Productivity Measurement with Natural Capital

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by

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ABSTRACT

Traditional measures of multi-factor productivity (MFP) growth generally do not recognise natural capital as inputs into the production process. Since productivity growth is measured as the residual between output and input growth, it will pick up the growth in unmeasured inputs, which can lead to a bias. The purpose of this paper is to gain a better understanding of the role of natural capital for productivity measurement and as a source of economic growth. To this aim, the production function is extended to incorporate the use of natural capital as an input factor in addition to labour and produced capital, such as machines, infrastructure and buildings. More specifically, this paper considers oil and gas, various minerals and roundwood as natural capital inputs, drawing on data from the World Bank. Results suggest that failing to account for natural capital tends to lead to an underestimation of productivity growth in countries where the use of natural capital in production is declining because of a dwindling natural capital stock. In return, productivity growth is sometimes overestimated in times of natural resource booms, if natural capital is not taken into account as an input factor. The direction of the adjustment to productivity growth depends on the rate of change of natural capital extraction relative to the rate of change of other inputs. The extended framework also makes the contribution of natural capital to economic growth explicit, and provides useful information regarding needs to tap into other sources of growth, once natural capital endowments start to decline.

1. Nicola Brandt and Vera Zipperer are members of the Economics Department of the OECD. Paul Schreyer is a member of the Statistics Directorate of the OECD. The authors owe thanks to Francisco M. Guillen from the Instituto Nacional de Estadistica y Geografia of Mexico for providing data on produced capital stocks for Mexico and Ilya B. Voskoboynikov for providing productivity data for Russia. The opinions expressed herein are those of the authors and do not necessarily reflect the opinions of the OECD. This research has been possible thanks to generous financial support from the Norwegian Government.
Introduction

1. Common measures of economic performance do not fully account for the role of the environment in production. While income generated through the depletion of natural capital, such as minerals, fossil fuels and timber, is captured in the value of Gross Domestic Product (GDP) and in profits, the role of natural capital as an input factor is generally ignored in traditional Multi-Factor Productivity (MFP) growth measures. The typical production function used in productivity analysis includes labour and produced capital as input factors, but not natural capital, although the extraction of subsoil assets contributes a large share to GDP in some countries.

2. Recognising natural capital as an input may give rise to new measures of productivity growth and may change the assessment of sources of economic growth. In addition, an explicit analysis of the role of natural capital in production is an important element to better understand the sustainability of economic development. Depleting natural capital often leads to higher economic growth in the short term, but this can only be sustained if a sufficient part of the associated revenues is used to build other assets, such as human or physical capital, to secure the economy’s ability to generate income in the long run. To assess this ability it is important to measure the development of natural capital, such as fossil fuels, minerals and forests, along with produced capital such as infrastructure, machines and buildings, along with factors like the education and skills of the workforce (human capital) as well as the quality of institutions. Measuring the growth contribution of natural capital provides a clearer idea about the extent to which the growth contribution of other production factors or productivity growth would have to increase to maintain similar levels of output growth when the natural capital stock declines and hence also the possibility to use it in production.

3. This paper is organised as follows. The first section spells out a production framework that integrates the use of natural capital in productivity measurement, and describes the data. Section 2 presents empirical results. Section 3 draws conclusions and suggests possibilities to extend this research.

A framework including the use of natural capital in productivity growth measurement

4. Productivity growth is typically measured as the difference between output growth and the growth in factor inputs. Traditional measurement of MFP within the Solow residual framework is based on a production function that combines inputs from labour, L, and produced (as opposed to natural, non-produced) capital, K, to generate output. Typically, when measuring productivity for the aggregate economy, the output measure is real GDP, denoted by Y in what follows. The production process is thus described by $Y = f(K, L, t)$, where $t$ is an index of time. Productivity growth is defined as the shift of the production function over time, allowing producers to obtain more output with the same amount of inputs. Productivity growth is equivalent to the difference between output and aggregate input growth. Weights for the growth of labour and produced capital correspond to their respective cost shares if producers maximize profits (or minimize costs) (see Appendix 1). Cost shares are equivalent to value added shares under perfect competition and constant returns to scale (for an overview see e.g. OECD, 2001; Diewert and Nakamura, 2007; Jorgenson, 1995):

$$\frac{d\ln MFP}{dt} \equiv \frac{\partial \ln f}{\partial t} - \left( \frac{\partial \ln Y}{\partial t} + \frac{\partial u_K}{\partial t} \right)$$

(1)

where $\frac{d\ln X}{dt}$ denotes the logarithmic rate of change of variable X with respect to time, which is almost identical to its growth rate, $w$ is the wage rate and $u_K$ the user cost of produced capital. Total resource costs are defined by $\frac{\partial \ln X}{\partial t} \equiv wL + u_KK$. In what follows, the shorthand $\frac{d\ln Z}{dt}$ will be used to capture the combined rate of growth of inputs:

$$\frac{d\ln Z}{dt} \equiv \left( \frac{\partial \ln L}{\partial t} + \frac{\partial u_K}{\partial t} \right)$$
5. Including natural capital into this framework requires an adjustment of the aggregate input measure. The input index is extended to include natural capital. The flow of natural capital inputs, such as minerals, oil, gas, coal and timber, will be denoted by $S$, the vector of quantities of natural capital inputs, $S=(S_1,...,S_i,...,S_9)$, that are used in production. Through the inclusion of $S$, the role of natural capital is explicitly taken into account. As in the traditional framework, productivity growth can be measured as the difference of the growth rates of output and aggregate inputs. However, the set of inputs will now be augmented by the natural capital input $S$. It should be noted that natural capital input is measured differently from produced capital input. While it is relatively easy to measure the flow of natural capital services as the volume of natural capital extraction, the services of produced capital, such as machines and buildings, are more difficult to observe and their service flow is assumed to be proportional to the produced capital stock. Proportionality implies that the rate of change of capital services equals the rate of change of the capital stock. Capital services thus enter the productivity calculations as the rate of change of the stock of different asset classes weighted by their user cost shares (OECD, 2009), which add up to the rate of change of the aggregate capital services measure, $K$. Natural capital, in contrast, enters the productivity calculations directly as a flow measure.

