Working Paper 11
16 April 2007

ENGLISH ONLY

ECONOMIC COMMISSION FOR EUROPE
CONFERENCE OF EUROPEAN STATISTICIANS

Joint UNECE/OECD/Eurostat Working Group on Statistics for Sustainable Development
Third meeting
Geneva, 19-20 April 2007
Item 11 of the Provisional Agenda

ANNOTATED OUTLINE – POLICY IMPLICATIONS OF THE CAPITAL FRAMEWORK

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1. General policy implications of the capital approach

a) Emphasizes the need to focus on the long-term determinants of development

b) Reveals the distinction between current income and capital consumption. This is of special importance in natural resource dependent countries

c) Encourages broader thinking about the concept of investment

d) Encourages policies that simultaneously attempt to maximize current welfare and to ensure that its capital basis is maintained over the long term

2. The capital approach will emphasize the need to focus on long-term determinants of development

a) Current economic and social policy making in most countries is focused primarily on maximizing welfare for the present generation. This focus is driven by the short time horizon of democratic governments, by time preferences of individuals (i.e., the fact that most people discount the future), and by the information that is produced in order to support policy making and assess its effectiveness.

b) The question of information and its impact on policy making is central to the debate surrounding sustainable development indicators. Given that information is an important factor in shaping policy making, the question is, “What information on sustainable development is best suited to ensuring that policy makers focus on the long-term determinants of welfare?”

c) The capital approach, rooted as it is in well-established development theory, provides a defensible and understandable argument for introducing greater balance in policy making between ensuring the welfare of the current generation and ensuring that the basis for generating welfare in the future (capital) is maintained over time.

d) The capital approach, because it is rooted in theory and not in political deliberation, is less subject to manipulation by successive governments that are indicators sets that are determined through political negotiation. This means that indicators derived from the capital approach should stand the test of time, allowing – indeed forcing – successive governments to invest the time and effort in learning how to shape policies to arrive at truly sustainable development.

3. The capital approach will reveal the distinction between current income and capital consumption

a) With its emphasis on the maintenance of stocks of capital as the basis for long-term welfare, the capital approach should lead governments to pay greater attention to the distinction between current income and capital consumption.

b) Current income is the income (interpreted broadly to include market and non-market sources of income) that a nation is able to generate in a given year. It is this income – and only this – that the nation can spend on current welfare-enhancing consumption (consumption again being broadly interpreted to include market and non-market sources) without impoverishing itself over time.

c) Capital consumption is the drawing down of stocks of capital, either by using them up (in the case of natural resources or money in the bank) or by degrading them so that they are less able in the future to produce welfare-enhancing flows of goods and services. Capital consumption can also be a means of supporting consumption in the current period, but it is not "income" in the true sense because consumption cannot be supported indefinitely on the basis of capital consumption.

d) With the distinction between current income and capital consumption clearly laid out within the capital approach, governments will have at hand information that will reveal when current welfare is being supported by the drawing down of capital stocks rather by the income generated by the society. This information should put pressure on them to design policies that eliminate reliance on capital consumption to support current consumption. If they do not do so, the capital-based SD indicators will reveal that the society is not on a sustainable development path. This sort of information will be of particular value in natural resource-dependent countries, where resource management policies have a significant impact on the long-term development prospects for the nation. It will show how nations that reinvest the returns from depleting natural resource capital in other forms of productive capital will, in the long term, enjoy a higher standard of living (i.e., greater current welfare) than those that use these returns to finance current consumption. Nations that are less resource dependent will also benefit from information that reveals whether their overall capital portfolios are being sustainably managed or not.

4. The capital approach will encourage broader thinking about the concept of investment

a) Traditionally, governments and enterprises have thought of investment in terms of increasing their stocks of produced capital (buildings, machinery, etc.) and financial capital (stocks, bonds, etc.). More recently, the notion of investment has been extended to include investment in knowledge through research and development and investment in workers through education and training.

b) This traditional view of investment served nations well in the past, as it focused surplus resources (i.e., savings) into increasing stocks of capital that were the limiting factors on economic development. Increasingly though, this traditional focus is inadequate as other factors, notably the environment, emerge as limiting factors on development.

c) By extending the traditional view of capital to include natural capital, human capital (explicitly as opposed to on an ad hoc basis) and (in principle) social capital, the capital approach makes it clear that the notion of investment can no longer be restricted to its traditional domain. Governments must begin to think not only about investing surplus resources in the maintenance and expansion of the traditional forms of capital, but also about investing in increasingly scarce natural, human and social capital.

d) This new focus for investment has many implications for policy making. Environmental policy, for example, is no longer seen as necessary mainly to protect endangered species or to address issues of local environmental degradation, but as a means of strategically investing in the long-term welfare generating capacity of the society. So too for investments in human and social capital.

e) Understanding where the greatest return on investment can be had in natural, human and social capital will take time. But by providing a coherent and stable set of indicators that can be monitored by governments and citizens over time, the capital approach will facilitate the development of effective policies to achieve this goal of long-term sustainability.

5. **The capital approach will encourage policies that simultaneously attempt to maximize current welfare and to ensure that its basis in capital is maintained over the long term**

a) As noted above, governments have focused for most of the post-WW II period on ensuring growth of current welfare. It is becoming increasingly apparent, particular with respect to the environment, that this narrow focus has come at the expense of loss of important parts of the capital basis that supports development in the long term. If the success that has been achieved (in developed countries at least) in increasing overall living standards is to be maintained in the future, it is clear that governments must begin to pay attention simultaneously to ensuring current welfare and to ensuring the maintenance of its basis in capital.

b) By providing indicators that reflect the evolution of capital over time, the capital approach will provide an incentive for governments to begin this rebalancing of their policy portfolios.

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