distinguish between cultivated aquatic resources on the basis of the farming practice.

### **5.9.3 Physical asset accounts for aquatic resources**

5.410 A physical asset account for aquatic resources shows the total biomass of all species that are subject to harvesting activity or cultivated within the national boundary, including within its EEZ, and a portion of shared resources biomass to which a country has access rights either through traditional practice, international agreement or providing part of the distribution areas. Aquatic resources that exist within other countries' EEZ but are harvested by fishing operators that are resident in the reference country should not be included. The physical asset account also shows the changes due to harvest, normal loss, growth (in size and in number) and other changes.

5.411 A basic asset account for aquatic resources in physical terms is presented in Table 5.9.2

**Table 5.9.2 Aquatic resources physical asset account (tonnes/numbers)**

	Type of aquatic resource		
	Cultivated aquatic resources – fixed assets	Cultivated aquatic resources - inventories	Natural aquatic resources
<b>Opening stock of aquatic resources</b>			
<b>Additions to stock</b>			
Growth in stock			
Upwards reappraisals			
Reclassifications			
<i>Total additions to stock</i>			
<b>Reductions in stock</b>			
Gross catch/Harvest			
Normal losses			
Catastrophic losses			
Uncompensated seizure			
Downwards reappraisals			
Reclassifications			
<i>Total reductions in stock</i>			
<b>Closing stock of aquatic resources</b>			

5.412 In all cases the units that are used to record the stock and changes in stock should be the same although the measurement unit may vary by type of aquatic resource. It may be necessary to convert some estimates of the mass into number and vice versa. Conversion factors by species and size are required for this purpose.

#### *Cultivated aquatic resources*

5.413 In the case of cultivated aquatic resources it is reasonable to assume that the stock and changes in the stock can be estimated by the operator or owner of the resource. Accounts should be structured by species as appropriate. Increases come from growth in stock (in both size and numbers) and decreases from harvesting and normal losses.

5.414 When natural aquatic resources are introduced either as seeds or breeding stock this should be recorded as a reclassification from natural to cultivated resources. In the case of ranching and enhancement of aquatic resources, cultured seeds released into the wild should be recorded as a reclassification from cultivated to natural resources. A risk for aquaculture undertaken in rivers and marine environments is that the fish may escape into the external environment. These escapes should also be considered a reclassification from cultivated to natural aquatic resources.

5.415 Unexpectedly large losses due to disease or natural catastrophic events should be considered catastrophic losses.

5.416 The majority of changes in the stock of cultivated aquatic resources should be accounted for as changes in inventories. However, there will be a proportion of the

cultivated aquatic resources that are considered to be breeding stock. In principle, these resources should be considered as fixed assets rather than inventories and their growth should be recorded as gross fixed capital formation with associated entries for consumption of fixed capital.

### *Natural aquatic resources*

#### Measuring stocks and changes in stocks of natural aquatic resources

5.417 Asset accounts for natural aquatic resources should be compiled separately for freshwater and marine aquatic resources within a country's EEZ and other aquatic resources over which the country has ownership rights. A distinction between freshwater and marine aquatic resources may also be compiled.

5.418 Fishery biologists define a "stock" as a group of individuals from the same species that constitute a unit in breeding new offspring. If mating between members of different groups occurs to the level required to modify their gene pools in the long term, those groups should be considered to belong to one stock. The resource management should be based on this concept of stock. The boundary of a stock in this sense does not correspond to national boundaries and when aquatic resources belonging to a stock move around multiple countries' boundaries, the international collaboration in management is needed and the national asset account of such stock can be defined as a proportion of share to access to the stock.

5.419 There are several definitions that can be used in measuring the size of the resources. The most important concept is to measure the sexually mature part of the stock (i.e. the spawning stock or parental biomass), as it is believed that the main purpose of fishery management is to maintain adequate level of spawning stock to be able to generate natural growth and to minimize the probability of collapse.

5.420 Another relevant concept is the exploitable stock size. This corresponds to the proportion of the stock that is subject to harvesting activity, that is, ignoring the cohorts that are younger than those being harvested about which little is known. In this regard, it is important to record separately catch of mature resources and the catch of immature resources within the same species. Similarly, in the case where stocking with cultured seeds is regularly conducted, as commonly observed in freshwater resources, it is important to include the amount of released seeds as a reclassification from cultivated aquatic resources in order to assess their potential impacts on wild ecosystems and gene pools.

5.421 Various methods can be used by fishery biologists to estimate the absolute size of the natural aquatic stocks including virtual population analysis (VPA), tag-recapture analysis, direct and indirect measurement with line-transect surveys or at randomly sampled areas (e.g. echo-sounder, trawl survey, sighting survey) according to the behaviour and distribution of the target species, the harvesting patterns and available data.

5.422 However, estimates of the absolute size of stocks can be imprecise. In practice, little can be done to estimate the variability in births and survivals before the recruitment to the stock, the effects of environmental factors affecting the growth of the individual fish, or the rate of natural death from accidents, sickness, age, predators and so on. Further, small modifications in

such parameters within assessment models and equations may result in substantial differences in the estimated size of a stock. It is therefore important to record the impact of changes in model parameters as reappraisals in the asset accounts to distinguish these changes from other physical changes in the stock size.

5.423 When scientific assessment of the absolute stock size is not available, an alternative approach is to measure the gross catch for a certain harvesting operation in relation to the amount of effort required to obtain the catch for a given species e.g. days at sea, number and type of fishing gear, size and power of vessel, expenditure on catch effort (including wages and fuel), etc. The ratio of catch per unit effort (CPUE) can provide a good indicator of the relative change in stock size assuming that population density and population size are closely correlated and that CPUE is higher at higher population densities. Importantly, not all species have the same ratios between population structure and the associated CPUE and this needs to be taken into account in using this technique. Since the CPUE is derived based on information about activity over an accounting period, it provides an indicator of the stock at the mid-point of the accounting period.

5.424 Estimates may be available of stocks for individual species, since this is often the basis on which quotas are determined. However, it may be more applicable to focus on the size of the stock within a given area (or fishery) regardless of the number of species harvested in that area. Commonly, particularly in tropical areas, multiple species may be harvested at one time and accessing relevant indicators and models of the stock size that supports this harvest may be the most appropriate measurement approach.

#### Accounting for the harvest of natural aquatic resources

5.425 In physical terms, all aquatic resources harvested and all effort used to realize the harvest (e.g. in terms of fishing days multiplied by vessel power) should be recorded. Records should differentiate between species and the type of fishing/harvesting fleet (i.e. vessels operating in a similar way with similar gear). Further, the aquatic resources harvested in the open seas, coastal waters or inland waters by commercial or recreational fishing should be counted as production at the time they are harvested regardless of whether they are sold in the market or used for own consumption. This scope includes the activity of subsistence fishing.

5.426 The FAO has defined terms for the different stages of the catch from when fish encounter fishing gear to when they are landed. They are summarised here with a complete depiction of the relationships presented in a diagram in Annex A5.5.

- i. *Gross removal*. The total live weight of fish caught or killed during fishing operations.
- ii. *Gross catch*. The total live weight of fish caught (Gross removal less pre-catch losses)
- iii. *Retained catch*. The total live weight of fish retained (Gross catch less discarded catch)
- iv. *Landings*. The net weight of the quantities landed as recorded at the time of landing

v. *Nominal catch*. The live weight equivalent of the landings.

5.427 The most common catch concept used in practice is “landings” which are directly linked to the economic value of the product. However, this measure excludes the discards of incidentally caught organisms through harvesting activity (discarded catch) as well as the amount of the catch used for own-consumption. For the SEEA, the measurement of discarded catch is an important component in fully understanding the linkages between economic activity and the impact on aquatic resources. For this reason, it is recommended that the concept of “gross catch” be used to measure the extraction of fish resources.

5.428 Conceptually, “gross removal” is most appropriate concept to measure the impact on aquatic resources and the damage to aquatic ecosystems, e.g. to coral reefs, as a result of fishing activity. However, the measurement of gross removal is not possible in practice.

### Depletion

5.429 In principle, depletion of natural aquatic resources is derived following the approach outlined in Section 5.4 and Annex A5.1, where depletion for renewable resources is equal to harvest less sustainable yield. Since the drivers for changes in populations of aquatic resources can only be modelled it may be difficult to obtain precise and consistent measures of sustainable yield over time. In these cases it is recommended that estimates from biological models be compared with indicators of stock size, such as CPUE, and also that estimation be carried out on an ongoing basis such that the dynamics of the various populations (natural growth, natural losses, etc) can be better understood.

5.430 With this information a level of sustainable yield may be established to which the level of harvest in any given period can be compared. As noted in Section 5.4, some year on year variation in the actual changes in the population must be accepted as part of the accounting and hence depletion should only be recorded when the extraction is beyond a normal level of natural growth (less natural losses).

### Capture fishing by non-residents

5.431 Given the nature of aquatic resources and harvesting activity there will be capture fishing undertaken by non-residents within another country’s EEZ. Following the principles of the SNA, the location of the aquatic resource is not the key determinant of the attribution of economic production. Rather production is allocated to the country of residence of the harvesting operation. On the other hand, the UNCLOS defines the exclusive sovereign right of exploring and exploiting resources within its EEZ to the coastal country.

5.432 Therefore, in the assessment of the change in the aquatic resources belonging to a country over an accounting period, it is not sufficient or accurate to focus only on the catch by operations of residents of that country. This estimate will exclude changes in the national aquatic resource due to catch by non-residents and will include catch by residents in other countries. For the purposes of accounting for the national aquatic resource the focus must be on

the total catch from the country's aquatic resource, including any resources on the high seas over which ownership rights exist, regardless of the residency of the harvesting operation.

#### Illegal fishing

- 5.433 If a resident harvests aquatic resources beyond the scope of their licence, they are harvesting illegally. Nonetheless, following the principles of the SNA, this harvest should still be recorded as production with an income accruing to the fisherman.
- 5.434 In cases where non-residents harvest aquatic resources illegally, either without a licence or by taking catch in excess of their allocated quota, the physical removals should be recorded. These flows should be recorded as uncompensated seizures. In recording such flows care must be taken to exclude these flows from estimates of gross catch.

