October 6, 2006

Dr. Paul Cheung
Director, Statistics Division
Department of Economic and Social Affairs
United Nations, Room DC2-1732
2 United Nations Plaza
New York, NY 10017

Dear Dr. Cheung:

Thank you for your inquiry regarding the United States' views on the totality of the full set of recommendations for the update of the System of National Accounts (SNA) made by Advisory Expert Group (AEG) at their February meeting. These comments supplement and provide a broader perspective on the comments BEA made earlier on the specific recommendations of the Expert Group.

First, we wish to emphasize that the U.S. Bureau of Economic Analysis strongly supports the update of the SNA. The economies of the United States and other countries have undergone important changes since 1993, and it is important for the credibility and usefulness of the accounting system to stay up to date with economic developments. The share of wealth accounted for by intangibles such as research and development and software has grown, and users are demanding a better accounting of these intangibles. The user community desires better information on tangible and intangible assets in order to better assess the sources of productivity change and economic growth. Natural disasters and terrorist attacks have demonstrated the need for improving the SNA's treatment of insurance. As the "baby boom" ages, analysts and policymakers are demanding better information about pension liabilities. New forms of employee compensation, such as stock options, are increasingly important. New business and public sector accounting standards are focusing attention on accounting for government assets.

These changes in the economic environment make urgent the task of successfully completing the update to the SNA. Indeed, BEA is already moving ahead with several of these changes; the new treatment of insurance has already been incorporated, and we have completed the first stage of a research and development satellite account that will be a precursor to full incorporation in the core accounts.

We are impressed that the major changes proposed by the AEG all move toward improving the overall consistency of the accounts. BEA supports all of the following AEG proposals as moving toward improved consistency of the accounts:

<u>Research and development</u>. The treatment of research and development in the 1993 SNA is fraught with inconsistencies—R&D is treated as a form of production that is immediately used up as intermediate consumption, yet it results in "intangible non-produced assets" (patented entities) and the associated royalties are classified as payments for service. Fortunately, the new treatment proposed by

the AEG will eliminate these inconsistencies and provide a conceptually consistent treatment of research and development as capital formation.

<u>Employer pensions</u>. The SNA's current treatment of employer pensions is inconsistent with the accrual approach that is a general principle of the system and leads to misleading information about the employer's liabilities and net worth. Certainly, the AEG's proposal to recognize the liabilities involved with all pension systems, including unfunded ones, is a move toward improving the overall consistency of the application of accrual principles.

<u>Cost of capital services</u>. The AEG's proposal to introduce the concepts of the cost of capital services also will improve the consistency of the system. These concepts provide an explanation for rental of capital assets and provide a rationale for the operating surplus. These concepts can also be used to develop estimates of changes in volume of real capital services that will be useful for measuring and explaining changes in productivity.

<u>Return to non-market assets</u>. The AEG's proposal to include a rate of return to assets held by non-market producers (general government and nonprofit institutions serving households), consistent with the concept of cost of capital services, also will improve consistency. It will eliminate a major inconsistency in the 1993 SNA, in which market assets reflect the cost of capital services (including the opportunity cost of foregone interest), whereas non-market assets exclude a portion of the cost.

<u>Non-life insurance</u>. The AEG's proposed new treatment of non-life insurance eliminates anomalies in the treatment of insurance and presents a measure of output that is more consistent with economic theory. BEA has already implemented the new treatment for property and casualty insurance.

<u>Military assets</u>. The AEG's proposal to capitalize military weapons systems that meet the other criteria of being a fixed asset also eliminates an asymmetry and inconsistency in the 1993 SNA. Defense agencies must plan for replacement of weapons systems like other assets. The new treatment will provide better measures of the government's stock of assets and consumption of fixed capital. BEA has already implemented this treatment.

<u>Employee stock options</u>. Employee stock options are a rapidly growing form of compensation in the United States and other countries. The AEG's proposal is an important improvement in the consistency of the SNA because it recognizes the appropriate value of employee compensation, while treating the subsequent holding gains and losses consistently with their treatment elsewhere in the accounts.

In conclusion, we reiterate our support for the update of the SNA and for the efforts that the AEG has made to ensure consistency in the set of recommendations.

Sincerely,

J. Steven Landefeld, PhD
Director

cc: Katherine Wallman, Chief Statistician, OMB