

What is the ESA?

The European System of National and Regional Accounts (ESA) sets down the harmonised methodology that must be used for the production of national accounts data in the European Union (EU). It is crucial to have such a methodological rulebook in the EU, in order to ensure that statistics on Member States' economies are compiled in a consistent, comparable, reliable and up-to-date way.

ESA is internationally compatible also beyond the EU, making it possible to describe the total economy of a region, country or group of countries, in a way that is reliably comparable with other economies.

Why changing the ESA?

The former methodological framework for producing national accounts data has been developed in the 1990s. In the meantime, substantial changes have impacted economies, in particular the increasing role of information and communication technologies in production processes, the growing importance of intangible assets, intellectual property products and services, and the globalisation of economic systems. The way in which macroeconomic statistics are compiled needs to be adjusted accordingly, to reflect these changes. It is not a revolution, but a necessary adaptation.

It is important to stress that this adaptation of the system of accounts is not only European, but world-wide. Europe's ESA 2010 is the counterpart of the 2008 System of national accounts (2008 SNA), adopted by the United Nations Statistical Commission, which is in the process of being implemented all around the world. It has already been implemented in countries like the USA, Australia and Canada.

What are the main changes?

- **Research and development expenditure is counted as investment.** Expenditures on research and development (R&D) have the nature of an investment and contribute to future economic growth. This is the major improvement introduced by ESA 2010.
- **Expenditure on weapon systems is counted as investment.** The new system recognises the productive potential of expenditure on weapon systems for the external security of a country, over several years. This identifies them as investment.
- **A more detailed analysis of pension schemes.** A compulsory supplementary table transparently shows the liabilities of all pension schemes, including those of government whether unfunded or funded, in order to improve comparability between countries.
- **Goods sent abroad for processing.** The value of goods sent abroad for processing will no longer impact on gross exports and imports figures because ESA 2010 uses a change in ownership approach and is no more based on physical movements. ESA 2010 just records an export processing service. This will reduce the level of exports and imports, but will not affect the overall current account balance.

Why are you changing the treatment of research and development expenditure?

In today's world, investment into research and development is at least as important as investment in buildings and machinery. This is why it should also be recognised statistically as an investment.

Why are you changing the treatment of expenditure on weapon systems?

A weapon system, such as an aircraft carrier, is available to a government over many years. This is why in the new methodology they are being treated as investment rather than current expenditure (the appropriate treatment for expenditure on items which are consumed within a limited timeframe).

Why has the reporting on pensions been enlarged?

In the context of an ageing society, information on pension wealth of households (on the one hand) and pension obligations of employers and governments (on the other hand) are of growing importance. ESA 95 recognised pension obligations only for funded schemes; unfunded employer schemes did not lead to recognition of liabilities for the employer. In addition 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, irrespective of whether the schemes are funded or not. In addition, a supplementary table presents all accrued-to-date pension entitlements; including unfunded government pension schemes and social security pensions. This supplementary table will provide a powerful tool for economic analysis of households' pension wealth across countries.

What's about the impact of ESA 2010 on GDP?

The ESA 2010 implementation and the introduction of other statistical improvements increased the level of GDP by 3.7 % in 2010.

- The methodological changes increased EU28 GDP by 2.3%
- The statistical improvements accounted for a revision of 1.4%.

The most significant ESA 2010 methodological changes have been the capitalisation of research and development expenditures and expenditures on weapons systems which revised EU28 GDP by 1.9% and 0.2%, respectively. 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 % in the level of GDP, with the capitalisation of research and development accounting for 2.5 %.

While there is an impact on the GDP levels, the effect of the changes on growth rates is very limited. The change in the annual GDP growth rates over the years 1997-2013 was around +/-0.1 percentage points for the EU28.

Is this going to rewrite history, and get rid of the recession?

Absolutely not. This is not a way of getting rid of the recession, as the changes are to the level of GDP not the growth from period to period.

Is this just a way of making government debt and deficit ratios look better?

No. In fact if this were the intention it would actually be a failure.

It is true that as a simple effect of an increase in GDP, there would be a corresponding decrease in all indicators calculated as a percentage of GDP.