6. To build an aggregate input growth measure, a price for natural capital inputs is needed. The (private) user costs for using natural capital is denoted by $u_{S_i}$, which may be explicit, such as license fees for exploiting a mine or using a stream to run a hydropower station, or implicit if the producer is an owner-user of a natural capital stock. In that case, $u_{S_i}$ would be the private shadow price of using natural capital in production, or the reduction in the value of the natural capital stock that results from extracting one (further) unit of it. Appendix 2 discusses the conditions under which $u_{S_i}$ is equivalent to the unit rent of natural capital input. $S$ should be thought of as an aggregate of different types of natural capital inputs $S_i$ (i=1,2,...) with user costs $u_{S_i}$. The total value of natural capital input is then $u_{S} = \sum_i u_{S_i} S_i$ and the growth rate of the volume of natural capital input is $\frac{dlnS}{dt} = \sum_i \frac{u_{S_i} S_i}{u_S} \frac{dlnS_i}{dt}$. Total input costs, $\gamma$, including natural capital, are defined by $\gamma \equiv wL + u_k K + \sum_i u_{S_i} S_i$. The productivity growth measure then becomes (see Appendix 1 for a derivation):

$$\frac{dlnGMFP}{dt} = \frac{dlnY}{dt} - \left( \frac{dlnL}{\gamma} \frac{dlnL}{dt} + \frac{dlnK}{\gamma} \frac{dlnK}{dt} + \sum_i \frac{u_{S_i} S_i}{\gamma} \frac{dlnS_i}{dt} \right)$$

(2)

7. Whenever it is available MFP data is taken from the OECD Productivity Database, where the user cost of capital is derived 'exogenously' from estimates of its elements, namely the long-run rate of return, the depreciation rate and the price of investment goods (OECD, 2009). This user cost estimate multiplied by the capital stock, corresponds to the cost of capital services, which, together with labour costs, make up total costs $\gamma' \equiv wL + u_k K$ in the traditional framework. In the extended framework with natural capital, costs are considered to be larger, including also the costs of services from natural capital, $\gamma \equiv wL + u_k K + \sum_i u_{S_i} S_i$. The cost shares of both labour and capital will have to be scaled down to reflect the increase in total costs, when the traditional measure is adjusted to include natural capital. The difference between the growth in $S$ and growth in the traditional input index, $Z$, comprising labour and capital, determines whether traditional MFP growth has to be adjusted upwards or downwards, as shown in Appendix 1. As there is no need to make any assumption regarding returns to scale or the degree of competitiveness of output markets to derive the MFP growth measure presented in the OECD Productivity Database, total costs $\gamma'$ do not necessarily equal the value of GDP in this framework. Typically costs $\gamma'$ are smaller than nominal GDP. One interpretation, which suits the extended framework with natural capital, would be that there are unmeasured inputs, such as the natural capital stock. The fact that the estimate of the user cost of natural capital is in most cases smaller than or equal to the difference between $\gamma'$ and GDP in the OECD Productivity Database fits this idea nicely.
8. A simplified method is used to measure the user costs of produced capital for countries for which no data are available in the OECD Productivity Database. Namely, the cost share of produced capital is measured as the difference between nominal GDP and labour costs. Thus, MFP measurement relies on the assumptions of constant returns to scale and perfect competition in these cases, which implies zero residual profits. Hence, total costs are considered to equal GDP and the weights of inputs are measured as their income shares in GDP. Assigning all non-labour income to produced capital, obviously does not allow for unmeasured outputs and when they are present, their income would be included in the estimate of the cost (or income) of produced capital. In this case, total costs are not underestimated, but the share of produced capital in these costs is overestimated. Hence, in this case only the cost share of capital needs to be adjusted downwards. The difference between the growth of produced and natural capital determines how productivity growth will have to be adjusted (Appendix 1 and 3).

\[ \frac{d\ln\text{GMFP}}{dt} = \frac{d\ln\text{MFP}}{dt} + \frac{uS}{\gamma} \left( \frac{d\ln Z}{dt} - \frac{d\ln S}{dt} \right) \]  

**GMFP growth for countries where user cost of capital is calculated endogenously:**

\[ \frac{d\ln\text{GMFP}}{dt} = \frac{d\ln\text{MFP}}{dt} + \frac{uS}{\gamma} \left( \frac{d\ln K}{dt} - \frac{d\ln S}{dt} \right) \]  

9. These equations show in which ways standard measures of MFP growth can be biased when natural capital inputs are not considered. Essentially, when disregarding natural capital as an input factor, input growth is underestimated by the traditional MFP growth measure whenever the natural capital input, \( S \), grows faster than traditional inputs (in the case of exogenous measurement of the costs of capital) or produced capital (in the case of endogenous measurement of the costs of capital). As a result, productivity growth is overestimated, given that productivity growth is the difference between output and input growth. Conversely, if the use of natural capital in production grows more slowly than the combined growth of labour and capital inputs, aggregate input growth is overestimated and productivity growth is therefore underestimated. The adjustment is more pronounced, the larger the cost share of natural capital, as this will increase the weight of natural capital in the aggregate input index.

**The data**

10. The analysis is conducted with aggregate economy data for a sample of OECD and a few emerging countries. This study covers 23 OECD countries, Russia and South Africa, (Table 1). Where data are available, we use the OECD Productivity Database to retrieve MFP growth and costs estimates, as well as input and output data. As mentioned above, the user cost of capital is estimated directly in this database. National data sources are used for a range of countries, for which no data are available in the Productivity Database, i.e. for Chile, Mexico, Russia and South Africa. Russian estimates are taken from Voskoboynikov (2012). The estimates for Chile, Mexico and South Africa are OECD calculations based on national data. The timeframe of the analysis is 1985 – 2008 for some countries, shorter for countries where consistent data were not available over the whole period. Table 1 describes the dataset in more detail.

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1 For a detailed description of the Productivity Database and methodology see OECD (2001) and the corresponding website (http://www.oecd.org/std/productivitystatistics).
Table 1. Dataset summary table

<table>
<thead>
<tr>
<th>Variable</th>
<th>Source</th>
<th>Countries covered</th>
<th>Time period covered</th>
</tr>
</thead>
<tbody>
<tr>
<td>MFP, GDP, labour, produced capital, wage share and user costs of capital</td>
<td>OECD Productivity database</td>
<td>AUS, AUT, BEL, CAN, CHE, DEU, DNK, ESP, FIN, FRA, GBR, IRL, ITA, JPN, KOR, NLD, NOR, NZL, PRT, SWE, USA</td>
<td>1985 – 2008</td>
</tr>
<tr>
<td>MFP, GDP, labour, produced capital, wage share</td>
<td>National Source</td>
<td>CHL, MEX, RUS, ZAF</td>
<td>1991 – 2008</td>
</tr>
<tr>
<td>Natural capital data</td>
<td>World Bank</td>
<td>AUS, AUT, BEL, CAN, CHE, CHL, DEU, DNK, ESP, FIN, FRA, GBR, IRL, ITA, JPN, KOR, MEX, NLD, NOR, NZL, PRT, SWE, USA, RUS, ZAF</td>
<td>1985 – 2008</td>
</tr>
<tr>
<td>Natural capital rent</td>
<td>World Bank</td>
<td>AUS, AUT, BEL, CAN, CHE, CHL, DEU, DNK, ESP, FIN, FRA, GBR, IRL, ITA, JPN, KOR, MEX, NLD, NOR, NZL, PRT, SWE, USA, RUS, ZAF</td>
<td>1985 – 2008</td>
</tr>
</tbody>
</table>

1) Productivity data are calculated on the basis of a dataset kindly provided by the Instituto Nacional de Estadística y Geografía from Mexico.

