CM.4 Use of Net measures in the presentation of the National Accounts

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Introduction

This is a recently produced Guidance Note (GN) as an extension to the original scope of the CMTT.

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This GN CM.4 also complements the net-to-gross issues covered elsewhere, in particular:
- CM.2 Terminology and Branding of the Macroeconomic Accounting Frameworks;
- WS.6 Accounting for the Economic Ownership and Depletion of Natural Resources; and
- WS.8 Accounting for biological resources.

Gross and Net Income and Saving Measures - Scope

Scope of this guidance note:

- 2008 SNA (2.141): as consumption of fixed capital (CFC) is not newly created value, value added is conceptually a net measure.
- Explaining circumstances have changed requiring a stronger advocacy for net income.
- Recap of what has prevented us from using net income to date.
- Clarifying the road to improving capital measurement.
- Recommendations for the 2025 SNA for the consideration of AEG.

Guidance Note CM.2 covers the use of the terms “net” and “gross”. In the current account and the capital account of SNA and BOP indicate whether an aggregate includes or excludes consumption of fixed capital; and (ii) in other cases, ‘only’ used in the context laid out in the 2008 SNA and BPM6.

Why the time has come to embrace net income and net saving

- Beyond GDP:
  - Stiglitz, Sen & Fitoussi Report (2009), sustainability is more closely related to Net rather than Gross income measures.
  - Changing Wealth of Nations (World Bank) “Governments should measure and monitor wealth, alongside GDP”.
  - Various other papers and reports.
- Increased prominence of recording natural resource depletion (GN WS.6).
- Expanding scope of IPs (R&D, data, marketing assets) diminishes National Accounts based information on their production costs and contributes to GDP inflation.
- Instant sourcing of IP and related services output may cause significant GDP shocks. NDP is lesser affected as added output is counterbalanced by the added CFC.

Why are we still focused with GDP and GNI?

- Users do not complain → although the validity of gross measures have been questioned.
- CFC is the outcome of a model → yet, analytical constructs are known within the SNA and conceptual thinking about capital measurement is well advanced (OECD: “Measuring Capital”).
- CFC calculations are data demanding → undoubtedly, improving the source data, sharing information and knowledge (e.g., service lives, age-efficiency profiles, asset price developments) will help. This also helps in harmonization and comparability of the estimates. The Penn World Table and CWON show a lot more is possible than currently undertaken by many of the NSIs.
- We should not be predicting the future → this is agreed but already done in CFC. However, asset values reflect future expectations. Without observable market values, the accountant is required to mimic these expectations. This is unavoidable when measuring capital.

What can be done to improve capital measurement?

Concepts are clearly developed but accounting practices require further harmonization.

- Strengthen international cooperation. Current Eurostat Task Force is examining the concordance of CFC estimations is a very good example. Goal of such an exercise is:
  - Avoiding arbitrary differences for example in the projections of service lives.
  - Respect justifiable differences. A road in one country is likely to have a different service life than in another country or even within a large country in terms of geographical size.
- Improve the weak language used in the 2008 SNA regarding CFC measurement and negative branding.
- Strengthen SNA guidance towards meaningful outcomes and easier compilation practices:
  - Recommend geometric depreciation as the default method and reject linear depreciation.
  - Propose a single 2025 SNA chapter dealing with all aspects of capital measurement including capital services.
- Set up an internet-based capital measurement information hub.

The scope of gross net adjustments (I)

- Transparency – illustrate the scope of gross-net adjustments in the accounts

Transaction / Balancing item	Code	2008 SNA data set
Gross Domestic Product	B1g	1 854
Consumption of fixed capital (−)	P51c	222
Net of CFC Domestic Product	B1n_P51c	1 632
Depletion of natural resources (−)	K21	14
Net Domestic Product	B1n_P51c+K21	1 618

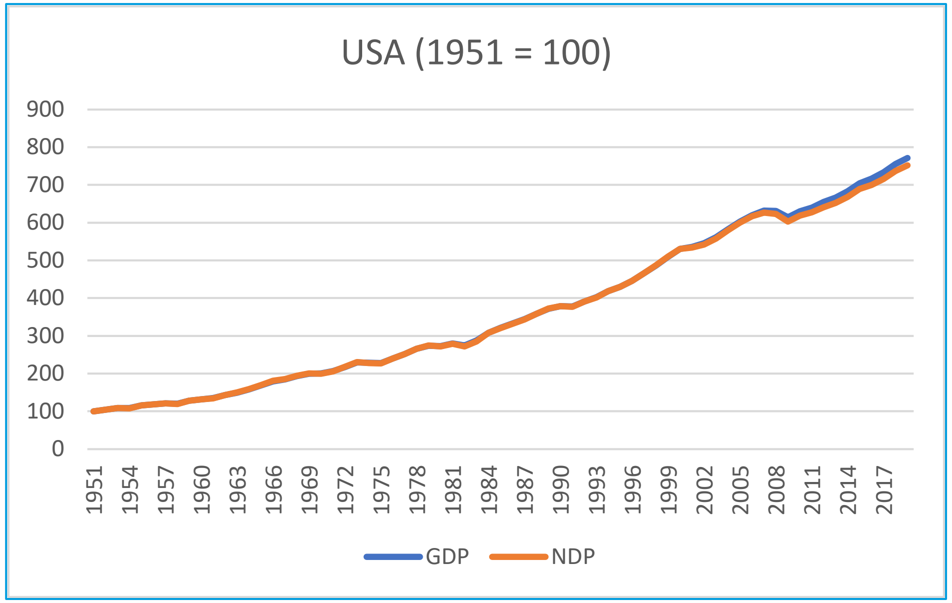
In terms of assets coverage:

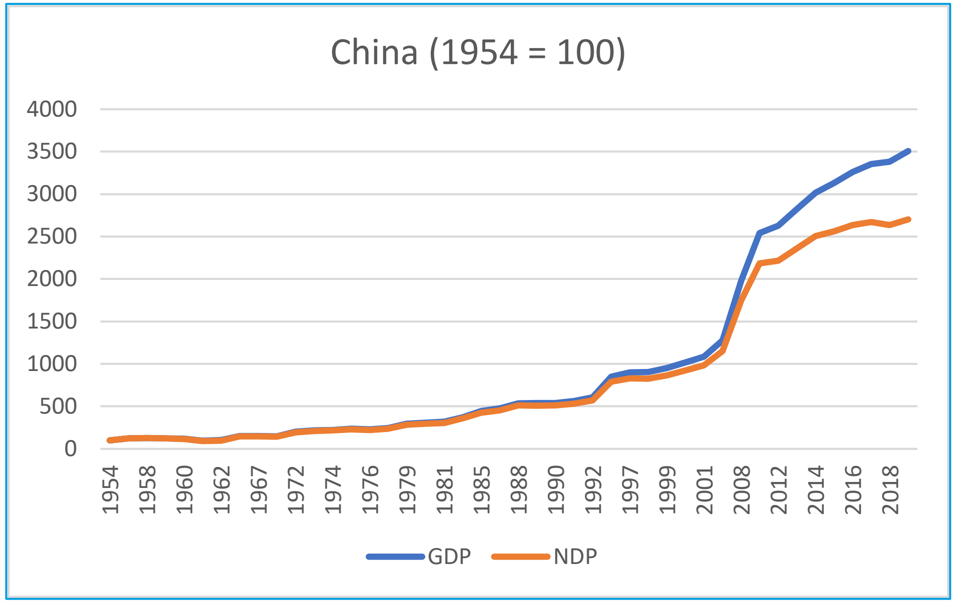
- Fixed assets covered in the PIM
- Scope of natural resources included in the natural resource accounts

- NDP as denominator:
  - Conceptually, there may or may not be good basis for GDP to be preferred over NDP as a denominator in critical ratio-based indicators, e.g., government debt or deficit to domestic product. In the main, the Net measure should be the steer.
  - Practically, there may be some obstacles (e.g., regulation changes) to overcome requiring a transition period to move from gross to net and resistance from some producers.

The scope of gross net adjustments (II)

- Feasibility of volume growth of NDP:
  - Constant price estimates of CFC and resource depletion are not likely to be a constraint.
  - Annex shows how NDP is compiled from the production, income and expenditure approaches.
  - NDP-GDP differences seem to occur in times of capital driven economic growth.





Source: Penn World Table version 10.0. Note: net-gross difference refers to CFC only.

GN Recommendations:

(i) For economic soundness, simplicity and making capital measurement accessible to a wider range of countries, the 2025 SNA should recommend **geometric depreciation** as the default option.

(ii) The stronger positioning of net income in the 2025 SNA should coincide with further practical guidance and improvements on capital measurement (e.g., capital stocks, consumption of fixed capital, capital services), for example by way of establishing an **international 'capital measurement internet-based information hub**'. This hub should also serve in providing more guidance on how to measure natural resource assets and their depletion.

(iii) In the 2025 SNA, **a much higher profile is given to net income and savings** according to the proposals in Section 2 of this GN.

(iv) The newly proposed **2025 SNA Chapter 17 should provide an all-inclusive coverage of measuring capital**: all stocks and flows of fixed assets, natural resources and land. The new chapter should cover and explain the differences between both wealth and productive capital stocks.

(v) In the national accounts as published by countries, the **scope of Gross-Net adjustments should be shown explicitly**, i.e., the two elements (P51c, K21).

(vi) The 2025 SNA **should advocate the volume change of NDP as the preferred measure of economic growth**, acknowledging that moving from gross to net product estimations will require a transition period.

Feedback received from the CMTT consultation

(The most critical points are shown below with a first response provided in brackets)

- High estimates of depletion may hamper a sound measurement of economic growth.
  (good point but the "hamper" aspect could occur with already existing components of GDP. Net components will be shown explicitly to allow users to interpret the underlying picture.)

- Depletion is different from regular production costs.
  (this addresses the recommendations in GN WS.6)

- Calculating NDP from the expenditure side implies a net capital formation concept, net of natural resource depletion. Such a concept seems unsound.
  (good point and will have to be addressed together with other feedback, maybe an aggrgegate level adjustment only)

- Proposal: create a new / additional account in the sequence of accounts showing the depletion adjustments.
  (showing both the net and gross balancing items for each account is open and transparent without the need for an extra account - consideration for the AEG)

- There are some situations where a GDP denominator is more appropriate for indicators.
  (this may be the case on practical grounds, less clear why on conceptual grounds)

Questions for AEG Members:

(1) Any further guidance or issues to address?

(2) Is this GN ready for global consultation?


THANK YOU
Gracias
Obrigado
Merci
Danke
Kiitos
Dziękuję
Děkuji
Köszönöm
Terima kasih
Teşekkür ederim
Спасибо
Mulțumesc
감사합니다
謝謝
ありがとう
Salamat
Takk
Dank U