However, ESA 2010 also has an impact on the absolute value of debt and deficit, which is likely to be upwards for most Member States due to changes in what is counted inside general government. Depending on the relative size of this change and the change in GDP, the ratios might go up, down or remain the same.

Will this change the amount Member States pay into the EU budget?

The budget of the EU is first set at a fixed amount and is then proportionally divided according to the economic weight of Member States, and is not set as a fixed share of GDP. Therefore the amount the Member States pay into the EU budget will at most be affected to a minor extent.

Why do some countries report an increased saving rate of households?

This is a result of the improved recording of pension entitlements of households. ESA 95 used a cash approach to measure household income from defined benefit pension schemes. ESA 2010 recommends a change in the recording. Now, pension contributions are determined in an actuarial way; independently from actual contributions. In the case of an underfunded pension scheme additional (imputed) pension contributions fill the gap and lead to a recording of higher income and higher saving of households.

Are there other changes being made at the same time?

While all Member States are implementing the ESA 2010 methodology in September, there are two further changes that will in many Member States occur at the same time.

Firstly, Member States will use this opportunity to also carry out additional statistical improvements, for example updates of data sources.

Secondly, as part of the process of harmonising methodology across the EU, many Member States will introduce improvements in the way they accounted for certain illegal activities in GDP.

Why are you including these illegal activities?

It must be stressed that this is nothing new, and in fact the changes being introduced simply reflect improvements to methodology. The inclusion of these activities has been required since 1993 under international standards.

GDP is about measuring all economic activity. Both declared and undeclared (which includes illegal) activities need to be taken into account in order to have a full and accurate picture of the value of production/consumption in a given period.

Since there was a need to agree on standards on how to measure illegal activities, common methodological guidelines have been agreed between the European Commission and the Member States to ensure consistency between all Member States. These guidelines concern prostitution, the production and trafficking of drugs, and alcohol and tobacco smuggling. By 22 September 2014 all Member States are required to comply with these guidelines. These methodological recommendations have no direct relation with ESA 2010.

What about GDP and beyond?

It is, of course, important to complement GDP with additional social and environmental indicators in order to provide a full picture of the progress of our societies. Work will be intensified along three interconnected axes: the "household perspective" and the distribution of income, consumption and wealth; the multidimensional measurement of quality of life; and sustainable development.

In these areas, Eurostat is, for example, adjusting household income taking into account social transfers in kind, has developed an initial series of indicators on quality of life and has created a section on its website on environmental accounts, which are satellites of the main accounts.

What will be the impact of ESA 2010 at the regional level?

At the regional level, two types of effects can be distinguished.

Firstly, the impact of changes at national level which do not have a specific regional variation. This is the case for instance for weapon systems expenditure, which is not allocated across regions in a different way than before. These changes will affect the GDP of all regions equally, and will therefore not affect the spread of GDP between regions.

Secondly, the impact of changes which do have a regional variation. The most important change of this type is the treatment of research and development expenditure as investment. Since R&D tends to have a higher incidence in Member States and regions with a relatively high GDP per inhabitant, a slight increase in the spread of GDP per inhabitant among regions is expected.

Since regional accounts are always compiled after the release of national figures, the first data with regional breakdowns will be delivered by the end of 2014, in line with the legal requirements.

Will the allocation of structural funds be affected by the implementation of ESA 2010?

The allocation of structural funds for the current multi-annual financial framework (2012-2020) was decided in 2012 on the basis of regional GDP data for the reference years 2007-

2009. The allocation will be reviewed in 2016, most probably on the basis of regional GDP data for the reference years 2012-2014. This data set will be compiled in accordance with ESA2010.

Due to the slight increase of the spread in regional GDP per inhabitant that will result from the implementation of ESA 2010 there could in theory be an impact on regions whose values of GDP per inhabitant were very close to the eligibility thresholds for structural funds assistance in 2012. However, since R & D activities tend to be concentrated in regions of relatively high GDP per inhabitant, including in comparatively less prosperous Member States, such effects would be very small compared to other changes resulting from the developments of economic activity at the regional level that have taken place since 2009.