2) Productivity data for Russia (1995 – 2009) were generously provided by Ilya B. Voskoboynikov. For more details on the dataset see the corresponding paper (Voskoboynikov, 2012).

11. The coverage of natural capital in this analysis is constrained by data limitations. Even though the World Bank’s wealth dataset provides an important milestone for the creation of an international database on the production and use of natural capital, it is mainly focused on sub-soil assets. Specifically, the sub-soil assets covered in the dataset as well as in this analysis are oil, gas, bauxite, copper, lead, nickel, phosphate, tin, zinc, gold silver, iron ore, soft and hard coal. In addition, timber is included. However, other types of natural capital which also contribute to the production process, such as water, soil, or renewable resources such as fish stocks, are not included in this analysis because data are not readily available.

12. Natural capital inputs are valued with their unit rent, which is the market price net of extraction costs. It can be shown that under the assumption of inter-temporarily optimal depletion of natural capital, the user cost of a natural capital, i.e. the change in its value after depletion of one unit, equals its marginal resource rent, that is the market price net of marginal extraction cost (Appendix 2). In this paper these user costs are approximated with measures of unit rents provided by the World Bank. However, while marginal extraction costs would be the relevant measure for unit rents, these are not readily available. The World Bank therefore approximates marginal with average extraction costs and this approach is followed in this paper for lack of better data.

Results

13. The adjustment of the traditional productivity growth measure depends on natural capital input growth relative to other input factors. This can be seen in Table 2 and 3, where a noticeable adjustment to the traditional MFP growth measure can be observed for countries with significant natural capital endowments, such as Norway, Russia, Chile, Mexico, Australia, Canada, South Africa and, to a lesser extent, the United Kingdom, the Netherlands, Denmark and Finland. In Australia, Denmark, Norway and New Zealand the adjustment to the traditional MFP growth measure is negative, as natural capital grew faster on average over the sample period, than the traditional input index, combining labour and produced capital input growth only. In Australia, this was due to a strong generalised increase in minerals production, in Denmark and Norway to oil production and in New Zealand mainly to roundwood, oil and gas production. By failing to account for a very fast-growing input factor, the traditional MFP growth measure overestimates productivity growth in these countries. Contrary to what one might be tempted to think, though, it is not necessarily the case that the traditional MFP growth measure underestimates
productivity growth in countries with resource booms. In fact, Table 2 and 3 show an upward adjustment of the productivity growth measure in Canada, Chile, Mexico, Russia and South Africa, all of which experienced a resource boom over recent years. This is because during resource booms not only natural capital grows very fast, but other factor inputs do as well. In particular, there is often an investment boom associated with resource booms, originating in the resource sector, but often spilling over to other parts of the economy. So even if natural capital inputs grow very fast during resource booms, other inputs may grow even faster. In that case, the productivity growth measure is adjusted upwards, once natural capital is taken into account.

<table>
<thead>
<tr>
<th>Country</th>
<th>Traditional MFP growth in %</th>
<th>MFP growth with natural capital in %</th>
<th>Difference in percentage points</th>
<th>Traditional inputs growth in %</th>
<th>Natural capital growth in %</th>
<th>Share of resource rent in total cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>AUS</td>
<td>0.92</td>
<td>0.88</td>
<td>-0.05</td>
<td>2.41</td>
<td>4.04</td>
<td>4.57</td>
</tr>
<tr>
<td>AUT</td>
<td>1.43</td>
<td>1.43</td>
<td>0.00</td>
<td>1.14</td>
<td>1.24</td>
<td>0.42</td>
</tr>
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<td>BEL</td>
<td>1.32</td>
<td>1.32</td>
<td>0.00</td>
<td>0.99</td>
<td>-30.76</td>
<td>0.02</td>
</tr>
<tr>
<td>CAN</td>
<td><strong>0.38</strong></td>
<td><strong>0.45</strong></td>
<td><strong>0.07</strong></td>
<td><strong>2.26</strong></td>
<td><strong>1.20</strong></td>
<td><strong>5.50</strong></td>
</tr>
<tr>
<td>CHE</td>
<td>0.06</td>
<td>0.06</td>
<td>0.00</td>
<td>1.42</td>
<td>-1.21</td>
<td>0.06</td>
</tr>
<tr>
<td>DEU</td>
<td>1.10</td>
<td>1.10</td>
<td>0.00</td>
<td>0.38</td>
<td>0.34</td>
<td>0.27</td>
</tr>
<tr>
<td>DNK</td>
<td><strong>0.75</strong></td>
<td><strong>0.72</strong></td>
<td><strong>-0.03</strong></td>
<td><strong>1.27</strong></td>
<td><strong>7.38</strong></td>
<td><strong>2.30</strong></td>
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<tr>
<td>ESP</td>
<td>0.35</td>
<td>0.36</td>
<td>0.01</td>
<td>2.87</td>
<td>-3.06</td>
<td>0.13</td>
</tr>
<tr>
<td>FIN</td>
<td>2.07</td>
<td>2.06</td>
<td>-0.01</td>
<td>0.54</td>
<td>1.33</td>
<td>1.65</td>
</tr>
<tr>
<td>FRA</td>
<td>1.06</td>
<td>1.06</td>
<td>0.00</td>
<td>1.03</td>
<td>-0.67</td>
<td>0.16</td>
</tr>
<tr>
<td>GBR</td>
<td><strong>1.26</strong></td>
<td><strong>1.33</strong></td>
<td><strong>0.08</strong></td>
<td><strong>1.43</strong></td>
<td><strong>-1.17</strong></td>
<td><strong>2.12</strong></td>
</tr>
<tr>
<td>IRL</td>
<td>2.84</td>
<td>2.86</td>
<td>0.02</td>
<td>2.40</td>
<td>-3.57</td>
<td>0.45</td>
</tr>
<tr>
<td>ITA</td>
<td>0.45</td>
<td>0.45</td>
<td>0.00</td>
<td>1.20</td>
<td>0.10</td>
<td>0.23</td>
</tr>
<tr>
<td>JPN</td>
<td>1.46</td>
<td>1.46</td>
<td>0.00</td>
<td>0.53</td>
<td>-1.69</td>
<td>0.05</td>
</tr>
<tr>
<td>KOR</td>
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<td>3.93</td>
<td>0.00</td>
<td>2.47</td>
<td>-2.85</td>
<td>0.07</td>
</tr>
<tr>
<td>NLD</td>
<td><strong>0.95</strong></td>
<td><strong>1.00</strong></td>
<td><strong>0.05</strong></td>
<td><strong>1.85</strong></td>
<td><strong>-0.68</strong></td>
<td><strong>1.84</strong></td>
</tr>
<tr>
<td>NOR</td>
<td><strong>1.18</strong></td>
<td><strong>1.02</strong></td>
<td><strong>-0.16</strong></td>
<td><strong>1.46</strong></td>
<td><strong>4.82</strong></td>
<td><strong>16.97</strong></td>
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<td>NZL</td>
<td><strong>0.68</strong></td>
<td><strong>0.65</strong></td>
<td><strong>-0.03</strong></td>
<td><strong>1.78</strong></td>
<td><strong>2.99</strong></td>
<td><strong>2.51</strong></td>
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<td>PRT</td>
<td>1.29</td>
<td>1.29</td>
<td>0.00</td>
<td>1.17</td>
<td>1.07</td>
<td>0.21</td>
</tr>
<tr>
<td>SWE</td>
<td>1.03</td>
<td>1.04</td>
<td>0.00</td>
<td>1.26</td>
<td>1.74</td>
<td>1.25</td>
</tr>
<tr>
<td>USA</td>
<td><strong>1.03</strong></td>
<td><strong>1.06</strong></td>
<td><strong>0.03</strong></td>
<td><strong>1.84</strong></td>
<td><strong>-0.74</strong></td>
<td><strong>1.41</strong></td>
</tr>
</tbody>
</table>

