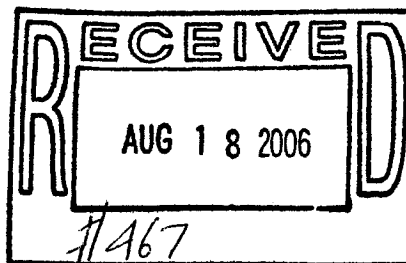


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CC: Eurostat and NSI of EU member countries

Dear Dr. Cheung, *Dear Paul*

In your letter of 19 May 2006 to the directors of the National Statistical Institutes, you suggested that comments should be given on the total of provisional recommendations on the SNA revision 2008 (1993 SNA Rev.1), which are now available. We are pleased to do so in the following:

1. We welcome and explicitly support the revision of the 1993 SNA. From our point of view, it is particularly important that the central and essential goal is reached, which is the adjustment of the concepts to new developments in economic reality. A good example of such an adjustment from our point of view is the treatment of issue 3 on the list of revision issues "employee stock options". This also applies to many other revision issues.
2. Nevertheless, there are some issues on the list which, from our point of view, must not be implemented under any circumstances in the core system of the new SNA because they violate the principles applicable to the 1993 SNA Rev.1 revision ("criteria for identifying issues for updating") as established by the UN Statistical Commission at its 34th meeting from 4 to 7 March 2003 (sometimes referred to as "fundamental principles").

From our point of view, the following issues are highly important:
Issue 2 Employers' pension schemes/Unfunded Pension schemes
Issue 9 Research and Development

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Issue 15 Cost of capital services
and 16 Government owned assets and capital services
as well as
Issue 19 Military expenditures

Here are our detailed comments:

Re issue 2: Employment retirement pension schemes (Unfunded pension schemes)
We reject the proposed change.

We generally doubt whether contingent liabilities for which neither the level nor the modalities of realisation are known should be recorded in the SNA.

Calculating that issue could be done only on a model basis involving many imputations and assumptions. Assumptions would have to be made, for example, regarding future life expectancy, retirement age, retirement claims, and retirement from active service, etc. The future pension claims calculated on a model basis would have to be discounted to the present value using a suitable interest rate. Choosing different interest rates may lead to considerable differences in value. International comparability would be seriously affected. Results already published would have to be corrected very often in the course of time, which would lead to considerable disturbance and subsequent changes within the core systems.

All the above arguments clearly support calculating pension liabilities outside the core system in supplementary tables or satellite accounts.

Re issue 9: Research and Development (as capital formation)
We reject this proposed change.

In our opinion, this is not a new phenomenon. The issue was discussed in detail already for the last SNA revision. Since that time, no major methodical progress has been made and the importance of the issue has not considerably increased. Our national user survey has very clearly shown that users reject the inclusion of own-account research and development (R&D) as capital formation into the national accounting core system. Users favour the representation of R&D in a satellite system. Another argument for treating R&D in this way is the multitude of unsolved practical statistical problems, such as problems of estimating own-account R&D, the lack of price indices for deflation, lack of quarterly data, lack of useful life, lack of regional data, etc.

Re issue 15: Cost of capital services (market producers)
and

Re issue 16: Government owned assets and capital services

In the context of issues 15 and 16, it is demanded that, for measuring the output of non-market producers, calculatory interest on capital should be included in addition to the

existing expenditure elements (compensation of employees, consumption of fixed capital, intermediate consumption, taxes less subsidies).

We reject both changes.

That issue, too, was discussed and rejected already on the occasion of the 1993 SNA revision. Since that time, no new knowledge has been gained, and the relevance of those elements has not changed either. In major parts, determining that aggregate is based on imputations, especially on the interest rate to be used. Consequently, the results would not be free from arbitrary decisions. International comparability would be affected negatively.

Re issue 19: Military Expenditures

We also reject including all military weapons systems into fixed capital formation (instead of into intermediate consumption).

The treatment of specific parts of military equipment was changed already in the 1993 SNA. There are no new relevant aspects, so that another change would be in conflict with the "fundamental principles". Also, we very much doubt whether military weapons, whose main purpose – as is generally known – is the destruction of assets – should be considered as capital formation. We also doubt very much that the basic data required for separate representation of weapons systems will be sufficient (military secrets) and that there are internationally comparable service life data for the consumption of fixed capital.

3. Beyond the objections against the small set of issues there are however some concerns on our side that we would like to articulate as well. Statistical information should be politically relevant, theoretically consistent and empirically reliable. The trade-off between these objectives requires the search for a balance, an optimum that has to be adjusted from time to time corresponding to new economic issues, new user needs, new statistical methods, etc. That is the general goal for a revision and – at least from our perspective – the common understanding underlying the principles of the updating process. We fear however, that we are going to jeopardize the balance we had found in the former versions of the SNA by implementing too many elements of imputation. The concepts are increasingly leaving the area of what can be monitored statistically and instead are focusing on artificial concepts that do not exist in business accounting. Examples are own-account production of software, research and development activities as capital formation, and the fictitious pension liabilities or claims.

The SNA is more and more drifting away from business reality and is creating its own fictitious world. Many data can be determined only by complex and difficult model calculations and are more difficult to understand for users because they differ from the generally familiar business reality. What can be relatively well covered by statistics and what is comprehensible to users is above all market transactions and assets that are tradeable. In our opinion, they should therefore be more at the centre of presentation in the SNA core system.

