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Agenda item: 11

Treatment of Rent for the "Recording of Data", "Marketing Assets" and "Biological Resources"

Issues Note on the National Accounts Treatment of Rent for the "Recording of Data", "Marketing Assets" and "Biological Resources"

Note prepared by Eurostat

1. Introduction

In the SNA 2008, rent is only recorded as payment for the use of natural resources such as land and subsoil mineral resources[1].

> SNA 2008 Definition – 7.109 *Rent is the income receivable by the owner of a natural resource (the lessor or landlord) for putting the natural resource at the disposal of another institutional unit (a lessee or tenant) for use of the natural resource in production*.

In the current updating of SNA 2008, there are two areas where it is being considered to extend the application of rent to payments for access to non-produced assets. The areas are:

1. Payment for access to Observable Phenomena (OPs) in the estimation of the value of data created on own account; and

2. Payment for access to an element of marketing assets which are not produced through advertising and other promotional activities, but due to the reputation and customer loyalty of brand names and trademarks owned by corporations.

In addition, in the context of biological resources and the current distinction in the SNA between cultivated and uncultivated, the question arises whether the recording of some income from non-produced assets as rent, as opposed to the recording of income from produced assets as part of output, is still justifiable.

When assets are created on own account, with no information on a market price, it is usual in the national accounts to estimate the value of the assets through a sum of costs approach.

The costs to be included are set out in SNA2008 6.128 as

a. Intermediate consumption
b. Compensation of employees
c. Consumption of fixed capital
d. A net return to fixed capital, and
e. Other net taxes on production.

Rent is not included in this list. However, in the two areas specified above, rent for use of non-produced assets is an important part of the costs of generating these own-account assets, and to omit it is to potentially significantly under-value them[2]. This also raises a general question about the treatment of rent in the sum of costs approach.

The relevant draft Guidance notes are as follows.

[1] This note does not consider the possible treatment of the atmosphere as a non-produced asset (see Guidance Note WS.7), with a related right to use asset being recorded for emission permits.

[2] Or, more correctly, to undervalue them at creation. Subsequently the value of asset in balance sheets may increase through revaluation.

2. DZ.6 Recording of data in the National Accounts

The GN discusses how data should be recorded in the national accounts, taking into account the increased generation and use of data from social media platforms and other large data sources since the drafting of SNA2008.

The following terminology is used:

Observable Phenomenon (OP) are a fact or situation, whose characteristics and attributes may be recorded.

Data is information content that is produced by accessing and observing phenomena; and recording, organizing and storing information elements from these phenomena in a digital format, which can be accessed electronically for reference or processing.

Data assets are data that is intended to be used in production for more than one year.

The GN recommends that costs associated with accessing OPs be included in the sum of costs calculation of the value of the resulting data assets. Also, all data assets should be considered as entirely produced.

For explicit purchases of OPs, in particular when there will be no recognisable effort on the part of the OP generating sector (often households), the GN recommends payments to access OPs be treated as **rent** in exchange for accessing a non-produced asset. This would imply an extension to the SNA2008 definition of rent which was limited to natural resources. The GN goes on to explain that this needs testing to see if compilers can identify such payments.

The GN goes on to consider this point in more detail and offers 4 potential options for recording payments to access OPs, that are then used as an input into the production of data:

Option 1: Purchase of a non-produced asset.

Option 2: Rent payment for accessing a non-produced asset.

Option 3: Payment for a service, considered output of the household sector.

Option 4: No specific treatment assigned, continue current way of recording.

The GN recommends recording all transactions directly related to obtaining access to OPs as a rent payment.

The task team also recommends that own account production of data should be valued as sum of costs, which would include a rent for accessing a non-produced asset (the OPs).

The GN recognises that this would require a significant change to the SNA2008 treatment:

"This issue of including rent on non-produced assets in the sum-of-costs valuations impacts areas of the National Accounts beyond the explicit purchases made to access and record the information elements of OPs and is being taken up in a separate guidance note. From the perspective of data, such an option will be recommended if the general guidance is changed to include such costs.

3. G.9 Payments for Non-produced Knowledge-Based Capital (Marketing Assets)

The 2008 SNA and BPM6 treat marketing assets (brand names etc) as non-produced, non-financial assets. Guidance is considered incomplete/inconsistent in SNA and BPM. Marketing assets satisfy the conditions of being considered **produced** assets (designed, used repeatedly etc.), but are recorded as non-produced for practical reasons.

The GZTT concluded that **marketing assets should be maintained as non-produced non-financial assets** for practical reasons.

However, it is recognised that there are often payments made for the use of marketing assets. Recording these payments as payments for services would be incompatible with the non-produced nature of the marketing assets. Therefore they would need to be recorded as rent. But because the SNA defines rent as "income receivable by the owner of a natural resource", a further category of rent for access to non-produced assets would be required[3].

