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WHY A NEW ESA?

In 2014, the new European System of National and Regional Accounts (ESA 2010) will replace the current ESA 1995 in order to bring the national accounts into line with the new economic environment, advances in methodological research and user needs.

Over the last twenty years, substantial changes have impacted economies, in particular the increasing role of information and communication technologies in the production processes, the growing place of intangible assets, intellectual property products and service activities, the globalisation of national economic systems. These changes require adjustments in the way in which macroeconomic statistics are compiled. It is not a revolution, but a necessary and useful adaptation.

National accounts are at the core of a modern system of economic statistics, and provide the systematic statistical framework for summarising and analysing economies. They have to be kept in line with structural economic changes in order to maintain their relevance. At the same time, user needs for more timely information has to be addressed.

This adaptation is not only European but world-wide. The ESA 2010 in Europe is the sister of the SNA 2008, which is in the process of being implemented all around the world. The USA has implemented it in August 2013. Europe will implement it in 2014, in a coordinated way.

ESA 2010 REGULATION (published on 26 June 2013 in the Official Journal)

National accounts data are used by governments, economic and social operators and the public in general (the media, enterprises, universities), who find in these sets of harmonised and reliable statistics the necessary information on which to base their decisions.

But in Europe, national accounts have a deeper role. They are at the source of many of the indicators that constitute the quantitative backbone of European economic governance. Gross Domestic Product (GDP), more precisely Gross National Income, is at the heart of the calculation of the EU budget. Ratios of public deficit and debt in % of GDP are used to determine European fiscal policies under the Excessive Deficit Procedure (EDP). Regional GDPs are used to rationally distribute structural funds. Several of the indicators of the recent Macroeconomic Imbalances Procedure (MIP) are based on national accounts. Moreover, quarterly growth rates of GDP are an important background element in the monetary policy of the Eurozone. This explains that, in Europe, the highest comparability and accuracy are needed. This is achieved by the ESA 2010 being a European Parliament and Council Regulation; the implementation of which being compulsory. The ESA 2010 defines:

– A methodology on common standards, definitions, classifications and accounting rules intended to be used for compiling accounts and tables on a comparable basis for the purposes of the European Union;

– A transmission programme comprising tables to be provided by Member States according to specific deadlines.

The European Union will fully move to ESA 2010 in September 2014, when the data transmission programme included in ESA 2010 Regulation enters into application. The national accounts data will then be compiled all around Europe based on the new methodology.

PROCESSES OF REVISION OF NATIONAL ACCOUNTS STANDARDS

The European Commission (Eurostat), with the United Nations (UN), the Organization for Economic Cooperation and Development (OECD), the International Monetary Fund (IMF) and the World Bank, together with experts from all around the world, and in particular from Europe, has actively contributed to coordinate and manage the update of the 1993 SNA, leading to the 2008 SNA which was adopted by the United Nations Statistical Commission in February 2009 and the ESA 2010, which was legally adopted in 2013.

The revision processes of both the SNA and the ESA have been fully transparent, with the broadest possible involvement of the statistical community. The revision of ESA has involved EU national statistical offices and central banks, the European Central Bank (ECB), the Directorate General for Economic and financial affairs (DG ECFIN), the Council, the European Parliament, through a large number of meetings and written consultations. EU countries unanimously adopted common European positions on each of the most debated issues.

In course of the revision processes, a list of 44 recommendations for changes was identified. Many of them have a limited scope and are destined to experts. The present note will therefore focus on the main improvements and will illustrate these methodological changes with some very provisional figures, given that the definitive estimates will only be available in September 2014.

PRESENTATION ON MAIN IMPROVEMENTS INTRODUCED BY ESA 2010

- Capitalisation of research and development expenditure:

Research and development (R&D) has long been recognised by economists as having the characteristics of fixed assets: defined ownership rights, long-lasting and repeated uses and benefits in production process. In a modern, more and more digital economy, R&D is an investment for the future even more important than buildings, trucks, or factories.

However, similarly to other accounting frameworks such as IFRS, the old system, ESA 95, did not recognise R&D as capital formation, despite the fact that it is thought to be a major contribution to future economic growth. Instead, R&D expenditure, whether conducted on own account or purchased, was recorded as "intermediate consumption", meaning that it was recorded as "completely used in the production process" at the end of the period. As a result, the balance sheet of the economy was understated, as well as GDP and operating profits. Indeed, being considered an expense consumed at the end of the period, R&D expenditures came in deduction of the global output of the economy and of operating profits of the period.

In ESA 2010, outputs of R&D are now "capitalised", meaning they are recognised as assets and the acquisition, disposal and depreciation of R&D fixed assets will be treated in the same way as other fixed assets. This is the major improvement introduced by 2008 SNA and ESA 2010. In the conservative world of accounting, it is quite a bold change, coming way ahead of business accounting practices. It will lead to macroeconomic balance sheet data that have better analytical capacity.