#### Other physical flows

- 5.435 It is unlikely to be the case that direct information can be separately obtained regarding the growth and normal loss in natural aquatic resources. Consequently, the estimates of growth and normal loss should be derived based on estimates of the opening and closing stock of aquatic resources and the extent of harvest when estimates of the absolute stock size are available. Otherwise, the change in CPUE over accounting periods should provide an indication as to whether the overall change (i.e. growth less gross catch less normal loss) is positive or negative.
- 5.436 It is also likely that reappraisals of the quantity of aquatic resources, both upwards and downwards, will occur; most commonly due to revisions in the parameters used in stock measurement models.

### **5.9.4 Monetary asset accounts for aquatic resources**

- 5.437 A monetary asset account for aquatic resources records the opening and closing values of aquatic resources in an accounting period and the changes over the period in the form of additions to the stock, reductions in the stock and revaluations. Aside from revaluations all of the monetary flows in the asset account have a direct parallel with the physical flows recorded in the physical asset account.
- 5.438 A basic monetary asset account for aquatic resources is presented in Table 5.9.3.

#### *Valuation of cultivated aquatic resources*

- 5.439 Aquatic resources farmed in an aquaculture facility are produced assets, either inventories, or fixed assets in the case of breeding stocks. In most cases, market prices can be obtained and can be used to estimate the value of the resources and the value of the flows of resources over an accounting period.

*Valuation of natural aquatic resources*

5.440 Monetary valuation of natural aquatic resources is complex. There are two main options. One possibility is to value the aquatic resource via the value of long term fishing licences and quotas where realistic market values are available. The other is to base the value on the net present value of the resource rent of the aquatic resources. Under the NPV approach there are two main approaches to estimating the resource rent – using information on annual licences or using information from the national accounts under the residual value method (see section 5.4 for details).

**Table 5.9.3 Monetary asset account for aquatic resources (monetary units)**

	Type of aquatic resource			
	Cultivated aquatic resources – fixed assets	Cultivated aquatic resources - inventories	Natural aquatic resources	Total
<b>Opening stock of aquatic resources</b>				
<b>Additions to stock</b>				
Growth in stock				
Upwards reappraisals				
Reclassifications				
<i>Total additions to stock</i>				
<b>Reductions in stock</b>				
Gross catch/Harvest				
Normal losses				
Catastrophic losses				
Uncompensated seizure				
Downwards reappraisals				
Reclassifications				
<i>Total reductions in stock</i>				
<b>Revaluations</b>				
<b>Closing stock of aquatic resources</b>				

5.441 If there is a perfectly functioning market for licences, if these licences cover the whole stock, and if resource rent can be accurately estimated, then these different valuation approaches should give the same result. However, because of market imperfections and uncertainties in the statistical assumptions required for net present value calculations, this is unlikely to be exactly the case in practice.

*Valuing natural aquatic resources using licence and quota information*

- 5.442 In many countries, a licence issued by government is required in order to practise either fresh water or marine fishing. A licence may be issued for a right to fish in general; a right to fish with specific gear; or a right to catch specific species. If these licences apply for a period not exceeding one year, they are recorded in the SNA as taxes. For enterprises, they are treated as taxes on production; for private individuals fishing for pleasure, they are recorded as taxes on income.
- 5.443 An increasingly common approach to controlling marine aquatic resources so as to prevent overharvesting is to issue quotas. These are usually issued by government (which is also responsible for ensuring their enforcement) and may apply both to harvesting within the waters of the country's EEZ and to fishing on the high seas. Quotas typically apply to a particular species.
- 5.444 Quotas may be given away free to certain designated persons (for example, people in locations where fishing is the main source of livelihood) or sold. A quota may be valid for one year only or for a longer period, sometimes for the lifetime of the quota-holder. It may or may not be tradable to third parties. Even if not tradable, in certain circumstances it may still be transferable, say, from one generation to the next.
- 5.445 If a quota can be sold by the holder to a third party, then the quota is recorded as an asset quite separately from the aquatic resources to which it relates.
- 5.446 When fishing/harvesting rights, evidenced by the existence of licences and quotas, are freely traded, it is possible to estimate the value of the aquatic resources from the market prices of these entitlements. In many cases, where the government hands the access rights to fishermen, trading in these access rights is prohibited and there is therefore no directly observable market valuation. In some cases, fishing rights may be tied to some asset (often a fishing vessel and, in some cases, land) that is freely traded. In these cases, it may be possible to infer market valuation of the access rights by comparing the prices of the associated assets when fishing rights are attached to them with prices of similar assets that do not encompass any such rights.
- 5.447 Two forms of individual transferable quota systems are common. An individual transferable quota (ITQ) provides entitlement to an absolute level of catch. An individual transferable share quota (ITSQ) provides entitlement to a fixed share of a total that may itself be variable from year to year in accordance with, for example, international agreements.
- 5.448 In theory, the value of the quota represents the NPV of the owner's expected income using the quota over its period of validity. If the aquatic resource is managed with such quotas and the quotas are valid in perpetuity, then the value of all quotas, at the market price, should be equal to the value of the aquatic resource.
- 5.449 If the quotas are valid for a single year only, the total should give an approximation of the resource rent in that year. By forecasting the estimate of the value of a single year quota, applying an appropriate discount rate, and estimating the resource life, an overall value of the aquatic resource can be derived using the NPV approach.

5.450 However, in most of those cases where ITQs, ITSQs and similar arrangements are used to manage aquatic resources, the market in these quotas is far from perfect and so the access rights do not reflect the full value of the resource. Licences and quotas are often introduced when considerable excess capacity exists in the fishing/harvesting industry. Unless those setting the total level of the quotas do so based on knowledge of the maximum catch consistent with preserving stocks, the earnings from the catch will not correspond to the level of income that maintains the aquatic resource intact. A total permissible catch resulting in earnings that are higher than this level will mean that some of those earnings should be regarded as depletion of the aquatic resources and not as income.

#### *Valuing natural aquatic resources using the NPV of expected resource rents*

##### Estimating resource rent

5.451 Following the approaches outlined in Section 5.4 and Annex A5.1, the operating surplus from harvesting natural aquatic resources can be used as a basis for the calculation of the resource rent of the resources. The total amount of gross operating surplus must be partitioned between that part representing the user costs of produced assets such as the ship, nets and other equipment used; and the part representing the resource rent of the aquatic resource.

5.452 There are a number of complications particular to the fishing industry that must be taken into account. One arises from the fact that artisanal fishing is very common, especially in developing countries. Here the generation of income account yields an item called “mixed income” as the balancing item rather than operating surplus. This item is so-named because it represents not only a return to the produced assets used and the natural aquatic resources but also an element of remuneration to the self-employed fisherman. In this situation an adjustment to remove this element of labour remuneration must be made.

5.453 It may also be difficult to separate harvesting and processing activities, both with respect to factory vessels and in cases where companies whose primary activity is land-based processing (that is, manufacturing) also have some harvesting operations. Although it is desirable to allocate the production and cost data to the relevant activity, this may be difficult in practice.

5.454 In addition, besides permitting harvest in excess of a sustainable level of catch, governments may sometimes subsidize fishing so that fishing continues even when the resource rent is negative.

##### Estimating the asset life

5.455 Estimating the asset life of aquatic resources presents a difficult measurement challenge. If the aquatic resource is to be preserved in perpetuity, harvest should not exceed the renewal rate of a stable population, i.e. the sustainable yield. In general, questions regarding the sustainable yield of an aquatic resource are answered using

biological models (as described in Section 5.4) or through analysis of trends in relevant indicators such as gross catch, CPUE, and the species and size of the fish caught. In particular a declining trend in CPUE is a strong signal that the rate of harvest is exceeding the renewal rate of the fish stock. In this case the asset life may be estimated by extrapolating the declining pattern of the CPUE to the point where the population is zero.

*Valuation of depletion and other changes in aquatic resources*

5.456 The value of aquatic resources may change due to a wide range of factors. When it is not possible to identify separate reasons for changes in the size or value of stocks and to attribute the changes to natural causes or harvesting activity, it will only be possible to prepare a minimal asset account. For example, the physical asset accounts may consist of extractions (based on catch data) for a number of species but without corresponding stock estimates for all of the species.<sup>61</sup> Thus, it may not be possible to value the stocks of individual species, so that only a regional or national aggregate resource values will be produced.

5.457 Ideally, changes due to growth, normal loss, depletion and other changes could each be measured and valued directly. However, due to data limitations, these changes may often only be available as a composite entry either measured as the difference between the amount harvested and the change between opening and closing stocks or based on trends in CPUE.

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<sup>61</sup> Further, many fishing operations harvest multiple species at the same time and it may not be possible to attribute CPUE to individual species.

## **5.10 Accounting for other biological resources**

### **5.10.1 Introduction**

- 5.458 Other biological resources are largely represented by cultivated animals and plants including livestock, annual crops such as wheat and rice, and perennial crops such as rubber plantations, orchards and vineyards. Together these biological resources form the basis of food production in all countries.
- 5.459 While the vast majority of other biological resources are cultivated, there is a range of natural biological resources that provide inputs to the economy and also form an important part of local bio-diversity. These resources may include wild berries, fungi, bacteria, fruits and other plant resources that are harvested for sale or own consumption. Alternatively they may relate to wild animals such as deer, boar or moose that are killed for sale or own consumption.
- 5.460 Since the majority of other biological resources are cultivated, estimates relating to the production and accumulation of these resources are an integral part of estimates of gross domestic product. The asset accounting for these resources is covered in detail in the SNA.
- 5.461 This section introduces asset accounting for natural biological resources. No tables are proposed because the compilation of accounts for these resources depends entirely on the resources of relevance in an individual country.

