MR. SUNGA'S TREATMENT: A FLY IN THE OINTMENT

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In his thought-provoking article[1] ,Mr. Sunga proposes to treat interest and rent as payments for services of intermediate products rather than as returns to factors of production. This is by no means the first attempt to exorcise interest from the national income; Mr. O. C. Stine has suggested that interest payments be treated as transfer payments.[2] There is no doubt that the presence of interest and rents in our national accounting system creates messy problems, and that many arbitrary assumptions are required to measure it; still, we wonder whether these problems warrant a solution as drastic as the elimination of these two groups of factor rewards. In this note we examine the problem which arises when interest is measured in financial industries (we will concentrate on banking), and we comment on Mr. Sunga's solution.

I

Property income originating[3] in each industry is measured as dividends paid less dividends received, interest paid less interest received, net rents (paid and imputed), and retained earnings. This formula appears to give strange results when applied to some financial industries (e.g. banking) where a negative result appears for net interest paid out.[4] This can be readily explained by resorting to the industry balance sheet[6] (see figure I).

An industry's assets include property which is considered part of the National Wealth (real estate, machinery, etc.) and Financial Assets.[6] On the credit side of the Balance Sheet we have Liabilities and Net Worth.

Property income originating in an industry is a return to that portion of the National Wealth found in the industry (Balance Sheet item 1). Now if there were no intercorporate holdings of wealth (that is, Balance Sheet item 2 were zero) then all *gross* factor property payments for each industry would equal returns to that portion of the national wealth originating in the industry; we would not have any interest or dividend receipts to deduct, since there were no intercorporate dividend or interest payments. When intercorporate holdings of financial assets exist we must deduct corporate interest and dividend receipts from payments to obtain property income from that portion of the national wealth found in the industry (since corporate income and dividend receipts have originated in some other company). In banking the return on financial assets is greater than the interest paid out on the industry's liabilities, which are mainly deposits (Balance Sheet item 3);[7] hence net interest may be negative (more interest is received than paid out).[8]

Now if we assume deposit funds are used by the banks to purchase financial assets (and not physical assets) then the interest paid to depositors is a partial return on their (the depositors') investments in these financial assets, assumed to be made through the banks. These interest payments (on deposits), therefore, are not a part of the national income originating in banking; these deposit interest payments actually originate in industries which pay the returns (interest and dividends) on the financial liabilities of theirs (which the banks hold) to the banks. That

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[1]P. Sunga. "The Treatment of Interest and Net Rents in the National Accounts Framework", *The Review of Income and Wealth* (March 1967).

[2]O. C. Stine, "Comment", *Studies in Income and Wealth,* vol. X, p. 64–65.

[3]See below for the meaning of "originating".

[4]Actually total net property income will be negative.

[5]See Morris Copeland, "Some Problems in the Theory of National Income", *Journal of Political Economy* (Feb. 1932).

[6]For simplicity we assume all financial assets are claims on other businesses.

[7]See Joan Robinson, "The Rate of Interest", Econometrica (April 1951), 97.

[8]Interest received will include dividend receipts for our purposes.

portion of the national property income originating in banking is a return for the services which arise from the property (physical assets) employed in banking; it has been measured in various ways,[9] but the essential point for our purposes is that we must separate income originating from indirect equities from income originating from factors of production within banking.

II

The nation's productive property wealth is divided up by industries. If we want to measure the contribution to national output of each industry we want the contributions of the property employed in the industry, as well as that of the labour employed in the industry, to total output. The returns to these factors are equal to their contributions to output—and we mean marketable (or marketed) output. Hence there is no sense in Mr. Sunga's assertion that "a firm or industry can have excellent technological relationships and high productivity ... but it can still go bankrupt because it cannot meet its interest charges."[10] All this says is that a firm is technologically efficient, but it is not economically efficient. If the firm is producing where the price of the factor equals the value of its marginal product, then it will meet these interest charges; if the firm cannot meet its costs, it is producing the wrong product.

Mr. Sunga's whole argument misses one (rather essential) point; this is dramatically illustrated in his parting shot, describing the essential difference between interest and dividends: "interest is the cost of obtaining money from someone else and has to be met, whereas dividends are a distribution of a residual return to one's own capital. Interest *has* to be met if a firm wishes to survive; dividend disbursements are a (discretionary) measure."

As shown below property income is a return to property employed in the industry. Property employed in any industry has alternative uses and for the owner of this property a return must be made. It must be measured too, we daresay.

Assets.

1. National Wealth in the Industry (Physical Assets).

2. Financial Assets (Loans to; and investments in bonds and stocks of, other businesses), and money.

Liabilities, etc.

3. Liabilities.

4. Proprietorship Equity (Net Worth).

Figure 1. Industry Balance Sheet

[9]Mr. Copeland attributes that part of the ownership of financial assets not related to depositor's funds to holders of banking stock. Thus only a portion of Proprietorship Equity in Banking is actually equity in the national wealth in banking. And so only a portion of proprietorship equity income, equal to the ratio of

$$\frac{\text{National Wealth in Banking,}}{\text{Proprietorship Equity}}$$

will actually be assigned to income originating in banking; the rest is assumed to originate elsewhere. To use an illustration, referring to our balance sheet (figure 1). Assume the National Wealth in Banking (Balance Sheet item 1) is \$50; Financial Assets (item 2) is \$450; Deposits (item 3) are \$400; and Net Worth (item 4) is \$100. Income on financial assets is \$31.50 (a 7 per cent return); deposit interest (5 per cent) is \$20; and Wages are \$5. Then proprietorship income is $\$(31.50-(20+5)) = \$6.50$. Proprietorship equity in the national wealth in banking is 50/100; and the amount of equity income assigned to financial assets is $(50/100)\times\$6.50 = \$3.25$. The rest originates in banking. Mr. Yntema's method gives different results. Deposit holders of banks are credited with imputed interest receipts equal to interest and dividends received by banks less deposit interest actually paid. This amount would equal \$11.50

($31.50—$20) in our example. Income originating in banking then equals imputed and actual interest paid, profits, and wages less interest and dividends received (= $43.00–$31.50) = $11.50. This amount, it is seen, just equals wages and profits: all proprietorship equity income in Mr. Yntema's scheme, is a return to the National Wealth in Banking. Dwight Yntema, "National Income Originating in Financial Intermediaries", *Studies in Income and Wealth*, v.x, 25.

[10]Sunga, op.cit., 33.4.

[11]*ibid.*, 34.