The most immediate and visible impact for users will be that the level of GDP will be increased for all countries, of an amount depending on their investment in R&D. According to preliminary estimates the level of GDP will be boosted by 1.9% in Europe (weighted average of Member States)[1]. The impact of this change has been estimated at 2.5% in the United States, due to, relatively, more R&D expenditure in the US. However, the European figure is an average that masks some diversity among Member States. Because of this increase in level, ratios expressed in terms of GDP will, everything else being equal, mechanically slightly decrease. This will be the case, for example, for the public debt ratio, which, in average and notwithstanding other changes, will decrease by approximately the same amount as the increase of GDP.

- Military expenditures:

In ESA 95, military acquisitions of weapon systems and their means of delivery such as military aircrafts or vessels were treated as intermediate consumption regardless of their life length. This treatment does not correspond to the economic reality as weapons and their means of delivery are used for a long period and can even be exported after several years. Military vessels are not "consumed" at the end of their first year (except if sunk at war!). These types of weapon systems can be used over many years.

Thus, in line with other accounting frameworks, ESA 2010 now treats as gross fixed capital formation all expenditure by the military which meets the definition of being used in production over a period in excess of one year, regardless of the nature of the expenditure or the purpose intended for it, in particular regardless of its destructive potential. The impact of this change for the accounting of destructive weapons and their means of delivery on GDP (equal to consumption of fixed capital of these weapons and means of delivery) obviously differs among countries depending on their military budget; a rough estimate is a weighted average increase of around 0.1% of GDP for the EU as a whole.

- Goods sent abroad for processing:

The ESA 95 treated goods that are sent abroad for processing and then returned to the country from which they were dispatched as exports for their full value when they leave the first country and in imports when they return to it. In the light of globalisation, the ESA 2010 and the new Balance of Payment Manual (BPM6) use a change of ownership recording which is no more based on physical movement. It recognises that many goods move from one country to another without entailing a consequential payment from the recipient to the sending country. In fact, the new treatment recognises that the recipient country does not export goods but exports its processing services.

Therefore, under ESA 2010, the value of goods sent abroad for processing will no longer impact both gross imports and gross exports figures. Also, the value of the processing will be re-classified as export/import of services. Thus, in the national accounts and the balance of payments, the level of exports and imports of goods will be slightly reduced while the level of exports and imports of services will increase. This is important for international trade analysis. For example, for countries that significantly undertake processing, their goods trade balance will be negatively impacted, while their service trade balance will be positively impacted.

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[1] The impact on GDP growth figures for recent periods will be very small, if not negligible.

It is important to note that, as the new recording affects symmetrically exports and imports, there is practically no impact on the overall *balance* of external trade of goods *and* services. So there is no impact on GDP. It is premature at this stage to estimate the impact on the levels of EU imports and exports expressed in national accounts and balance of payments. However, this impact should not be very substantial and should be much less than for countries specialised in processing, such as China.

– Pension schemes:

ESA 95 recognised pension obligations on the balance sheet only for funded schemes; unfunded employer schemes did not lead to recognition of liabilities for the employer. Also no pension entitlement was recognised for households (employees and retirees) in the case of unfunded schemes.

ESA 2010 recognises in its core accounts employment-related pension entitlements, irrespectively of whether the schemes are funded or not. In addition, a supplementary table presents all accrued-to-date pension entitlements in social insurance; including unfunded government pension schemes and social security pensions. The supplementary table will provide a powerful tool for economic analysis of households' pension wealth across countries. This is particularly important, as the 2008 SNA left some flexibility for the recording of unfunded pension entitlements of government; inside or outside the core accounts. The US and other non EU OECD countries will record such entitlements in the core accounts while ESA 2010 prescribes to present them only in the supplementary table.

ESA 2010 will also change the recording of lump sum payments that are sometimes received by governments from public corporations in exchange of the taking over of the pension liabilities of these employers. Previously, under ESA 1995, such a lump sum was considered revenue of the government, and thus positively impacted its deficit in the year of the transaction. ESA 2010 does not recognise it as revenue, as, in fact, it is compensated by an increase in the pension obligations of the government. This will lead to some correction of the deficit figure for the few Member States (Portugal, Hungary) that have recently undertaken such transactions.

– Non-life insurance:

ESA 2010 should improve significantly the measure of the contribution of insurance services to GDP. Under the previous system, this contribution was based on the difference between premiums and claims. As the level of claims may be quite volatile (catastrophes are more and more frequent), the result was itself volatile. In ESA 2010, the formula of calculation of the non-life insurance output has been amended in order to smooth the level of this output.