### **5.10.2 Accounting for natural biological resources**

- 5.462 Natural biological resources are distinguished from cultivated biological resources because their natural growth and regeneration is not under the direct control, responsibility and management of an institutional unit.
- 5.463 As a consequence of not being under direct control of institutional units natural biological resources are not easily accounted for. Aside from wild fish and natural timber resources, most animals and plants that provide significant economic benefits have become cultivated. Thus while there are a range of animal and plant resources that are harvested that are not cultivated, there is typically only active measurement of the animals, plants and other biota for which access rights are controlled (e.g. through hunting licences) or for which there are other management or conservation arrangements in place. As well, many of the examples that might be considered pertain to use for own consumption or as part of subsistence farming.
- 5.464 At the same time there are particular species in certain countries where reasonably significant commercial operations operate, possibly illegally, and where there is significant extraction of animals and plants from the wild. Examples include the hunting of elephants for ivory and hunting of kangaroos for meat. There may therefore be interest in the organisation of data and other information on the quantity and value of the available

resources, the extraction rates and the possible extent of loss in animal or plant populations due to over harvesting.

5.465 The structure and logic of the accounting for these resources is consistent with the accounting presented in sections 5.8 and 5.9 on timber resources and fish resources.

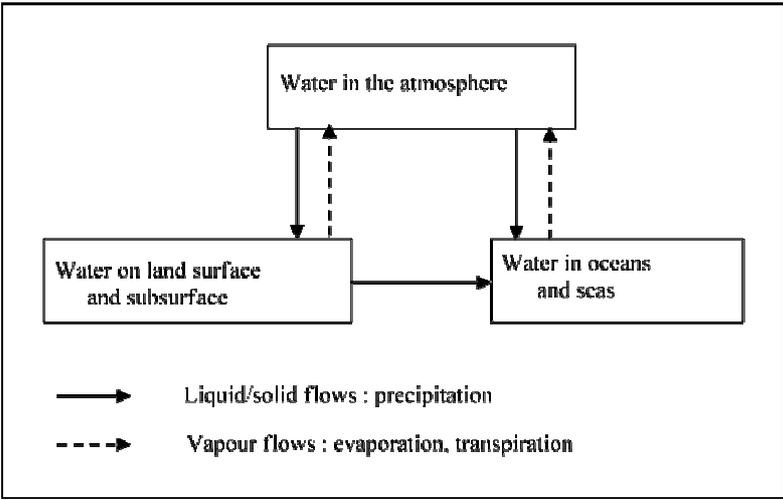
5.466 As natural biological resources may form an important part of bio-diversity and ecosystems in particular regions, there may be interest in compiling data on the availability and extraction of these resources at sub-national spatial levels. Further, information on these resources may be able to form an input into broader measures of ecosystem health that are discussed in SEEA Experimental Ecosystem Accounts.

**5.11 Asset accounts for water resources**

**5.11.1 Introduction**

5.467 Unlike other environmental assets, such as timber resources or mineral resources that are subject to slow natural changes, water is in continuous movement through the processes of evaporation, precipitation, sub-surface flows, river runoff and other flows. The natural cycle of water, the hydrological cycle, involves connections between the atmosphere, the oceans and land surface and sub-surface as shown in Figure 5.11.1.

**Figure 5.11.1: Elements of the global hydrological system**



5.468 Within the hydrological cycle, asset accounts for water resources focus on the inflows and outflows of water to and from the land surface and sub-surface, and on the destination of these flows. In conjunction with information on instream flows, seasonality and other factors, such a focus allows assessment of the availability of water to meet demands from the economy and to assess whether those demands are consistent with the longer term sustainability of water supply.

5.469 The asset accounts themselves present information on the stock of water at the beginning and end of an accounting period whether it is in artificial reservoirs, lakes or rivers or stored as ground or soil water. The accounts then record the flows of water as it is abstracted, is consumed, is added to through precipitation, or via flows to and from other countries and returned to the sea.

5.470 Water is included in two places in the central framework environmental asset classification – as part of “Land and other areas” and as part of “Water resources”. As a component of land it is the in situ or passive use of water that is being considered, for example, in the provision of space for transportation and recreation. Consequently it is the area of water that is of interest. In the context of water resources, the focus is on the amount of water in the environment, its abstraction, and the use of water through the economy and hence it is the volume of water and the changes over time that are of interest.

5.471 This section defines water resources and the classes of water resources that are within scope of the asset accounts. It then presents the physical asset account for water resources and describes the relevant flows. A final part discusses related measurement issues such as the measurement of the value and quality of water resources.

**5.11.2 Definition and classification of water resources**

5.472 *Water resources consist of fresh and brackish water in inland water bodies including groundwater and soil water.* Inland water bodies are classified as shown in Table 5.11.1.

5.473 Freshwater is naturally occurring water having a low concentration of salt. Brackish water has salt concentrations between that of fresh and marine water. The definition of brackish and freshwater is not clear cut as the salinity levels used in the definition vary between countries.<sup>62</sup> Brackish water is included in the asset boundary on the grounds that this water is often used, with or without treatment, for some industrial purposes, for example, as cooling water, for desalination or irrigation of some crops. Countries may choose to present accounts by salinity levels or for freshwater only.

5.474 The definition of water resources excludes water in oceans, seas and atmosphere. At the same time, flows of water in oceans, seas and the atmosphere are recorded in the accounts in a number of places. For example, abstraction from the ocean and outflows to the ocean are recorded in the asset account and evaporation to the atmosphere from inland water resources is also recorded there. Flows to and from inland water resources are also recorded in the physical flow accounts for water (see Chapter 3).

**Table 5.11.1 Classification of inland water bodies**

<b>Code</b>		
	Surface water	
		Artificial reservoirs
		Lakes
		Rivers and streams
		Glaciers, snow and ice
	Groundwater	
	Soil water	

5.475 Surface water comprises all water that flows over or is stored on the ground surface regardless of its salinity levels. Surface water includes water in *artificial reservoirs*, which are purpose built reservoirs used for storage, regulation and control of water resources; *lakes* which are, in general, large bodies of standing water occupying a depression in the earth’s surface; *rivers and streams* which are bodies of water flowing continuously or periodically in channels; *snow and ice* which include permanent and seasonal layers of snow and ice on the ground surface; and *glaciers* which are defined as an accumulation of ice of atmospheric origin,

<sup>62</sup> For further details see International Glossary of Hydrology, UNECSO/WMO, 2<sup>nd</sup> edition, 1992.

generally moving slowly on land over a long period.

5.476 Although artificial reservoirs are not natural components of the earth's surface, once in place, the stocks and flows of water are equivalent to the stocks and flows associated with natural stores of water, in particular natural lakes. Thus flows of precipitation, abstraction and evaporation affect artificial reservoirs in the same way as they affect natural lakes and hence artificial reservoirs form one part of the hydrological system. They are separately identified in the classification of inland water resources since, in many cases, the flows associated with artificial reservoirs, in particular evaporation, are of particular analytical interest.

5.477 Groundwater comprises water that collects in porous layers of underground formations known as aquifers. An aquifer is a geologic formation, group of formations, or part of a formation that contains sufficient saturated permeable material to yield significant quantities of water to wells and springs. It may be unconfined, by having a water table and an unsaturated zone, or may be confined when it is between two layers of impervious or almost impervious formations. Depending on the recharge rate of the aquifer, groundwater can be fossil (or non-renewable) in the sense that water is not replenished by nature in human life spans.<sup>63</sup>

5.478 Soil water consists of water suspended in the uppermost belt of soil, or in the zone of aeration near the ground surface. Soil water can be discharged into the atmosphere by evapotranspiration, be absorbed by plants, flow to groundwater or to rivers (run-off). In the SEEA, the measurement of soil water is limited to soil water in agricultural and forestry areas as defined by the area of land used for agriculture and forestry in the land use classification.

### **5.11.3 Physical asset accounts for water resources**

5.479 Physical asset accounts for water resources should be compiled by type of water resource and should account for both the stock of water at beginning and end of the accounting period and the changes in the stock of water. The accounts are generally compiled in terms of millions of cubic metres of water.

5.480 Changes in the stock of water should consider additions to the stock, reductions in the stock and other changes in the stock. The structure of the physical asset account for water resources is shown in Table 5.11.2.

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<sup>63</sup> Certain lakes may also be considered fossil water bodies.

**Table 5.11.2 Physical asset account for water resources (cubic metres)**

	Type of water resource		
	Surface water	Groundwater	Soil water
<b>Opening stock of water resources</b>			
<b>Additions to stock</b>			
Returns			
Precipitation		na	
Inflows – from other territories			
- from other national water resources			
Discoveries of water in aquifers			
<i>Total additions to stock</i>			
<b>Reductions in stock</b>			
Abstraction			
of which: for hydro power generation			
for cooling water			
Evaporation/Actual evapotranspiration			
Outflows – to other territories			
- to other national water resources			
<i>Total reductions in stock</i>			
<b>Closing stock of water resources</b>			

#### *Defining the stock of water*

5.481 The concept of a stock of surface water is related to the quantity of water in a territory of reference measured at a specific point in time (usually the beginning or end of the accounting period). The stock level of a river is measured as the volume of the active riverbed determined on the basis of the geographic profile of the riverbed and the water level. This quantity is usually very small compared to the total stocks of water resources and the annual flows of rivers.