1. The adjustment of the productivity growth measure is very likely negative, once natural capital endowments start to decline. Some countries, notably the United Kingdom, the United States and the Netherlands, experienced a decline in natural capital inputs over the sample period. This is because oil and gas reserves were dwindling already over the largest part of period considered here. Productivity growth in these countries was stronger than the traditional MFP growth measure would suggest, because the failure to account for declining natural capital inputs leads to an overestimation of aggregate factor input growth, which is equivalent to an underestimation of productivity growth. Since labour and capital generally tend

2. Note that productivity growth measures in Tables 2 and 3 are not comparable, because of differences in the measurement of produced capital stock/capital services (see OECD, 2009, for details)
to grow, save in very severe recessions, the adjustment will be negative when natural capital input growth is negative.

Table 3. Average productivity growth per year, with and without natural capital

Based on national data, 1985 – 2008

<table>
<thead>
<tr>
<th>Country</th>
<th>Traditional MFP growth in %</th>
<th>MFP growth with natural capital in %</th>
<th>Difference in percentage points</th>
<th>Capital stock growth in %</th>
<th>Natural capital growth in %</th>
<th>Share of resource rent in GDP in %</th>
</tr>
</thead>
<tbody>
<tr>
<td>CHL</td>
<td>0.54</td>
<td>0.73</td>
<td>0.19</td>
<td>5.85</td>
<td>4.46</td>
<td>7.03</td>
</tr>
<tr>
<td>MEX</td>
<td>0.97</td>
<td>1.10</td>
<td>0.12</td>
<td>2.81</td>
<td>0.80</td>
<td>3.84</td>
</tr>
<tr>
<td>RUS</td>
<td>2.21</td>
<td>2.49</td>
<td>0.28</td>
<td>3.16</td>
<td>2.18</td>
<td>13.58</td>
</tr>
<tr>
<td>ZAF</td>
<td>1.62</td>
<td>1.70</td>
<td>0.07</td>
<td>2.01</td>
<td>0.45</td>
<td>2.75</td>
</tr>
</tbody>
</table>

1. The adjustment of the traditional MFP growth estimate may change over time, in particular when periods of resource scarcity follow resource abundance. This is the case for Norway (Figure 1). In the years up until 2000 when oil reserves were still relatively plentiful and the rate of extraction was fast, the use of natural capital grew faster than aggregate capital and labour inputs. As a result, the traditional MFP growth measure underestimate input growth in those years and productivity growth is overestimated. After 2000, however, as oil reserves in Norway became scarcer, the rate of oil extraction actually declined. Aggregate input growth is therefore overestimated if only labour and the capital stock are considered. As a result, the traditional MFP growth measure underestimates productivity growth.

Figure 1. Difference between MFP growth adjusted for natural capital inputs and traditional MFP growth

15. The size of the correction has sharply increased over the most recent years of the sample period in many countries, owing to a strong and generalised increase in commodity prices. This is the case regardless of whether productivity growth is corrected upwards or downwards. Given that the data series for Russia and South Africa starts only in 1995, and is thus shorter than for the rest of the countries, the strong weight of the correction term in the last years of the sample period also magnifies the average correction of productivity growth in these two countries compared to others. In fact, the correction is slightly negative on average between 1996 and 2004 in both Russia and South Africa, but much smaller than the positive correction after that (Figure 2). Another example is Norway (Figure 1). The sharp rise in oil and gas prices led to an increase in the share of natural capital rents in costs, thus magnifying the upward-correction of the traditional productivity growth estimate through the second term in equation (3).
In New Zealand, the average correction is close to zero up until 2006. The negative correction over the whole sample period is driven by strong spikes of roundwood, oil and gas production in the last two years of the sample period, which are more strongly weighted than natural capital input developments in prior periods, owing to rising commodity prices (Figure 3).

**Figure 2.** Difference in traditional MFP growth and MFP growth adjusted for natural capital use

**Figure 3.** Difference between traditional MFP growth with and without natural capital

17. Overall the growth contribution of natural capital is relatively small, compared to other production factors. Even in resource-rich countries, the share of natural capital income in overall production costs is hardly higher than 5% (Table 2 and 3). As a consequence, the growth contribution of natural capital rarely attains a quarter of a percentage point. There are only a handful of countries where the growth contribution of natural capital is significant, including Australia, Canada, Chile, Norway, and Russia. In all cases, though, it is much smaller than the contribution of labour and produced capital. Small though it may be, it is still useful to have a clear picture of the growth contribution of natural capital. In this context, it is also important to note that subsoil assets and timber capture a small part of countries’ natural capital stock, leaving out many other aspects, such as land, water and renewable resources, such as fish stock. Another aspect is that this paper looks at user costs of natural capital from the producer perspective. The social costs of natural capital inputs may be much higher in some cases. One example would be forests, which offer valuable services, such as the absorption of CO₂, providing habitat to many species and ingredients for many medications. Finally, results in table 4 show the growth contribution of natural capital only from an accounting perspective. While that can give some interesting insights, the
overall impact of resource booms and busts on economic growth is often larger through their effects on investment and the reaction of productivity growth.