In many countries, reducing the statistical response burdens on respondents is of high political importance. Generally, additional statistical surveys can therefore not be conducted.

Consequently, we cannot assume that we will have more and better statistical basic data in the future – the opposite will probably be the case.

For a future new, and fundamental SNA revision, we would generally wish that, before actual discussion of concepts starts, the goal of the SNA or the new SNA revision would be shown more clearly than in the past, that is especially the question of what the primary focus should be: market processes or welfare considerations. We would prefer the core system to be oriented much more consistently towards market processes.

Additionally, it would be very important for the new SNA to state more clearly than is the case now that economic performance is better represented by the net aggregates such a net domestic product or net value added (item 2.176 of the 1993 SNA says “Thus, theoretically, value added is a net concept.” and 2.177 “This conclusion applies to domestic product as well”). As many countries calculate consumption of fixed capital now, too, this would be a logical step, especially because more and more aggregates are to be shown as capital formation and are thus covered “twice” in the gross domestic product and in gross value added (but not in the net domestic product and in net value added).

4. Our arguments towards a clear orientation and limitation of the core system of National Accounts would however not be meaningful and sustainable if we did not suggest a solution for those applications and questions, which are not reflected in the “core”, correspondingly. Hence, we propose to have a two-fold approach in which core accounts are combined with a set of complementary satellite accounts. Welfare considerations and other analytical applications could then be shown in the satellites. Problematic and critical issues should also at first be treated and checked for feasibility in satellite systems. From our point of view, for such purposes, satellite systems provide only advantages without any disadvantage:

- Satellite Accounts are able to address particular fields of research and applications.
- Heterogeneous user wishes can be optimally satisfied with a portfolio of accounts with specific strengths and weaknesses.
- Different data quality profiles can be separated and properly described by metadata.
- Difficult concepts in new developments of National Accounting can be tested in satellites, firstly. If successful, the results can be transferred to the core system. The new concepts can be applied, for example, only for annual data at current prices. Price adjustment, quarterly and regional accounts can gradually be tested.
- The coherence of the core accounts is not impaired.

We therefore would like to repeat our urgent appeal to envisage the above issues of the SNA revision at first only for satellite systems, to test the calculation or the feasibility and to implement them in the core system only after successful testing. Strategically, we would like to suggest following a paradigm for National Accounting in which core and satellite accounts form a symbiotic relationship. The more we emphasize the importance of satellite accounts the less we need to extend core accounts to issues, which are not meaningful to be integrated.

5. The current revision of the SNA should comprise only updates and should not end up in a new version of the SNA. In order to ensure this, we are pleased to take the occasion to summarise what we think the SNA revision should look like:
- New economic facts and developments which did not exist, or had minor importance, before the introduction of the 1993 SNA must be shown in the 1993 SNA Rev.1.
 - Dealing again with any issues that were already discussed and rejected for the last revision requires a well documented justification.
 - User interests should in any case be transparently documented. (For example, in a user survey conducted in Germany, the majority of users voted against the inclusion of research and development into fixed capital formation.)
 - Feasibility must be ensured to a large extent. It is not sufficient that a few countries think to be able to implement the new concepts. Rather, it is necessary that the majority of countries are able to produce internationally comparable data. (After the last large-scale 1993 SNA revision, for example, the introduction of the "own-account production of software" concept failed entirely, as did the introduction of the FISIM concept and the chain-linked indices on a quarterly basis.) Aspects of theoretical consistency are not necessarily sufficient as a reason for changing the concepts.
 - The costs of implementation and the burden on respondents must be taken into account.
 - Problematic and critical issues should at first be treated and checked for feasibility only in satellite systems, i.e. outside the national accounts core system (similar to a prototype in industrial production).
6. For the next steps in the procedure of the SNA revision, two aspects are of major importance to us:
- It should be possible for as many UN member countries as possible – in the best case for all countries – to implement the new 1993 SNA Rev. 1. However, objectively, this is not even the case for the 1993 SNA; the concepts envisaged for the new 1993 SNA Rev.1 are even more difficult to implement than those applicable now, which means that for a long time only few countries would be able to do so. Even in a country like Germany, which has a highly developed statistical system, there are considerable doubts as to whether the concepts proposed for the 1993 SNA Rev.1 could be introduced appropriately. As a member of the United Nations Statistical Commission, we take very seriously our responsibility especially towards less developed statistical institutes, and we will shape our vote accordingly.
 - The second aspect regards the fact that the ESA, which has been derived direct from the SNA, is legally binding for all European Union member states and has direct political, administrative and fiscal consequences for those states. This results in much more demanding requirements to be met by the quality and reliability of the results than is the case in countries where the SNA/(ESA) is used predominantly as an input for political consulting processes, for general information or for scientific analyses.

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Dear Dr. Cheung, after having outlined our concerns and suggestions I would like to emphasize that the Federal Statistical Office of Germany is very interested in a success of the revision project. Satisfaction of user needs, conceptual consistency and reliable data quality are our strategic objectives. You can be assured, that Germany will provide its competences and capacities for the development of widely acceptable and feasible solutions. Since we know that other National Statistical Institutes have similar concerns, we consider it urgent to elaborate common proposals for the controversial issues before submitting the draft to the UN Statistical Committee for decision. Furthermore, a clarification of the long-term paradigm for National Accounting would be appreciated from our side.

Hopefully, our letter can help to progress in the current revision project.

With best regards



Walter Radermacher