5.482 The stock of groundwater is the volume of water at a particular point in time, which has collected in porous and permeable underground layers known as aquifers that can yield significant quantities of water to wells and springs. An aquifer may be unconfined, that is it has a water table and an unsaturated zone immediately above the water table, or may be confined when it is between two layers of impermeable or nearly impermeable material.<sup>64</sup>

5.483 The stock of soil water is the volume of water suspended in the uppermost belt of soil, or in the zone of aeration near the ground surface, which can be discharged into the atmosphere by

<sup>64</sup> See *International Recommendations on Water Statistics*, paragraph 4.24

evaporation or taken up by the roots of plants and transpired. In countries where there is a consistent and regular hydrological year with a distinct dry period, the stock of soil water at the end of the hydrological year may be negligible in comparison to groundwater or surface water. While soil water can be distinguished from groundwater and surface water in theory, at present it may be difficult to measure it directly but it can be estimated indirectly using a variety of data.<sup>65</sup>

#### *Additions to and reductions in the stock of water resources*

5.484 Additions to the stock of water resources consist of the following flows.

- i. Returns represent the total volume of water that is returned to the environment by economic units into surface, soil and groundwater during the accounting period. Returns can be disaggregated by type of water returned, for example, irrigation water, treated and untreated wastewater. In this case, the breakdown should mirror that used to disaggregate the returns in the physical supply and use tables in chapter 3.
- ii. Precipitation consists of the volume of atmospheric wet precipitation (e.g. rain, snow, hail etc.) on the territory of reference during the accounting period before evapotranspiration takes place. The majority of precipitation falls on the soil but generally would be recorded as run-off to rivers, especially in cases of flooding. Most precipitation is therefore recorded as an addition to surface water although amounts retained in the soil should be recorded as additions to soil water. Some precipitation also falls directly into surface water bodies. It is assumed that water would reach aquifers after having passed through either the soil or surface water (e.g. rivers, lakes, etc.), thus no precipitation is shown in the asset accounts for groundwater. The infiltration of precipitation to groundwater is recorded in the accounts as an inflow from other water resources into groundwater.
- iii. Inflows represent the amount of water that flows into water resources during the accounting period. The inflows are disaggregated according to their origin: (a) inflows from other territories/countries; and (b) from other water resources within the territory. Inflows from other territories occur with shared water resources. For example, in the case of a river that enters the territory of reference, the inflow is the total volume of water that flows into the territory at its entry point during the accounting period. If a river borders two countries without eventually entering either of them, each country could claim a percentage of the flow to be attributed to their territory. If no formal convention exists, a practical solution is to attribute 50 per cent of the flow to each country. Inflows from other resources include transfers, both natural and man-made, between the resources within the territory. They include, for example, flows from desalination facilities and flows of infiltration and seepage.
- iv. Discoveries of water in new aquifers. These flows should be recorded in terms of the quantity of water in the newly discovered aquifer as distinct from the overall capacity of the aquifer. Changes in the volume of water in an aquifer should be included as an inflow

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<sup>65</sup> See *International Recommendations on Water Statistics*, paragraph 4.29

of water resources to groundwater.

5.485 Reductions in the stock of water resources consist of the following flows.

- i. Abstraction represents the amount of water removed from any source, either permanently or temporarily, during the accounting period. The abstracted water may be directly returned to the environment or used for production activities (including the abstraction of water by households for own-consumption). Water used for hydroelectric power generation and as cooling water is considered part of water abstraction. Given the large volumes of water abstracted for hydroelectric power generation and for cooling purposes, it is advisable to separately identify the abstraction and returns of water for these purposes. Abstraction also includes the abstraction from soil water by plants in areas of rain-fed agriculture and cultivated timber resources. The water abstracted from soil water is either absorbed by the plants or returned to the environment through transpiration.
- ii. Evaporation/Actual evapotranspiration is the amount of evaporation and actual evapotranspiration that occurs in the territory of reference during the accounting period, excluding amounts already recorded as abstracted from soil water (i.e. water transpired by cultivated plants). Note that evaporation refers to the amount of water evaporated from water bodies such as rivers, lakes, artificial reservoirs, etc. Evapotranspiration refers to the amount of water that is transferred from the soil to the atmosphere by evaporation and plant transpiration. Evapotranspiration can be “potential” or “actual” depending on the soil and vegetation conditions: potential evapotranspiration refers to the maximum quantity of water capable of being evaporated in a given climate from a continuous stretch of vegetation covering the whole ground and well supplied with water. Actual evapotranspiration, which is reported in the accounts, refers to the amount of water that evaporates from the land surface and is transpired by the existing vegetation/plants when the ground is at its natural moisture content that is determined by precipitation and the soil’s properties. Note that actual evapo-transpiration will typically be estimated through modeling and may be a rough approximation.
- iii. Outflows represent the amount of water that flows out of water resources during the accounting period. Outflows are disaggregated according to the destination of the flow, namely (a) to other water resources within the territory, (b) to other territories/countries and (c) to the sea/ocean. Outflows to other water resources within the territory represent water exchanges between water resources within the territory. In particular, they include the flows of water going out of a water body and reaching other water resources within the territory. Outflows to other territories represent the total volume of water that flows out of the territory of reference during the accounting period. Shared rivers are a typical example of water flowing from one upstream country to a downstream country. Outflows to the sea/oceans represent the volume of water that flows into the sea/oceans.

#### **5.11.4 Other water resource measurement issues**

##### *Monetary asset accounts for water resources*

5.486 The measurement of the stock of water in monetary terms is particularly difficult. The main problem is that, historically, water has often been made available free of charge as a public good supplied at less than the cost of production in order to support agricultural production; or supplied for a flat charge because it has been seen to be not subject to scarcity. The monetary prices, therefore, have tended to be related to the fixed infrastructure costs of collecting and transporting water to designated outlets rather than to actual volume of water used which may vary considerably.

5.487 Given this situation, the standard approaches to valuation of environmental assets, and in particular the net present value approach (described in Section 5.4), do not work because the resource rent that is derived following standard definitions is commonly negative. Estimates of negative resource rent arise when the income earned from the sale of abstracted water does not cover the costs of maintaining the produced assets required to distribute the water.

5.488 There is a trend towards water pricing to reflect the full costs of managing, abstracting and distributing water resources. Consequently, there may be some instances where approaches such as NPV can be applied. In these cases these values should be incorporated as part of the overall monetary value of environmental asset and as part of the value of economic assets.

5.489 Another approach to the valuation of water resources is to consider the value of water access entitlements which, in some countries, are traded in distinct markets. Often, the value of these entitlements may be closely connected to the value of the associated land and determining the relevant proportion of the total value of land that can be attributed to the access entitlements may be a way of determining the value of the associated water. These approaches to valuation are more likely to be most relevant in agricultural contexts where access to water by farmers is a significant consideration.

##### *Spatial and temporal detail*

5.490 Water statistics can provide data for water management at many geographic levels, from local levels, at the level of river basins and to the national and multinational levels. The choice of spatial reference for the compilation of water accounts ultimately depends on the data needed by users and the resources available to data producers. The choice of spatial scale is important as many countries have significant geographic variation in the availability of water (e.g. areas of very high or very low rainfall) and national aggregates may not accurately reflect the issues facing particular countries.

5.491 It is recognized internationally that a river basin is the most appropriate spatial reference for integrated water resource management (e.g., Agenda 21 (United Nations, 1992) and European Water Framework Directive, 2000). This is because the people and economic activities within a river basin will have an impact on the quantity and quality of water in the basin, and conversely the water available in a basin will affect the people and economic

activities that rely on this water. In areas where groundwater is an important source of water, aquifers may also be appropriate spatial references for the compilation of water statistics.

5.492 Although data for specific spatial scales within a country are often more appropriate for the analysis of water resources, integration of physical data on water at relevant spatial levels, e.g. river basins, may not align with the available spatial detail for economic data (which are more commonly compiled based on administrative boundaries). In these situations, common areas of observation, accounting catchments, should be defined.<sup>66</sup>

5.493 When integrating or collecting water data, it is important that the reference periods for the different data items be aligned. In water and economic statistics, the calendar year is the recommended temporal reference. However, in practice water and economic data may not be available for calendar years. For example, for national accounts many countries use a financial year, while for water statistics, they may use a hydrological year. Financial and hydrological years may be the same as or different from calendar years. It is also noted that in some cases high seasonal variability in relationship between the demand and supply of water may mean that annual data (either on a financial or hydrological year) are insufficient and, instead, sub-annual data are required.

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<sup>66</sup> For details see SEEA Water, paragraph 2.90.

## Annex A5.1: The Net Present Value method for valuation of stocks and the measurement of depletion and revaluation for natural resources

### Introduction

1. This annex explains, in some detail, the assumptions and computations needed to implement the net present value method (NPV) with a view to deriving valuations of the stock of natural resources and consistent flow measures of depletion, income, and revaluation. In particular, the latter element is often neglected in presentations of the NPV. Also, it must be accepted that the NPV is not applied under conditions of perfect foresight. Hence, revisions in the set of information available to the compiler over an accounting period need to be accounted for.

### Defining the unit resource rent

2. Consider an enterprise that harvests and sells timber resources from an uncultivated, natural forest. The enterprise uses produced assets in the extraction process (e.g. lorries, saws, etc) as well as labour and intermediate inputs (e.g. fuel). The enterprise receives income from the sale of timber and pays input costs for labour, produced assets and intermediate inputs.
3. The enterprise must also pay for the timber resources to be extracted. This variable is best understood as the price per unit of timber resources extracted that the enterprise would be charged if the timber resources were owned by another unit (for example, the government). While *in principle* this amount is observable, often it is not available in practice, in particular when the extracting enterprise is itself the owner of the resource.
4. This amount is commonly referred to as the resource rent,  $RR_t$  and is equivalent to the total value of the natural resource input into the production process during an accounting period. It is comprised of two parts (i) the quantity of timber extracted,  $S_t$ , and (ii) the price per unit of timber extracted,  $P_{S_t}$ . The variable  $P_{S_t}$  is equivalent to the unit resource rent – i.e. the resource rent per extracted unit of timber resource.
5. Empirically, the resource rent can be measured *ex-post* (i.e. at the end of the accounting period) as a residual provided there is only one type of natural resource per enterprise or per industry. In this case,  $RR_t$  equals gross operating surplus plus the non-labor component of mixed income less the user costs of produced assets. Alternatively,  $RR_t$  may be observable from rent payments that extraction enterprises pay to the owners of a natural resource. (The various methods for estimating  $RR_t$  are discussed in Section 5.4). Given  $RR_t$  and  $S_t$ , it is straightforward to compute the unit resource rent,  $P_{S_t}$ .
6. Having estimated the unit resource rent, two important tasks remain to be completed: first, the value of the stock of the natural resource needs to be established, and second, the period-to-period gross income attributed to the resource,  $RR_t$  needs to be split up into a part that represents the value of depletion and into a part that represents net income. These tasks are directly related and need to be addressed consistently.