Table 4. Growth accounting results incorporating the natural capital stock

<table>
<thead>
<tr>
<th>Country</th>
<th>MFP growth adjusted (natural capital) in %</th>
<th>GDP growth in %</th>
<th>Growth contribution of labour input in %</th>
<th>Growth contribution of capital input in %</th>
<th>Growth contribution of natural capital in %</th>
<th>Natural capital income share</th>
</tr>
</thead>
<tbody>
<tr>
<td>AUS</td>
<td>1.04</td>
<td>3.42</td>
<td>1.19</td>
<td>1.03</td>
<td>0.16</td>
<td>4.55</td>
</tr>
<tr>
<td>AUT</td>
<td>1.43</td>
<td>2.60</td>
<td>0.57</td>
<td>0.56</td>
<td>0.01</td>
<td>0.41</td>
</tr>
<tr>
<td>BEL</td>
<td>1.21</td>
<td>2.01</td>
<td>0.13</td>
<td>0.69</td>
<td>0.00</td>
<td>0.02</td>
</tr>
<tr>
<td>CAN</td>
<td>0.64</td>
<td>2.61</td>
<td>0.90</td>
<td>0.97</td>
<td>0.08</td>
<td>5.61</td>
</tr>
<tr>
<td>CHE</td>
<td>0.06</td>
<td>1.46</td>
<td>0.60</td>
<td>0.82</td>
<td>0.00</td>
<td>0.06</td>
</tr>
<tr>
<td>CHL</td>
<td>0.89</td>
<td>4.09</td>
<td>0.73</td>
<td>2.27</td>
<td>0.19</td>
<td>4.90</td>
</tr>
<tr>
<td>DEU</td>
<td>1.10</td>
<td>1.48</td>
<td>-0.21</td>
<td>0.58</td>
<td>0.00</td>
<td>0.25</td>
</tr>
<tr>
<td>DNK</td>
<td>0.72</td>
<td>2.16</td>
<td>0.47</td>
<td>0.95</td>
<td>0.05</td>
<td>2.58</td>
</tr>
<tr>
<td>ESP</td>
<td>0.25</td>
<td>2.89</td>
<td>1.42</td>
<td>1.23</td>
<td>0.00</td>
<td>0.10</td>
</tr>
<tr>
<td>FIN</td>
<td>1.97</td>
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<td>-0.02</td>
<td>0.45</td>
<td>0.02</td>
<td>1.61</td>
</tr>
<tr>
<td>FRA</td>
<td>0.90</td>
<td>1.77</td>
<td>0.18</td>
<td>0.70</td>
<td>0.00</td>
<td>0.15</td>
</tr>
<tr>
<td>GBR</td>
<td>1.42</td>
<td>2.50</td>
<td>0.17</td>
<td>0.97</td>
<td>-0.03</td>
<td>2.13</td>
</tr>
<tr>
<td>IRL</td>
<td>2.74</td>
<td>5.43</td>
<td>1.71</td>
<td>0.97</td>
<td>-0.01</td>
<td>0.38</td>
</tr>
<tr>
<td>ITA</td>
<td>0.19</td>
<td>1.25</td>
<td>0.31</td>
<td>0.75</td>
<td>0.00</td>
<td>0.23</td>
</tr>
<tr>
<td>JPN</td>
<td>0.96</td>
<td>1.19</td>
<td>-0.56</td>
<td>0.78</td>
<td>0.00</td>
<td>0.05</td>
</tr>
<tr>
<td>KOR</td>
<td>3.44</td>
<td>5.60</td>
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<td>1.65</td>
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<td>0.04</td>
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<tr>
<td>MEX</td>
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<td>1.54</td>
<td>-0.01</td>
<td>3.66</td>
</tr>
<tr>
<td>NLD</td>
<td>0.94</td>
<td>2.63</td>
<td>0.91</td>
<td>0.80</td>
<td>0.00</td>
<td>1.86</td>
</tr>
<tr>
<td>NOR</td>
<td>1.29</td>
<td>2.91</td>
<td>0.50</td>
<td>0.86</td>
<td>0.26</td>
<td>18.38</td>
</tr>
<tr>
<td>NZL</td>
<td>0.61</td>
<td>2.89</td>
<td>1.34</td>
<td>0.87</td>
<td>0.07</td>
<td>2.65</td>
</tr>
<tr>
<td>PRT</td>
<td>1.29</td>
<td>2.47</td>
<td>0.31</td>
<td>0.86</td>
<td>0.00</td>
<td>0.21</td>
</tr>
<tr>
<td>RUS</td>
<td>2.49</td>
<td>4.53</td>
<td>0.66</td>
<td>0.85</td>
<td>0.28</td>
<td>13.02</td>
</tr>
<tr>
<td>SWE</td>
<td>1.23</td>
<td>2.28</td>
<td>0.11</td>
<td>0.88</td>
<td>0.02</td>
<td>1.19</td>
</tr>
<tr>
<td>USA</td>
<td>1.15</td>
<td>2.75</td>
<td>0.77</td>
<td>0.87</td>
<td>-0.01</td>
<td>1.39</td>
</tr>
<tr>
<td>ZAF</td>
<td>1.70</td>
<td>3.61</td>
<td>1.00</td>
<td>0.92</td>
<td>-0.01</td>
<td>2.52</td>
</tr>
</tbody>
</table>


18. Growth accounting with natural capital is also useful to study the changing role of natural capital during times of abundance and scarcity. This can provide important information regarding the sustainability of growth. Figure 4 shows how the growth contribution of natural capital changed over time in Norway and the United Kingdom. From the mid-1980s to 2000 the growth contribution of natural capital was relatively large in Norway. After that it turned negative, as oil reserves started to diminish. Although the growth contribution of other factors of production increased a little, GDP growth declined almost in tandem with the growth contribution of natural capital. One interpretation would be that during times of resource abundance Norway did not invest sufficiently in other forms of wealth, such as human or physical capital, that would maintain its ability to generate GDP growth at the same high level, for example through higher productivity growth. It should be noted, however, that Norway has been investing a good part of its natural capital revenues in a sovereign wealth fund that invests in foreign assets, thus transforming natural into financial capital for the benefit of future generations. The income generated from
foreign assets does not contribute to GDP, but to national income (GNI). Yet, the average annual growth rate of GNI declined as much as the GDP growth rate over the two periods considered here, so taking the sovereign wealth fund into account does not change the picture described before. In the United Kingdom the growth contribution of natural capital was already very low during the first period. It then turned negative after 2000. However, MFP growth picked up to compensate for this negative growth contribution of natural capital, and GDP growth stayed roughly the same. Again, one interpretation would be that the United Kingdom invested sufficiently in human or knowledge capital to compensate the (small) drag on growth from a negative contribution from natural capital.

