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Part IV

Economic Measures of Capital Consumption

Chapter 9

Accounting Estimates and Economic Concepts

WE have defined capital consumption as the current value of the portion of durable goods that is used up in current production. In an effort to measure this quantity we have compiled the available accounting estimates that bear on it in business and have prepared analogous accounting estimates for other segments of the economic system. In order to understand these accounting estimates we have discussed in detail the character of the business accounts from which they are drawn and the accounting procedures underlying them.

The accountant's conceptions of cost constitute economic forces that affect the conduct of business. Accounts, and the limitations to which they are subject, influence the behavior of business men and the manner of their reaction to the fact of capital decline. The accounting concept and the accounting estimates of capital consumption are therefore essential objects of study in an analysis of business behavior. But neither is *ipso facto* the most adequate from the broad social point of view. In an economic evaluation of national income, savings, and wealth, both must be accepted merely as first approximations, subject to revision.

That accounting estimates are in fact merely raw materials for the construction of an economic measure of capital consumption becomes obvious when the variety of bases of the available accounts is considered. Thus, the recognition and recording of capital consumption by business men differ from one industry to another and from one period to another. In the estimation of capital consumption from the economic point of view these differences must be reconciled. It is a question whether the economist should not accept the particular method of evaluating capital consumption current in each business, even at the expense of consistency. At first sight the method seems to be current because it is the most suitable under the given conditions: who is a better judge of suitability than the entrepreneur, experienced through contact with the special conditions of the industry? The economist, however, would be avoiding the essential problem if he were to take this position. He would be assuming that the method of evaluation used during a particular period was selected because it was the one most suitable. Consequently, he would be ignoring the possibility that habits adapted to earlier conditions had persisted.

We must remember, also, the bias in the direction of 'conservatism' that is common to all periods and industries and is indicative of the skepticism of business men and accountants toward their own accounts. It makes understandable their penchant for the objectivity of original cost. Based upon the adherence to original cost (and less conservative) is a reluctance to admit certain types of capital consumption or to make capital adjustments. Whether credits to contingency reserves, or even business savings, represent rough forecasts of, and provision for, capital losses is not clear in business records. The ambiguity is itself one phase of the difficult problem of allocation in time. Of course an asset account is eventually credited for any decline in the value of the asset. But this eventual credit cannot be accepted without further consideration as an appropriate record of current capital consumption.

Finally, there is the occasional confusion of tangible and intangible assets. In the valuation (or perhaps more frequently the revaluation) of fixed assets there is sometimes a tendency to ascribe to them monopoly values that are ordinarily imputed to intangibles. Goodwill and other monopoly assets may be reflected on the books of business enterprises either explicitly as intangible assets or as written-up values of other assets, or they may be completely ignored. From the viewpoint of the individual the distinction between tangible and intangible assets is in some ways unnecessary and, because of the difficulties involved, is not always pressed.

These are some of the ambiguities and faults inherent in the business concepts and records of capital consumption. We should not, however, expect to find completely satisfactory concepts applied in business practice. Economists, as well as business men, have had difficulty in satisfactorily clarifying their ideas of capital and capital consumption, even within the limitations theorists may impose. The difficulties in constructing rigorous theoretical concepts of capital consumption are identical in nature and source with many of the difficulties that trouble accountants and statisticians in their attempts to describe the changing status of business enterprise. Changes in prices, technological progress, improvements in the quality of goods, the discovery and exhaustion of natural resources—these dynamic factors continually complicate the situation. Further, in dealing with concrete situations, 'non-economic' factors must be considered, factors that may be set aside in theoretical discussions. But although theoretical discussions have not yet led to precise concepts, they provide us with several valuable guides to the direction that may usefully be taken in modifying the business measures.

Two major characteristics of the records of capital consumption concern us in the following chapters. The first deals with the price at which capital consumption is evaluated. We wish to measure the current value of goods used up in production, not some other value such as original cost. Or we may wish to eliminate price changes entirely in order to get as close as possible to 'real' values. The second is the time distribution of capital consumption. We wish to measure the value of goods used up in current production, not the amount that is arbitrarily allocated to a given fiscal period, as is done on a straight line basis.[1]

Other modifications of the accounting figures are theoretically desirable. The element of interest, for example, might be treated differently from the way it commonly is in accounting practice. But these modifications are, on the basis of the available data, extremely difficult to make, and in fact are less important.

[1] Logically the problem of time allocation should be treated before that of price changes. However, modifications of the available figures, or if these are not possible, a summary of the assumptions involved in using the data, are made more readily if the order is reversed.