## Valuing the stock of a natural resource

7. To tackle the valuation of the stock of a natural resource, start with the fundamental asset market equilibrium condition or NPV that the value of an asset (the timber resources in this example) at the end of period  $t$ ,  $V_t$ , equals the discounted flow of future resource rents  $RR_{t+\tau}$  ( $\tau=1,2,\dots,N_t$ ) over  $N_t$  periods. The estimate of the number of remaining periods of extraction may vary over time, therefore  $N_t$  depends on  $t$ . In the simplest case, and for a fixed finite period of exploitation,  $N_t$  declines by one period as  $t$  progresses. If the exploitation of a natural resource is judged to be sustainable,  $N_t$  will take an infinite value. It is assumed here that the resource rent accrues at the end of the accounting period.<sup>67</sup> The standard NPV condition is shown in equation (1).

$$V_t = \sum_{\tau=1}^{N_t} RR_{t+\tau} / (1+r_t)^\tau \quad (1)$$

where  $r_t$  is a nominal discount rate valid at time  $t$ , but not necessarily constant over time.

8.  $RR_{t+\tau}$  ( $\tau=1,2,\dots,N_t$ ) is a nominal value of expected future resource rents and the projected time profile of the resource rent  $\{RR_{t+1}, RR_{t+2}, \dots\}$  may be non-constant. Note that the sequence of resource rents  $\{RR_{t+1}, RR_{t+2}, \dots\}$  is an *expected* sequence and that the expectation is formed at the end of period  $t$ .
9. As time goes on, information may change and a different sequence of resource rents may be expected. Similarly, the value of the stock at the beginning of period  $t$  may have been constructed with a different set of expectations about future resource rents or discount rates. Such a change in the set of information needs to be allowed for and will be addressed later.
10.  $V_t$  is the value of the stock at the end of period  $t$ . In concept, this value is composed of a price and a quantity component, call them  $P_t$  and  $X_t$ . Indeed without this price-quantity distinction, the meaning of 'V' would be unclear. In the timber example, if  $V_t$  is the value of the timber resource,  $P_t$  equals the price per cubic metre of the timber resources at the end of period  $t$ , and  $X_t$  is the cubic metres of timber resources at the end of period  $t$ . (In the case of an oil field,  $X_t$  would be the estimated quantity of oil in the ground.) Therefore, one has

$$V_t = P_t X_t \quad (2)$$

11. To obtain an estimate of the price  $P_t$  and consequently of  $V_t$ , use the NPV condition from equation (1) together with the definition of the resource rent  $RR_t = P_{st} S_t$  :

$$V_t = P_t X_t = \sum_{\tau=1}^{N_t} P_{s,t+\tau} S_{t+\tau} / (1+r_t)^\tau \quad (3)$$

12. Next, a hypothesis has to be formed concerning the future profile of extractions and the expected price change of  $P_{st}$ . One simple possibility is to assume that the most recent *quantity of extraction* is the best estimate of future extractions so that  $S_{t+\tau} = S_t$  ( $\tau=1,2,3,\dots,N_t$ ). This is only one possibility and different assumptions could be made, for instance if the extraction in year  $t$  was unusually large or small and unlikely to be occurring again in the future. Another possibility is to assume a constant *rate of extraction* such that

<sup>67</sup> Preferably, resource rent should be assumed to accrue to the mid-point of the accounting period. The assumption made here is used to simplify the explanation and the associated notation and has no impact on the underlying relationships described.

$S_{t+\tau}/X_{t+\tau}$  is constant for  $\tau=1,2,3,\dots,N_t$ . For the expositional purpose at hand, a constant quantity of extraction is assumed.

13. Similarly, a hypothesis needs to be formed regarding the evolution of the price  $P_{st}$  and the proposal here is consider the long-run trend in the unit resource rent or, even more straightforwardly, to assume that  $P_{st}$  evolves in line with an expected general rate of inflation,  $\rho_t$ .

14. Using these two hypotheses, the NPV condition can then be re-written as

$$\begin{aligned} V_t = P_t X_t &= \sum_{\tau=1}^{N_t} P_{s,t+\tau} S_{t+\tau} (1+\rho)^{\tau-1} / (1+r_t)^\tau \\ &= P_{s,t} S_t \sum_{\tau=1}^{N_t} (1+\rho)^\tau / (1+r_t)^\tau = P_{s,t} S_t \Omega_t = RR_t \Omega_t \end{aligned} \quad (4)$$

$$\Omega_t \equiv \sum_{\tau=1}^{N_t} (1+\rho)^\tau / (1+r_t)^\tau \quad (5)$$

15.  $\Omega_t$  is a ‘discount’ factor that links future resource rents to the present value of the asset. Equation (4) provides the desired estimate for the value of the stock,  $V_t$ , as well as the price level for the unit value of the resource in/on the ground,  $P_t = RR_t \Omega_t / X_t$ . The above expression also shows the relationship between the unit resource rent  $P_{st}$  and the price of the asset in/on the ground  $P_t$ : the latter is the discounted value of the former, multiplied by the current extraction rate  $S_t/X_t$ .

$$P_t = P_{s,t} \Omega_t S_t / X_t \quad (6)$$

16. One conclusion from this relationship is that it is incorrect to use the unit resource rent,  $P_{st}$  as the price of the asset, i.e., for valuation of the stock of the resource. It is also useful to note that with the simplifying hypotheses made above, the main element of  $\Omega_t$ ,  $(1+r_t)/(1+\rho_t)$ , is a real interest rate. In many countries, real interest rates tend to be relatively stable and should therefore not be too difficult to estimate.

17. The real interest formulation also relates to Hotelling’s rule for non-renewable resources. Hotelling’s rule states that under certain market conditions, non-renewable resource rents will rise at the rate of the nominal discount rate as the resource becomes scarce. Under these circumstances, the value of the resource stock can be calculated simply as the unit resource rent times the size of the stock. Because nominal resource rent rises over time at a rate that is exactly sufficient to offset the nominal discount rate, there is no need to discount future resource income. In terms of the notation at hand, this corresponds to a situation where  $\rho_t=r_t$  so that  $\Omega_t=1$  and  $P_t=P_{st} S_t/X_t$ , the unit resource rent. The application of Hotelling’s rule is not recommended for the valuation of environmental assets in the SEEA.

### **Estimating the value of depletion, discoveries and losses for non-renewable natural resources**

18. The next task consists of valuing the changes to the natural resource over the accounting period. In this section the flows associated with non-renewable natural resources are considered. The following section considers accounting for renewable natural resources.

19. As before, it is assumed that the quantity of natural resources at the end of period  $t$ ,  $X_t$  is known and that there is a projected sequence of extractions, based on the information available at the end of period  $t$ . At the end of period  $t$ , the quantity at the end of the preceding period,  $X_{t-1}$  is also known. *Ex-post*, the difference between  $X_t$  and  $X_{t-1}$  can be decomposed into three components: depletion, discoveries and other additions (referred to in the following as “discoveries”) and catastrophic losses and other reductions (referred to in the following as “catastrophic losses”). *Ex-ante*, i.e. based on the information at the end of the preceding period  $t-1$ , discoveries and catastrophic losses will not be known.
20. To operationalise the measurement of these three components, it is necessary to distinguish between the information available at the end of period  $t-1$  and at the end of period  $t$ . The notation used for this purpose is such that  $X'_t$  relates to the quantity of the natural resource at the end of period  $t$ , given the information available at the end of period  $t-1$ . Thus, for example, using this notation  $X'_{t-1}=X_{t-1}$  as no new information arises during period  $t$  about the stock at the end of period  $t-1$ . But in general it is *not* the case that  $X'_t=X_t$  or  $P'_t=P_t$ .
21. With this notation it is now possible to define depletion, discoveries and catastrophic losses. Depletion, i.e. the regular and expected reductions from the stock of the asset, is defined as  $X'_{t-1}-X'_t=S_t$  where  $S_t$  is the extraction during period  $t$ . (As we are dealing with a non-renewable resource, extraction equals depletion.) Thus, depletion is the difference between the quantity of resource at the end of period  $t-1$  less the quantity of resource expected to be remaining in the ground at the end of period  $t$ .
22. Discoveries constitute an unexpected addition to the natural resource during the accounting period. The main body of the Chapter 5 describes, for each type of natural resource which types of discoveries should be recognized as such. Catastrophic losses relate to unexpected and significant reductions in the natural resource during the period. They constitute exceptional and significant losses. The combined effect of discoveries and catastrophic losses can now be measured as  $X_t-X'_t$ , i.e. the difference between expected and actual quantities at the end of the period.
23. To separately account for discoveries and catastrophic losses, let  $I_t$  be the physical amount of discoveries and let  $L_t$  the physical amount of catastrophic losses such that  $X_t-X'_t=I_t-L_t$ . Recall that  $X'_{t-1}=X_{t-1}$  as no new information arises during period  $t$  about the natural resource at the end of period  $t-1$ . The same holds for prices and values of the asset:  $P'_{t-1}=P_{t-1}$  and  $V'_{t-1}=V_{t-1}$ . With these remarks in mind, the total physical changes in the non-renewable resource between the beginning and the end of the accounting period are:

$$(X_t-X_{t-1}) = (X_t-X'_{t-1}) \equiv \Delta X_t = (X_t-X'_t + X'_t-X'_{t-1}) = I_t - L_t - S_t \quad (7)$$

24. Using equations (2) and (7), the value of the natural resource between the beginning of period  $t$ , given the available information at that time, and the value of the natural resource at the end of the period, given the available information then, can be decomposed as follows:

$$(V_t-V_{t-1}) = (V_t-V'_{t-1}) = (P_t X_t - P_{t-1} X_{t-1}) = P_{t-1} \Delta X_t + X_t \Delta P_t \quad (8)$$

25. In (8), the change in value of the natural resource ( $V_t-V_{t-1}$ ) has been decomposed into a quantity effect and a revaluation effect. The quantity effect  $P_{t-1} \Delta X_t$  measures the change in

the quantity of the resource valued at the price of the beginning of the period, the revaluation effect  $X_t \Delta P_t = X_t(P_t - P_{t-1})$  captures the price change of the resource, multiplied by the quantity at the end of the period.