**Figure 4. GDP growth and contributions – Norway and United Kingdom**

19. Growth accounting results suggest that the impact of resource booms on productivity and investment is important for an economy to benefit in terms of higher GDP growth. In Russia the resource boom that intensified towards the middle of the last decade was accompanied by an increase in both the produced capital stock growth and productivity growth (Figure 5). As a result, Russia benefitted through a substantial increase in GDP growth. In contrast, when comparing the same two episodes for Australia, it turns out that while the growth contribution of produced capital increased in the later, natural resource boom period, productivity growth decelerated significantly. As a result, GDP growth actually declined. Likewise, New Zealand (Figure 6) did not benefit from higher GDP growth as a result of a higher growth contribution of natural capital and other factors of production over 2004-2008 compared to the earlier period, because productivity declined significantly at the same time, actually turning negative.

**Figure 5. GDP growth and contributions - Australia and Russia**
20. Some countries are able to compensate declining contributions of natural capital through higher productivity growth, or produced capital. This was the case for Denmark (Figure 7) when comparing 2004-2008 with 1997-2003. Mexico, in contrast, experienced a decline in productivity growth along with the decline in the growth contribution of natural capital, but was able to compensate both with higher growth contribution of the produced capital stock.

21. Chile is an interesting case to assess some of the potential uses of the framework presented in this paper. It is a basis to study the impact of different scenarios for natural capital use in production on long-term income developments. To this end it is useful to update the data used in this paper. While the World Bank’s natural capital is available only until 2008, copper production data from national sources is available until 2011. Since copper makes up the lion’s share of natural capital in Chile, looking at an extension of growth accounting that integrates the production of copper only, still gives important insights into the role of natural capital for long-term growth developments. The copper rent has accounted for 80% of the total natural capital rent on average since 1990 and for 90% since 2005, owing to the copper price boom. In fact, growth accounting results hardly change if only copper is considered as natural capital rather than the full set of natural capital assets considered in this paper (Figure 8). The growth accounting exercise based on copper shows that the growth contribution of copper has vanished since 2005 (Figure 9). This owes to bottlenecks related to declining copper content in ores and harder to reach reserves, along
with energy and water scarcities. It is instructive to look at some scenarios for potential future developments of copper production to gain insights into the importance that this might have on Chile’s growth path. The discussion in Box 1 shows that declining copper production might drag down expected economic growth to a considerable extent in Chile, unless the country is able to improve its productivity performance through productive investments in human and knowledge capital and further improvements in its conditions for competition and entrepreneurship. It should be noted, though, that it is impossible to predict future developments in copper production, as much depends on the success of exploration efforts to find new reserves and technological progress. What is described in Box 1 are merely illustrative scenarios.

**Figure 8. GDP growth and contributions in Chile**

with natural capital stock and with copper only

**Figure 9. GDP growth and contributions in Chile**

with copper only

**Box 1. The impact of copper on long-run growth scenarios in Chile**

While it is extremely difficult to predict copper production in the long term, as much will depend on technology developments and the success of exploration efforts, it is illustrative to look at some scenarios and their effects on GDP developments for Chile.
The scenarios presented in here build on the OECD’s long-term growth scenarios (Johansson et al., 2012). The production function used in that work is augmented to include a natural capital stock (see Appendix 4). Since for Chile copper makes up the lion’s share of natural capital inputs, the scenario presented here includes copper only for the sake of simplicity. Up to date data on copper production and rents is more readily available then some of the other elements of the natural capital stock as defined in this paper.

In a scenario in which copper production overcomes the current stagnation and continues to grow at the average rate observed since 1970, the expected growth path would be unaffected (Figure 11). In fact, starting around 2040, GDP would be higher under this scenario than under the baseline scenario, as continued copper production growth would offset some of the effects of the declining working age population.

**Figure 10. Long-term Growth Scenario with copper**

<table>
<thead>
<tr>
<th>Scenario 1: continued copper boom</th>
</tr>
</thead>
<tbody>
<tr>
<td>Copper</td>
</tr>
<tr>
<td>GDP</td>
</tr>
</tbody>
</table>

![Graph showing copper and GDP over time](image)

The picture looks different in a second scenario, in which copper production would continue to grow until 2020, then stagnate and start to decline after 2030. The developments until 2020 are based on expectations regarding the expansion of production capacity based on current investment plans. It should be noted, though, that these plans are behind target. In this scenario, GDP might be 20% below the level expected in the baseline scenario in 2060 (Figure 12). The scenario for copper production does not seem unrealistic, given that the sector is already hitting bottlenecks. If Chile were to continue to extract copper at the current rate, proven reserves - that are known and can potentially be exploited with available technologies - would last another 35 years. Yet, new technologies and exploration tend to lead to discovery of new reserves and the possibility to exploit them, especially in times of scarcity and rising prices. It is thus likely that Chile will be able to exploit its copper reserves for much longer than what a simple calculation based on current proven reserves and extraction rates would suggest. On the other hand, assuming declining production at some point in the future, given the bottlenecks observed already today, has some validity.

**Figure 11. Long-term growth scenario with copper**

<table>
<thead>
<tr>
<th>Scenario 2: hitting bottlenecks</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP</td>
</tr>
</tbody>
</table>

![Graph showing copper and GDP over time](image)
Conclusions and further steps

22. When taking natural capital into account, the adjustment of traditional productivity growth measures is generally small, but this partly owes to lacking data and measurement uncertainties. The growth contribution of natural capital is significant only for a handful of countries based on the data analysed in this paper. However, this partly reflects the fact that the notion of natural capital used here is not all-encompassing. Neither soil nor water are included, nor is wild fish stock. Moreover, the various services that the forest and other ecosystems provide to keep humans and other creatures alive are not captured, although this is the very basis of any economic activity. However, as long as it remains impossible to account for the full contribution of ecosystem services, even a broader concept of natural capital would probably not change the general picture that labour and produced capital contribute the largest shares to growth in the production of goods and services in most countries.

23. Further insights might be gained by conducting this exercise at the industry level. The role of natural capital can obviously be attributed to the corresponding natural capital sectors, such as mining for energy and minerals, forestry and the pulp and paper industry for timber. The growth contribution of natural capital in these sectors and their role for productivity growth will very likely be much greater than in the aggregate economy. An important future source of data for industry-level analysis will be data compiled in the framework of the System of Integrated Environmental Economy Accounts (SEEA) as it will be consistent with national accounts aggregates of inputs and outputs.