4. WS.8 Accounting for biological resources

For biological resources which are considered to be part of the asset boundary, both the 2008 SNA and SEEA CF make a distinction between cultivated and non-cultivated biological resources, depending on whether the growth and regeneration process of the biological resources is controlled by, managed by and under the responsibility of an economic agent. The two cases are treated differently as regards the recording of *natural growth* as output or not, of *growth and depletion of natural resources* as GFCF and CFC vs other changes in volume of assets, of *leasing of natural assets* as output and intermediate consumption vs receipts/payments of rent.

Regarding this last aspect, the GN argues that distinction between produced and non-produced assets becomes more and more blurred and raises the question whether the difference in accounting for leasing produced assets versus leasing non-produced natural assets is still a valid one. It suggests that also in the case of non-produced natural assets, the leasing could be accounted for as a form of production of services, instead of recording it as primary income, although it recognises that this alternative recording as output would change the recording of transactions in relation to these resources quite dramatically.

5. The general issue of rent

The idea of **expanding the definition of rent to payments to access a broader range of non-produced assets (beyond natural resources)** is a common feature of the two Guidance Notes DZ.6 and G.9 above.

The expansion of the definition may seem somewhat uncontroversial – if new non-produced assets are defined in the SNA, then payments for using these assets should logically be considered as rent. However the overall concept of rent followed in the SNA is that of an "economic rent" which economists – since the classical political economists Smith/Ricardo/George - consider to be "unearned"[4]. This works for OPs, where the household does not have to make any extra effort. It is more arguable in the case of a marketing asset, which is built up from both expenditure on advertising and from the accumulation of image/status amongst consumers.

[3] Guidance note *WS.8 Accounting for biological resources* questions the distinction between produced and non-produced natural resources in the 2008 SNA. See section 4 for details.

[4] Simply put, you receive a payment because you are lucky enough to have property rights over an asset which you have not built and do not need to spend much to maintain.

A related – and potentially more controversial - aspect to consider is **if rent should be included as a cost in the calculation of the value of production of own account assets** (as part of the 'sum of costs' approach).

In the cases described above the logical extension of the recording of rent on these non-produced assets is that any own account asset produced as a result of using inputs from these non-produced assets would potentially be undervalued if rent is not included as one of the costs in the 'sum of costs'[5].

This general issue is not new to the SNA, and there have been past discussions as the SNA developed if rent on land should be included in the sum of costs approach. However the new element here is that the flows involved could form a much more significant part of the sum of costs of asset creation, and therefore ignoring them would have a larger impact on initial asset valuation.

One important conceptual objection raised against including rents in sum of costs for measuring the value attached to the creation of a produced asset is that it could introduce the notion that the resulting asset has a non-produced component. But it could be equally argued that the inputs to a produced asset do not necessarily have to be produced themselves – the act of production of a <u>new</u> asset is sufficient, and the valuation of that production should consider all costs involved[6].

Another consideration is the placing of rent in the sequence of accounts. The existing sum of costs approach takes into account elements which appear in the production and generation of income accounts. Some have argued that – should rent be included in sum of costs – then rent should be moved higher in the sequence of accounts to reflect that it has a role in production (which would have an impact on earlier balancing items). But the distinguishing feature of rent is that the underlying asset is not used up in the System (of course this does not take into account the debate on depletion of natural resources).

These two GN show the need for keeping the distinction between produced and non-produced assets, which the GN on biological resources suggests to dismiss. However, the proposal to include rent payments on non-produced assets in the sum of costs and to move them higher in the sequence of accounts, basically aligning the treatment of produced and non-produced assets while keeping them conceptually distinct, is in line, from a practical perspective, with the proposal of GN WS.8.

6. Additional remark

The communication Task Team, which is reviewing the terminology used in the SNA, is considering ways to avoid user confusion between "rent" and "rental" that frequently occurs. Preliminary ideas focus on labels that emphasise the link between rent and natural resources. Proposals include for instance "Natural resource rent" or "Natural resource lease revenue". Should rent be extended beyond natural resources, as suggested by this issue note, or the distinction between produced and

[5] Of course, it may be argued that own-account assets in a market output context are valued by including a mark-up to reflect the value of such assets on the market, and that this mark-up will implicitly include any costs arising from non-produced assets (as observed market prices can be expected to reflect these costs). But this is an indirect and hard-to-quantify inclusion of these costs.

[6] Nevertheless this raises the question of what to do with other property income, particularly interest. Private and public accounting standards allow the capitalisation of interest where it can be directly attributed to the creation of an asset. In national accounts, interest would not be viewed in this way. Perhaps one could argue that the link of interest (and indeed dividends and reinvested earnings) to financial assets is the key distinguishing feature from rent (which derives from non-financial assets).

non-produced natural resources be dismissed, as suggested by WS.8, the terminological question may have to be reconsidered.

The attention of the ISWGNA and the AEG is drawn to these horizontal issues, and their explicit views are sought.