26. There is an alternative way to de-compose the term  $(P_t X_t - P_{t-1} X_{t-1})$ , namely with a quantity effect  $P_t \Delta X_t$  and a revaluation effect  $X_{t-1} \Delta P_t$ . Neither is *a-priori* superior to the other, so an arithmetic average of the two effects can be employed:

$$\begin{aligned} (V_t - V_{t-1}) &= 0.5[(P_{t-1} + P_t) \Delta X_t + (X_{t-1} + X_t) \Delta P_t] \\ &= 0.5(P_{t-1} + P_t)(X_t - X'_{t-1}) + 0.5(P_{t-1} + P_t)(X'_{t-1} - X_{t-1}) + (X_{t-1} + X_t) \Delta P_t \\ &= 0.5(P_{t-1} + P_t)(I_t - L_t) - 0.5(P_{t-1} + P_t)S_t + 0.5(X_{t-1} + X_t) \Delta P_t \quad (9) \end{aligned}$$

27. The final expression for the value of discoveries is then  $0.5(P_{t-1} + P_t)I_t$ , for the value of catastrophic losses is  $0.5(P_{t-1} + P_t)L_t$ , for the value of depletion is  $0.5(P_{t-1} + P_t)S_t$  and for revaluation is  $0.5(X_{t-1} + X_t)\Delta P_t$ . It is of note that the valuation of depletion with the average price of the period is consistent with the rules in the SNA for the valuation of consumption of fixed capital. Also, discoveries and catastrophic losses are valued with mid-period prices, implying an assumption about these events occurring mid-year on average. Finally, it should be pointed out that  $P_t$  when estimated by applying the NPV method (4) at the end of period  $t$ , takes into account any modifications in the expected extraction profile  $\{S_{t+\tau}\}$  ( $\tau=1,2,\dots,N_{t+1}$ ) that may have arisen as a consequence of discoveries or catastrophic losses during the accounting period.  $P_t$  thus constitutes the correct valuation of the balance sheet entry for the asset under consideration.  $P_t$  will also reflect any other informational changes, for example changes in the discount rate.

### Estimating the value of depletion for a renewable asset

28. Unlike non-renewable resources, natural plant and natural animal resources have the potential to reproduce and grow over time and this natural growth enters as an additional flow that determines the evolution of the natural resource over the accounting period. Depletion, in physical terms is the decrease in the quantity of a natural resource that is due to the extraction of the resource occurring at a rate that will not permit the same amount of resource being extracted in all future periods. Depletion is thus determined as a relationship between extraction or harvest and sustainable yield, i.e. the largest amount that can be harvested for a given population size without reducing the long-term viability of the resource. In its simplest form, sustainable yield equals the natural growth of the asset. These issues are discussed in more detail in Section 5.4.
29. For the purpose of this annex, it is assumed that an estimate of sustainable yield can be made and hence an estimate of depletion in physical terms is available. In what follows, sustainable yield in period  $t$  will be called  $G_t$ . Physical depletion  $D_t$  is then estimated as  $D_t = S_t - G_t$  and consequently  $X'_t - X'_{t-1} = -S_t + G_t$ , the (expected) change in the stock that is not due to discoveries or catastrophic losses. Note that the depletion for non-renewable resources can be seen as a special case where  $G_t = 0$ .
30. It is now possible to enhance expression (7) for the case of renewable natural resources:

$$(X_t - X_{t-1}) = (X_t - X'_{t-1}) \equiv \Delta X_t = (X_t - X'_{t-1} + X'_{t-1} - X_{t-1}) = I_t - L_t - S_t + G_t \quad (10)$$

31. Following the derivations for non-renewable natural resources, monetary depletion is physical depletion valued at average prices of the period,  $0.5(P_{t-1} + P_t)D_t$ .
32. In summary, the entries between the beginning and end of the accounting period,  $t$ , are as follows.

Closing balance sheet item of period $t-1$ based on information available at end of $t-1$ :	$V'_{t-1} = P'_{t-1} X'_{t-1}$
+ Discoveries (and other additions):	$0.5(P_{t-1} + P_t)I_t$
- Depletion:	$- 0.5(P_{t-1} + P_t)(S_t - G_t)$
Of which due to natural growth	$0.5(P_{t-1} + P_t)G_t$
Of which due to extraction	$- 0.5(P_{t-1} + P_t)S_t$
- Catastrophic losses (and other reductions)	$-0.5(P_{t-1} + P_t)L_t$
+ Revaluation due to price changes:	$0.5(X_{t-1} + X_t) \Delta P_t$
Equals closing balance sheet item of period $t$ based on information available at end of $t$ :	$= V_t = P_t X_t$

### Net income and depletion

33. As a final step, the value of depletion can be subtracted from the resource rent to yield an expression for the depletion-adjusted resource rent:

$$\text{Depletion-adjusted resource rent} = RR_t - 0.5(P_{t-1} + P_t)(S_t - G_t) \quad (11)$$

34. The depletion-adjusted resource rent represents the net income generated by the natural resource. Putting aside any changes in expectations or differences between expected and realized variables, it corresponds to a return to capital or return to natural resources. This can be demonstrated as follows. Multiplying  $V'_{t-1}$  by  $(1+r_t)$ , subtracting  $V'_t$  (the expected value of the asset at the end of the period) and applying the NPV condition (1) yields

$$V'_{t-1}(1+r_t) - V'_t = RR'_t \quad (12)$$

35. Note that all expressions are in terms of the information set at the end of period  $t-1$  and, hence, discoveries and catastrophic losses are ignored. Combined with (9), one obtains

$$RR_t = r_t V'_{t-1} - (V'_t - V'_{t-1}) = r_t V'_{t-1} - 0.5(X'_{t-1} + X'_t) \Delta P'_t + 0.5(P'_{t-1} + P'_t)(S_t - G_t) \quad (13)$$

36. The depletion-adjusted resource rent is then

$$RR_t - 0.5(P'_{t-1} + P'_t)(S_t - G_t) = r_t V'_{t-1} - 0.5(X'_{t-1} + X'_t) \Delta P'_t \quad (14)$$

37. Thus, net income consists of the nominal return to capital,  $r_t V'_{t-1}$  less (expected) revaluation of the asset. This does not imply that revaluation enters the measurement of income. It should be remembered that  $r$  relates to the returns that an investor or shareholder would *expect* from the use of an asset in production, i.e. it is a forward looking rate. Whether, ultimately, these returns come from normal business operations or from holding gains/losses is irrelevant to the (financial) investor. Hence, conceptually, the expected rate

of return  $r$  *includes* expected holding gains or losses. Therefore, to get to an income measure consistent with the definition of income in the national accounts<sup>68</sup>, revaluations must be subtracted. After subtraction, expression (14) shows the return from ‘normal business operations’ excluding holding gains or losses.

38. The derivations above are valid for both renewable resources and the limiting case of non-renewable resources. When there is depletion, the term  $S_t - G_t$  will increase in absolute terms with a rising rate of depletion. In general, the quicker the resource is depleted, the higher will be the price change of the resource in the ground. When natural growth exceeds extraction, depletion should be recorded as zero and the excess amount added to additions of stock.
39. It should be noted that the specifications above leave no ambiguity about the valuation of stocks and flows:
- The input of natural resources into production, the extractions, should be valued at the unit resource rent  $P_{st}$ .
  - The value of the stock of natural resources, and flows concerning depletion should be valued using the price of the asset *in situ*. ( $P_t$ )

### Volume measures

40. With the price, quantity and value of the natural resource in situ in hand, it is fairly straight forward to compute a volume measure of the stock of natural resources. In the case of a single homogenous asset, the volume measure simply equals the evolution of the physical quantity in the ground,  $\{X_t\}$ . In the case of different types of natural resources, an aggregation procedure must be identified to construct a volume index across different types of natural assets.
41. The balance sheet entry for the value of natural resources at the end of year  $t-1$  in end-year prices of  $t-1$  is simply  $\sum_{i=1}^z P_{t-1}^i X_{t-1}^i$  if there are  $z$  different types of assets. Assuming a chain Laspeyres index as is customary in the national accounts, the volume change between  $t-1$  and  $t$  is then given by:

$$\text{Volume change} = \frac{\sum_{i=1}^z P_{t-1}^i X_t^i}{\sum_{i=1}^z P_{t-1}^i X_{t-1}^i} \quad . \quad (14)$$

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<sup>68</sup> See OECD (2009) section 8.3.2 for a more detailed discussion in the context of produced assets.

## **Annex A5.2: Discount rates**

### Introduction

1. In the SEEA, a discount rate is a rate of interest used to adjust the value of a stream of future flows of revenue, costs or income such that the value of future flows can be compared with the value of flows in the current period.
2. Underpinning the use of discount rates is the concept that the value of money in the future is not the same as the value of money now. A common explanation of this concept is to consider how much money would be needed now to purchase a given amount of goods and services in one year's time.
3. This question may be answered by considering the interest rate at which a consumer should invest their money now in order to earn sufficient interest over one year to purchase the goods and services in one year's time. The consumer may then make a choice as to whether they consume the goods and services in the current period or wait, earn the interest from investing the money, and purchase the goods and services in one year's time. In making this choice the consumer indicates a time preference and the extent of the preference is given by the interest rate, or discount rate. A lower discount rate will apply if the consumer is relatively indifferent between receiving the benefits of consumption now or in one year's time. A higher discount rate will apply if the consumer has a stronger preference for consumption in the current period.
4. When time preferences are seen not from the perspective of an individual consumer but from the perspective of society, they entail comparisons of welfare across different generations. There is no immediate reason that the time preferences of individuals and society should coincide.
5. Discount rates are also affected by risk preferences and there is the question as to whether consumption foregone in the current period will induce more or less utility in future periods. Again, these two factors may be valued differently by individuals and society as a whole.
6. The application of the general concept of a discount rate to economic problems has generated much discussion (as yet unresolved) by many economists (e.g. Arrow, Nordhaus and Stiglitz, *et al.*). The choice of discount rate has become a feature of discussion in environmental economics because of the impact that the choice of discount rate has on models of economic outcomes over long periods of time and because of the ability to ascribe ethical underpinnings to the choice of discount rates and the nature of the assumed preferences.
7. This annex explains, in broad terms, the key aspects of the discussion on discount rates and the logic of the choice of discount rate that aligns with the SEEA's approach to valuation in monetary terms.