24. Although the framework presented in this paper is not designed to track environmental sustainability as such, it provides useful insights into the role of natural capital for national income over time and these feed into considerations on sustainability. Even if the contribution of natural capital to national income is relatively small, it is useful to make it explicit and understand just how much it contributes to increases in GDP. This will also help researchers and policy makers better understand what happens when natural capital endowments become scarcer over time. In such cases, the growth contribution of natural capital will inevitably become smaller and – eventually – negative. If countries that have exploited their natural capital want to maintain their GDP growth rates, this can happen only if the growth in productivity or other input factors increases at the same rate as the growth contribution of natural capital decreases, perhaps as a result of previous investments in human or knowledge capital. In that sense, a simple growth accounting exercise that explicitly takes into account the natural capital stock can contribute to a better understanding of the sustainability of economic development in resource-rich countries.
It should be noted, though, that the growth contribution of natural capital is captured only from an accounting perspective and in a very direct way. Indirect effects of natural resource booms and busts, for example on the formation of produced capital and on industrial production cannot be taken into account with the kind of framework presented here. The growth effects of natural resource booms and busts can of course be much larger than the direct effects from an accounting perspective, when all indirect impacts are taken into account.

The framework can also be used to study the impact of natural capital on income developments in the long run. Difficult though it may be to predict long-term developments for natural capital endowments and use in production, the impact of different scenarios for such developments on expected income can be studied with the framework presented in this paper, as demonstrated for the case of Chile. This would give policy makers and researchers a better understanding of productivity growth improvements that would be needed to make up for a potentially declining growth contribution of natural capital. The example presented for Chile could be extended to the full set of natural capital assets considered in this paper and to all resource-rich countries.

At the same time, results presented in this paper are subject to many limitations, some of which can be addressed in further work; others are more difficult to tackle. In addition to the difficulties with measuring natural capital in a comprehensive way, there are the following issues:

- The country sample and time period: At present the sample used in this paper includes only a few resource-rich countries, and in some cases, such as the United Kingdom and the Netherlands, the time period for which natural capital is available includes only years when oil and gas reserves were already nearing exhaustion. This precludes an analysis of how a resource boom and following scarcity can affect overall factor input and productivity growth. While it is probably difficult to obtain reliable measures of productivity growth and natural capital for the resource boom years in the United Kingdom and the Netherlands, it would be possible to extend this work to other resource-rich countries, in particular some Latin-American and Asian countries to gain some more insights in these issues.

- The scope of natural capital assets: In 2012, the international community agreed on a new accounting standard for environment-economic data (SEEA). Implementation of the SEEA will make available more physical and monetary data on natural capital, in particular land, aquatic resources and freshwater.

- The choice of prices reflecting private rather than social values. Since the extended productivity framework used here is derived from profit maximization, it is appropriate to value natural capital with resource rents based on market prices. However, private prices do not reflect the value of natural capital to society. Forests, as an example, provide important ecosystem services; as a habitat for a wide range of species; as a source of medication; and via its role in absorbing CO₂ and thus limiting climate change. These services are important for welfare and for the sustainability of economic development in the long run. At the same time, they are not reflected in the market price of timber and by using this price to value forests, both a country’s broad wealth and its reduction through forest depletion is underestimated. The framework presented in this paper is adapted to studying the efficiency of the production process from the producer perspective given the prices that producers face, but it is not suited for assessing societal welfare. To do that, natural capital would have to be valued with social costs. However, measurement of social costs is subject to considerable uncertainties. Moreover, the production framework would have to be replaced by a welfare framework: Producers do not choose inputs and outputs on the basis of social costs and it is debatable whether social prices should be used at all in productivity
measurement or whether different frameworks are needed to study the welfare effects of the production of goods and services.
1. To include natural capital into productivity measurement the traditional production function is extended to include the flows of natural capital used in production, \( S = [S_1, S_2, ...] \) which will in most cases correspond to natural resource extraction.

\[
Y = F(K, L, S, t) \quad (A1.1)
\]

with \( F_K, F_L, F_S > 0, F_{KK}, F_{LL}, F_{SS} < 0 \) \((i=1,2,\ldots)\) as first- and second-order partial derivatives of \( F \).

2. Constant returns to scale in production are assumed, such that \( F \) is homogenous of degree one in \( K, L \) and \( S \). Totally differentiating \((A1.1)\) with respect to time and rearranging yields

\[
\frac{d\ln \text{GMFP}}{dt} \equiv \frac{d\ln F}{dt} = \frac{d\ln Y}{dt} - \frac{F_L}{Y} \frac{dlnL}{dt} - \frac{F_K}{Y} \frac{dlnK}{dt} - \sum_i \frac{F_{S_i}S_i}{Y} \frac{dlnS_i}{dt} \quad (A1.2)
\]

where \( F_X \) denotes the derivative of function \( F(X, .) \) with respect to its argument \( X \).

3. If producers minimise costs, the marginal productivity of each input factor will equal its real input price as shown as follows:

\[
\text{Min} \mathcal{L} = wL + u_KK + u_S S + \lambda (\bar{Y} - F(L, K, S, t)) \quad (A1.3)
\]

With first order conditions for \( L, K, \) and \( S \):
\[
\frac{\partial \mathcal{L}}{\partial L} = w - \lambda F_L = 0; \frac{\partial \mathcal{L}}{\partial K} = u_K - \lambda F_K = 0; \frac{\partial \mathcal{L}}{\partial S_i} = u_{S_i} - \lambda F_{S_i} = 0.
\]

Evaluating the Lagrange multiplier \( \lambda \) and using the assumption of linear homogeneity of \( F \) yields:

\[
y = wL + u_KK + u_S S = \lambda \left( F_L L + F_K K + \sum_i F_{S_i} S_i \right) = \lambda F = \lambda Y \rightarrow \lambda = \frac{Y}{\bar{Y}} \quad (A1.4)
\]

Given the valuation of \( \lambda \) and the first order conditions, it follows that the production elasticities of inputs equal their income share in total costs:

\[
\frac{F_L L}{\bar{Y}} = \frac{wL}{\bar{Y}} = \frac{wL}{y} \quad (A1.5)
\]

\[
\frac{F_K K}{\bar{Y}} = \frac{u_K K}{\bar{Y}} = \frac{u_K K}{y} \quad (A1.6)
\]

\[
\frac{F_{S_i} S_i}{\bar{Y}} = \frac{u_{S_i} S_i}{\bar{Y}} = \frac{u_{S_i} S_i}{y} \quad (A1.7)
\]