– Other changes:

There will be a number of other changes that could affect GDP or some other important variables, such as public deficit and debt, due, for example, to some reclassification of units. However, in most countries, these changes should have a limited impact on the final figures.

A REVISED AND EXTENDED DISSEMINATION PROGRAM

ESA 2010 comes with an extended transmission program to Eurostat from the Member States. This will allow Eurostat to progressively disseminate new sets of data for the better usage of all users.

The improvement in availability of data covers many areas of the transmission programme, for instance balance sheets for non-financial assets, so that users can develop wealth analysis. In this context, the split between the households sector and the Non Profit Institutions Serving Households sector becomes compulsory, in particular to provide better information on wealth of households. Financial accounts and balance sheets are presented with an increased breakdown by sub-sectors of financial corporations. An additional table on pensions is formatted to provide essential information for analysing pensions and make international comparisons. More variables will be disseminated for distributive transactions at sector level, with quarterly seasonal adjustments.

User needs for more timeliness in order to analyse economic changes are also taken into account through the advancement of transmission deadlines. For instance, main aggregates (quarterly and annual GDP and components) are now to be transmitted at t+ 60 days (rather than t+70 days). Euro-aggregates quarterly non-financial accounts by sector will be published at t+90 days rather than today at t+120 days.

Also Eurostat will be collecting and disseminating starting early 2015, in parallel to the new ESA transmission program, new comparable sets of data regarding contingent liabilities and potential obligations of government, such as the amounts of guarantees, the debt of public corporations, non-performing loans, and potential obligations under Public Private Partnerships.

ESTIMATED IMPACT OF THE METHODOLOGICAL CHANGES OF ESA 2010 ON GROSS DOMESTIC PRODUCT

Member States have been asked by Eurostat to deliver first preliminary estimates of the introduction of ESA 2010 methodological changes on their GDP. It is important to stress that the figures presented in the table below only relate to the methodological changes introduced by ESA 2010, and not to possible statistical changes (improvement of data sources, new data sources) that will be made in the context of the implementation of ESA 2010. It is only after the transmission by Member States of their new ESA 2010 data, in September 2014, that we will be in a position to present the total impact of methodological and statistical changes.

The results of 23 Member States, representing 97.6% of the EU GDP, are the following:

The weighted average impact on GDP of methodological changes is an increase of 2.4%, of which +1.9 (around 80% of the total impact) is due to the capitalisation of research and development. The remaining methodological impact is due to different elements, the most important of which is capitalisation of military expenditure which represents +0.1.

The impact differs among Member States. These differences are in the first place due to the variability of the expenses in R&D between the different Member States.

By way of comparison, it is worth mentioning that, in the United States, the introduction of the new international standards led to an increase of 3.5% of GDP for years 2010 to 2012, with the capitalisation of research and development accounting for 2.5%. However, taking into account that changes which impact by 0.5% the US GDP (capitalisation of entertainment, literary and artistic originals) were already included in EU GDP according to ESA 1995, we should consider that the weighted average impact of 2.4% in Europe should be compared to 3% in the United States (of which research and development contributes 1.9% and 2.5% respectively).

	Table – Estimated impact of the methodological changes of ESA 2010 on Gross Domestic Product *First preliminary estimates* *Reference year: mainly 2011*		
Percentage of GDP increase	**Number of countries**	**Countries**	**Contribution to EU GDP**
0 to +1%	5	LV, LT, HU, PL, RO	5.1%
+1 to +2%	9	CZ, EE, IE, ES, IT, LU, PT, SI, SK	25.5%
+2 to +3%	4	BE, DK, DE, FR	41.7%
+3 to +4%	3	AT, NL, UK	20.8%
+4 to +5%	2	FI, SE	4.5%
+2.4%	**23**	**EU average**	**97.6%**
+3.0%		**USA**	
No estimates provided yet	5	BG, EL, CY, MT, HR	

Eurostat has put in place a web site dedicated to the implementation of ESA 2010 http://epp.eurostat.ec.europa.eu/portal/page/portal/esa_2010/introduction

It has been developed for both producers and users of national accounts data. In order to help Member States to prepare the implementation of ESA 2010, Eurostat has issued a "Manual on the changes between ESA 95 and ESA 2010". This manual presents each change, illustrated with numerical examples. It is already available on the website dedicated to the implementation of ESA 2010.

Eurostat has also prepared a training programme on main changes and has developed specialised implementation manuals to help Member States in their adaptation of national accounts. This material will be available on the dedicated website.

An important event that will mark the adoption of ESA 2010 will be a high level National Accounts conference, planned in June 2014 in Luxembourg. This conference is meant to illustrate the many innovations in national accounts with the implementation of ESA 2010, but also the research agenda in this important field of statistics.