### Types of discount rates

8. There are two broad types of discount rates: individual discount rates and social discount rates. They are quite distinct in concept. An individual discount rate considers preferences from the perspective of an individual consumer or firm and is directly related to the prices for goods, services and assets faced by the individual. In addition, the preferences are generally considered within the normal decision making timeframes of an individual consumer or firm. Finally, the discount rate relevant to an individual consumer or firm needs to take into account the likelihood of earning interest (or more generally a return) such that consumption can be undertaken in the future. Put differently, if an individual faces a smaller likelihood of making a return then they should seek a higher discount rate to compensate for this risk.
9. A social discount rate concerns the time and risk preferences of a society as a whole. Unlike individuals, societies must consider future generations to a greater extent and must also balance the benefits accruing to different sections of society in current and future periods (i.e. the distribution of income and consumption). In addition the risks of earning returns are far more dispersed and balanced at a societal level than for an individual and hence the compensation for risk will usually be lower for a society as a whole. Often, social discount rates are applied in a government context in relation to their decision making on behalf of a society.
10. A useful characterisation of the difference between individual and social discount rates is to consider that discount rates can take into account preferences in terms of both efficiency and equity. Generally speaking, individual discount rates take into account only aspects of efficiency in the allocation of resources over time from the perspective of an individual consumer or producer. On the other hand, social discount rates may consider only aspects of efficiency or may take into consideration aspects of both efficiency and equity between societies or between generations. Most discussion on discount rates revolves around the equity aspects – either due to the fact that they are not taken into account at all (e.g. in individual discount rates) or due to the philosophical basis for assumptions concerning equity that underlie a social discount rate.
11. Another characterisation of the difference between individual and social discount rates is in terms of descriptive and prescriptive discount rates. A discount rate determined on a descriptive basis is based only on prices faced by individuals and governments or other measurable factors; whereas a prescriptive discount rate incorporates assumptions regarding the preferences of individuals and societies particularly regarding equity between and within current and future generations.

### Individual discount rates

12. The determination of discount rates for individuals focuses on information concerning the return needed by the individual consumer or firm to justify investment in the current period with the aim of receiving income or other benefits in the future. Relevant considerations are the expected returns an individual may earn by investing in different assets and the

degree of risk associated with different investments. Under pure market conditions it would be expected that the price of an asset (e.g. a building) would reflect the expected returns to the purchaser over the life of the asset and would take into account the likelihood of earning the income (i.e. the degree of risk). Thus there is a link between the choice of discount rates and the concept of market prices for assets.

13. In the SEEA, as in the SNA, the application of discount rates is in the valuation of assets not traded on markets. For these assets, market prices are not available and the technique of net present value (see Annex A5.1) can be used to estimate market prices. This technique requires the choice of a discount rate. The selection of a descriptive discount rate that considers only the prices faced by an individual consumer or firm, that relates to the expected returns, and accounts for the degree of risk associated with the investment, is the most appropriate discount rate in order to align with the market price valuation principle used in the SEEA.
14. For individual consumers and firms a relevant discount rate may be reflected in the cost of funds to the individual. Thus the interest rates needed to finance an investment either through loans, equity issues or the issue of corporate bonds may be appropriate discount rates that reflect the rate of return needed by the individual and also the degree of risk in the investment as assessed on the market. However, at the more aggregate level at which the SEEA operates, taking into account the variety of ways in which investment is financed and targeting the financing method to the valuation of specific non-traded assets makes the financing cost approach difficult to apply across individual firms within an industry, particularly if financial markets are not well developed within a country. It is also noted that returns to financial instruments, particularly equities, may be influenced by many external factors thus limiting their appropriateness in the valuation of non-traded assets.
15. The other approach to the estimation of a discount rate is to consider information on the actual returns accruing to specific activities, e.g. mining activity, where the related income streams all have similar risk profiles. This may be done by considering national accounts information on the operating surplus of relevant firms and the associated stock of produced assets. Underpinning this approach is the idea that the total operating surplus is the return to the firm for their use of a combination of produced assets, e.g. mining equipment, and non-traded natural resources.
16. Ideally, if the value of the relevant natural resources was known, the implied rate of return (total operating surplus divided by total value of assets) would apply to both produced assets and natural resources. However, since the value of the natural resources is unknown two alternatives must be considered. First, for a specific activity (e.g. coal mining) a rate of return equal to the total operating surplus divided by the value of the stock of produced assets can be calculated and the rate of return on natural resources and the discount rate can be set equal to this rate. By the manner of its construction this rate will overstate the rate of return since the denominator (the value of the stock of produced assets) excludes the value of natural resources. At the same time, this rate of return does take into account the returns accruing to the specific activity and hence the associated risks.

17. The second approach is to assume that the rate of return on produced assets should be equal to an external rate of return that the firm would have received if they had invested in alternative assets. This rate is then assumed to apply also to the natural resources. Since this rate of return takes into account investment in a broader range of assets across the economy, the industry specific risks of investment are less likely to be taken into account.
18. Although both of these relatively direct methods do not generate a discount rate that completely measures the desired concept, a comparison of both rates may yield useful information. In particular, a useful approach may be to use a general, external rate of return as a base rate and to adjust it using industry specific information to account for specific investment risk. Adjustments may be made on the basis of relative financing costs or the relative difference in the return to produced assets in the target industry compared to an economy wide return to produced assets.
19. It is noted that, in the valuation of assets owned by individual firms, the choice of external rate under the second approach should take into account some degree of risk, even if only general economy wide risks of investment. Often the use of relatively risk free rates of return is suggested, such as the rate of return on long-term government treasury bonds, but these rates take no account of individual risks that are faced in determining consumption and investment preferences.

#### Social discount rates

20. Social discount rates are used in the context of evaluating actions and assets that have value from the perspective of a society as a whole. Often this is applied in the assessment of government decisions and social discount rates are used to evaluate the costs and benefits of investment in public infrastructure since both the benefits and the costs are usually spread across many individuals and over long periods of time. However, social discount rates can also be used to provide social valuations of assets owned and operated by individuals and firms.
21. As noted above, both descriptive and prescriptive approaches may be taken to the determination of an appropriate social discount rate. A descriptive approach follows the same logic as for the determination of individual discount rates in that the rate is determined through a focus on the prices and returns relevant to the society rather than any explicit consideration of equity issues.
22. Prescriptive social discount rates that take into account equity considerations cannot be determined following the logic applied to individual discount rates. Rather, consideration must be given to the relative preferences of current and future generations and, ideally, to the relative preferences of different sections of society. A common approach by economists to determining prescriptive social discount rates is to apply the Ramsey growth model (Ramsey 1928) which takes specific account of consumption and saving choices for an economy as a whole. This model has underpinned many recent works on evaluating the impacts of environmental issues, in particular the 2006 Stern Review in the United Kingdom into the economic impacts of climate change. (Reference needed).

23. The formula for a prescriptive discount rate that emerges from the Ramsey model requires information or assumptions regarding (i) the “pure” rate of time preference, (ii) the rate of growth in per capita consumption and (iii) the extent to which the extra benefits to people from consumption decrease as their income increases (the marginal utility of income). The second and third terms are multiplied together and then added to the first term to derive the discount rate.
24. Much discussion on prescriptive social discount rates has focused on the first term which asks the question as to whether the preferences of current generations are more important than those of future generations. If the value of the first term is set to zero then the assumption is that all generations’ preferences have equal weight. This assumption is distinctly at odds with the underlying premise of individual discount rates in which there is an underlying assumption that the present year (let alone the present generation) is always preferable (unless there is suitable return). The implications of choices for the pure rate of time preference are discussed in the next section of this annex.
25. A common misconception is that setting a zero “pure” rate of time preference implies a discount rate of zero. In fact, following the Ramsey model there are two other assumptions that need to be considered. Generally, it is understood that as income rises, the extra or marginal benefits that a person receives from spending additional income decline. Put differently, someone on a low income gains greater benefit from spending a dollar than someone on a higher income. When the same concept is considered over time, then if an individual in the future is assumed to have a higher level of income than someone today, it would be the case that they would get relatively lower benefit from spending that additional income compared to someone spending the same amount today. Thus even assuming all peoples’ preferences are the same, there may still be an overall preference in consumption now because the marginal benefits from undertaking the same consumption in the future are lower (assuming growth in incomes). Different choices for the rates of growth in income and consumption and in the marginal utility of income will lead to different (non-zero) estimates of the social discount rate following the Ramsey model.
26. A different approach to taking into account the preferences of future generations is the use of declining discount rates. Different models may be used and there is mention in the literature of hyperbolic discount rates, gamma discounting and geometrically declining rates. Simple step functions have also been proposed whereby the discount rate is set at progressively lower levels as one moves away from the current period. The general aim of declining discount rates is to counter an impact of constant rate discounting that implicitly fixes the relationship of the preferences across generations. Declining rates effectively give relatively larger preferences to future generations than would otherwise be implied (although the preferences of future generations generally have less weight than those of current generations). The exact relationship depends on the function assumed for the pattern of decline.

### Estimates of discount rates

27. In practice, the approaches to the selection of discount rates vary widely. Both prescriptive and descriptive approaches are often used and within both approaches a wide variety of solutions are adopted. It seems generally to be the case that those rates determined on a more prescriptive basis are lower than rates determined on a descriptive basis but this is not always the case.
28. An important consideration is whether the discount rate should be in real or nominal terms. A real discount rate is one that has been adjusted to remove the impact of inflation whereas a nominal discount rate has not had any such adjustment. The choice depends on the assumptions made in relation to the future flows. If the future flows, say of income, are measured in terms of the prices of the period to which they relate (e.g. an income flow for 2050 is in terms of 2050 prices), then the flow is said to be in nominal terms and a nominal discount rate should be used.
29. However, if the flows are expressed in terms of prices of the current period, then a real discount rate should be used. Since it is very difficult to project prices into the future, a common assumption is that the future flows are the same as the flows in the current period and, if this assumption is made then a real discount rate should be used.
30. The choice of discount rate – however determined – can have a significant impact on the value of an asset. Table A5.2.1 shows the differences in the value of an asset at different discount rates for a different length of asset life. Assuming that the income flow is \$100 per year, then over 10 years, the net present value (see Annex 5.1) can range from \$614 for a discount rate of 10% to a value of \$853 for a discount rate of 3%. Over 100 years the differences are even more stark, with the NPV of \$1000 for a discount rate of 10% but an NPV of \$3160 for a discount rate of 3%.
31. Of particular note is that for higher discount rates, increasing the asset life has little impact on the total current net present value of the asset. That is, there is relatively little difference in the NPV for an asset that has a life of 30 years or one of 100 years at higher discount rates.

**Table A5.2.1: Net present value (\$) for constant income flow of \$100 over varying asset lives and at varying discount rates**

		Asset life (years)			
		10	30	50	100
Discount rate	3%	853	1960	2573	3160
	5%	772	1537	1826	1985
	8%	671	1126	1223	1249
	10%	614	943	991	1000

### Analytical implications of the choice of discount rate

32. The implications of the choice of a discount rate may be seen in a number of ways. First, the choice of approach to selecting a discount rate may provide an area of concern for users. The selection of a descriptive approach consistent with market valuations may generate concern that equity issues – especially those across generations – are not being adequately considered. At the same time, the selection of a prescriptive approach may raise concern about the role of statisticians in selecting implicit societal preferences.
33. Second, various interpretations may be made concerning the estimates derived based on particular discount rates. For example, there may be concerns about the use of relatively high discount rates (usually attributed to the use of market based approaches) since these give relatively lower values to long lived assets, such as many natural resources, and this may imply a preference for either immediate use of the resources or a preference for substitution with produced assets.
34. At the same time, the use of market based approaches to the determination of the discount rate permits a stronger parallel to be drawn with the valuation of produced assets and hence trade-offs between assets can be more consistently considered. In this regard the estimation of concepts such as national net worth can be consistently estimated across all asset types. Also, the use of a market-based descriptive approach does not necessarily ignore inter-generational and equity issues.
35. A general concern on the use of market based discount rates is that they tend to be relatively higher rates which in turn tend to provide relatively low values in absolute terms beyond normal planning timeframes, say 30 years. Thus for long lived and potentially everlasting resources, the use of relatively lower rates will tend to recognise values for these resources into the future to a greater extent. Independent of any implied societal preferences, lower discount rates may therefore better reflect the likely values of these resources. Also, especially for environmental resources, the recognition of values over a longer time period may assist in understanding the problem that while the benefits received from the environment tend to be received immediately, the costs to the environment may only be evidenced much later. The use of declining discount rates may be a way to deal with these issues.

### Conclusions

36. For the purposes of the SEEA it is recommended that a discount rate be determined that is consistent with the general approach to valuation in the SEEA and the SNA, i.e. consistent with valuation at market prices. This suggests the choice of an individual discount rate which reflects the return needed by those undertaking an activity to justify investment in that activity. Consequently the relevant rate should be descriptive and, ideally, adjusted for any activity specific risks.
37. The derivation of an activity specific rate of return is difficult in the case of natural resources because the value of the natural resources is not known. Nonetheless, relevant

discount rates should be able to be determined on the basis of national accounts data and financial sector information.

38. Because judgements are required regarding societal preferences, it is not recommended that prescriptive approaches to the determination of discount rates be used for the purposes of official statistics.
39. Different discount rates can be selected under any approach to the determination of discount rates for valuing environmental assets. Given the significance of the choice of discount rate it is recommended that sensitivity analysis using different discount rates be undertaken in the compilation of valuations of environmental assets using the net present value approach. The varying estimates may be published to provide users with information on the impact of the choice of discount rate.

### **Annex A5.3: Description of the UN Framework Classification for Fossil Energy and Mineral Reserves and Resources 2009 (UNFC 2009)**

1. The UNFC-2009 categorizes mineral and energy resources by looking at whether, and to what extent, projects for the extraction or exploration of the resources have been confirmed, developed or planned. Based on the maturity of the projects the underlying natural resources are classified. The UNFC-2009 is based on a breakdown of the resources according to three criteria affecting their extraction:
  - Economic and social viability (E)
  - Field project status and feasibility (F)
  - Geological knowledge (G)
2. The first criteria (E) designates the degree of favourability of economic and social conditions in establishing the commercial viability of the project. The second criteria (F) designates the maturity of studies and commitments necessary to implement mining plans or development projects. These extend from early exploration efforts before a deposit or accumulation has been confirmed to exist through to a project that is extracting and selling a product. The third criteria (G) designates the level of certainty in the geological knowledge and potential recoverability of the quantities.
3. Each criteria, E, F and G, is sub-divided into categories characterizing the projects for exploring and extracting the resource. The categories for the economic and social criteria are numbered from E1- E3.
  - The category E1 includes projects where extraction and sale is economically viable, i.e. the extraction is assumed to be economic on the basis of current market conditions and realistic assumptions of future market conditions. It includes considerations of prices, costs of the legal and fiscal framework, and various environmental, social and other non-technical factors that could directly impact the viability of a development project. The economic viability is not affected by short-term adverse market conditions provided that longer-term forecasts remain positive.
  - For projects falling into category E2, extraction and sale has not yet been confirmed to be economic but, on the basis of realistic assumptions of future market conditions, there are reasonable prospects for economic extraction and sale in the foreseeable future.
  - For E3 extraction and sale is not expected to become economically viable in the foreseeable future or evaluation is at too early a stage to determine economic viability.
4. The categories for project status and feasibility are numbered F1 – F4 with further sub-categories in some cases.
  - The category F1 includes projects where extraction is currently taking place (F1.1); or capital funds have been committed and implementation of the

development project or mining operation is underway (F1.2); or sufficiently detailed studies have been completed to demonstrate the feasibility of extraction by implementing a defined project or mining operation (F1.3).

- Both F2.1 and F2.2 includes projects where the feasibility of extraction is subject to further evaluation. For F2.1 project activities are ongoing to justify development in the foreseeable future; and for F2.2 project activities are on hold and/or justification as commercial development may be subject to a significant delay. F2.3 indicates that there are no current plans to develop or to acquire additional data at the time due to limited potential.
  - F3 indicates that the feasibility of extraction by a defined development project or mining operation cannot be evaluated due to limited technical data.
  - F4 indicates that no development project or mining operation has been identified.
5. The categories for geologic knowledge are numbered G1-G4. Quantities associated with a high level of confidence (or low level of uncertainty) are classified as G1, quantities associated with a moderate level of confidence are classified as G2 and quantities associated with a low level of confidence as G3. Quantities associated with a potential deposit based primarily on indirect evidence are classified as G4.

## Annex A5.4 Land use classification

	<b>LAND</b>
	<b>Agriculture</b>
	Land under temporary crops
	<i>Cereals</i>
	<i>Vegetables and melons</i>
	<i>Temporary oilseed crops</i>
	<i>Root/tuber crops with high starch or insulin content</i>
	<i>Temporary spice crops</i>
	<i>Leguminous crops</i>
	<i>Sugar crops</i>
	<i>Other temporary crops</i>
	Land under temporary meadows and pastures
	Land with temporary fallow
	Land under permanent crops
	<i>Fruit and nuts</i>
	<i>Permanent oilseed crops</i>
	<i>Beverage and permanent spice crops</i>
	<i>Other permanent crops</i>
	Land under permanent meadows and pastures
	<i>Cultivated permanent meadows and pastures</i>
	<i>Naturally grown permanent meadows and pastures</i>
	Land under protective cover
	<b>Forestry</b>
	Forest land
	<i>Primary regenerated forest</i>
	<i>Other naturally regenerated forest</i>
	<i>Planted forest</i>
	Other wooded land
	<b>Land used for aquaculture</b>
	Land used for hatcheries
	Managed grow-out sites on land
	<b>Use of built-up and related areas</b>
	Mining and quarrying
	Construction
	Manufacturing
	Technical infrastructure
	Transport and storage
	Commercial, financial and public services
	Recreational facilities
	Residential
	<b>Land used for maintenance and restoration of environmental functions</b>
	<b>Other uses of land n.e.c.</b>
	<b>Land not in use</b>
	<b>INLAND WATER</b>
	<b>Inland waters used for aquaculture or holding facilities</b>
	<b>Inland water used for maintenance and restoration of environmental functions</b>
	<b>Other uses of inland water n.e.c.</b>
	<b>Inland water not in use</b>

**Other Classes for extended measurement scope**

	<b>INTERNAL WATERS</b>
	<b>Internal waters used for aquaculture or holding facilities</b>
	<b>Internal waters used for maintenance and restoration of environmental functions</b>
	<b>Other uses of internal waters n.e.c.</b>
	<b>Internal waters not in use</b>
	<b>EXCLUSIVE ECONOMIC ZONE</b>
	<b>EEZ areas used for aquaculture or holding facilities</b>
	<b>EEZ areas used for maintenance and restoration of environmental functions</b>
	<b>Other uses of EEZ areas n.e.c.</b>
	<b>EEZ areas not in use</b>

**Annex A5.5 Catch concepts: Diagrammatic presentation** (from Integrated Environmental and Economic Accounting for Fisheries, 2004)