4. Equation \((A1.2)\) can thus be written as

\[
\frac{d\ln \text{GMFP}}{dt} = \frac{d\ln Y}{dt} - \frac{wL}{Y} \frac{dlnL}{dt} - \frac{u_KK}{Y} \frac{dlnK}{dt} - \sum_i \frac{u_{S_i}S_i}{Y} \frac{dlnS_i}{dt} \quad (A1.8)
\]
5. Denoting total factor input costs in the traditional MFP framework by \( \gamma' \equiv wL + u_K K \), it can be shown that the ratio between the traditional and the extended input cost measure is \( \frac{\gamma'}{\gamma} = \sum_i \frac{u_S S_i}{\gamma} \). A shorthand measure \( Z = Z(L,K) \) is used for the volume of aggregate of traditional labour and capital inputs where the growth rate of \( Z \) is given by

\[
\frac{d\ln Z}{dt} = \left( \frac{wL d\ln L}{\gamma'} + \frac{u_K K d\ln K}{\gamma'} \right)
\]

(A1.9)

such that

\[
\frac{d\ln MFP}{dt} = \frac{d\ln Y}{dt} - \frac{d\ln Z}{dt}
\]

(A1.10)

6. Equation (A1.8) can then be rewritten as:

\[
\frac{d\ln GMFP}{dt} = \frac{d\ln Y}{dt} - \frac{\gamma'}{\gamma} \left( \frac{wL d\ln L}{\gamma'} + \frac{u_K K d\ln K}{\gamma'} \right) - \sum_i \frac{u_S S_i d\ln S_i}{\gamma}
\]

\[
= \frac{d\ln MFP}{dt} + \left( 1 - \frac{\gamma'}{\gamma} \right) \frac{d\ln Z}{dt} - \sum_i \frac{u_S S_i d\ln S_i}{\gamma} \frac{d\ln S_i}{dt}
\]

(A1.11)

7. This equation shows that the difference between the traditional MFP growth measure and the extended measure, including natural capital, will depend on the difference between the growth rate of the traditional composite input index, comprising labour and produced capital only, and the growth in the use of natural capital \( S \), as well as on the share of natural capital rents in production.

**APPENDIX 2**

1. The optimal extraction of a non-renewable capital stock \( N(t) \) over a lifetime \( T \), which is depleted at the quantity \( S(t) \) in period \( t \) follows:

\[
\max V(t) = \int_t^{T-t} R_S(a, S(a), N(a)) e^{-r(a-t)} da
\]

(A2.1)

\[
\text{Given } N = -S(t).
\]

\( V(t) \) is the net present value of resource rents, \( R_S(t, S(t), N(t)) \), which corresponds to the revenues from natural capital extraction net of costs \( R_S = P_S S(t) - C_S(S(t), t) \), where total costs, \( C_S \), include a normal return. \( P_S \) is the market price at which the extracted natural capital can be sold and \( r \) is a nominal interest rate. To keep things simple, it is assumed that resource rents do not depend on the remaining stock of natural capital, \( N \). The present value Hamiltonian for this optimization problem is:
The static efficiency condition then requires:

\[ \frac{\partial H}{\partial S} = \frac{\partial R_s}{\partial S} - \lambda(t) = 0 \]  \hspace{1cm} (A2.3)

2. Because \( \lambda(t) \) is the shadow cost of using (depleting) one unit of the capital stock, in terms of the associated change of the present value of resource rents, it can be interpreted as the user cost of the natural capital, \( u_S \). In the case of unit extraction costs that are independent of the level of extraction \( \frac{\partial c_s}{\partial S} = \bar{c}_S(t) \), resource rents can be expressed as \( R_s \left(t, S(t)\right) = P_s(t)S(t) - \bar{c}_S(S(t), t) = P_s(t)S(t) - \bar{c}_S(t)S(t) \), in which case equation (A2.3) states that the user cost of the natural capital equals its unit rent \( \frac{\partial R_s}{\partial S} = \frac{R_s}{S} = P_s(t) - \bar{c}_S(t) = u_S(t) \). In that case, user costs can be measured as the surplus market price of the natural capital, \( P_s \), over extraction costs. This is the World Bank method applied in this paper.

**APPENDIX 3**

1. For some countries, where data necessary to estimate the user costs of capital is difficult to find, MFP growth estimates are based on the assumption that all non-labour income accrues to capital and hence the user cost of capital is calculated as residual. In this case, the natural capital rents are picked up by the cost share allocated to produced capital \( K \). As a consequence, the cost share of capital is overstated if indeed some of this income accrues to natural capital instead. This implies that the user cost as measured in this framework is actually composed of two parts, the true user cost of produced capital and the user cost of natural capital: \( u'_K K = u_K K + \sum_i u_S S_i = P_Y Y - wL \). Total input costs are equal to value added, because this measurement framework relies on the assumptions of constant returns to scale and perfect competition, which implies zero profits. In that case equation (1) from the main text can be written as

\[ \frac{d \ln MFP}{dt} = \frac{d \ln Y}{dt} - \left( \frac{wL}{P_Y} \frac{d \ln L}{dt} + \frac{u'_K K}{P_Y} \frac{d \ln K}{dt} \right) \]  \hspace{1cm} (A3.1)

Using \( u'_K K = u_K K + u_S S \), equation (A3.1) can be rewritten as

\[ \frac{d \ln MFP}{dt} = \frac{d \ln Y}{dt} - \left( \frac{wL}{P_Y} \frac{d \ln L}{dt} + \frac{u_K K}{P_Y} \frac{d \ln K}{dt} + \sum_i \frac{u_S S_i}{P_Y} \frac{d \ln K}{dt} \right) \]  \hspace{1cm} (A3.2)

Given zero profits, \( \gamma = P_Y Y \), equation A2.4 can be written as

\[ P_Y Y = wL + u_K K + u_S S = \lambda (F_L L + F_K K + F_S S) = \lambda F = \lambda Y \rightarrow \lambda = \frac{P_Y Y}{Y} \]  \hspace{1cm} (A3.3)

The elasticities of the inputs can then be rewritten as \( \frac{F_L L}{Y} = \frac{wL}{P_Y Y} \cdot \frac{F_K K}{Y} = \frac{u_K K}{P_Y Y} \cdot \frac{F_S S}{Y} = \frac{u_S S}{P_Y Y} \). The equation for the adjusted MFP measure is then given by:
\[
\frac{d\ln GMFP}{dt} = \frac{d\ln Y}{dt} - \frac{wL}{P_Y} \frac{d\ln L}{dt} - \frac{u^*_K}{P_Y} \frac{d\ln K}{dt} - \sum_i \frac{u^*_S_i}{P_Y} \frac{d\ln S_i}{dt}
\]

(A3.4)

2. Which is equivalent to equation (A1.8) remembering that nominal GDP equals total costs in the framework described in this appendix, \( P_Y = \gamma \). Comparing (A3.4) with equation (A3.2) yields:

\[
\frac{d\ln GMFP}{dt} = \frac{d\ln MFP}{dt} + \sum_i \frac{u^*_S_i}{P_Y} \left( \frac{d\ln K}{dt} - \frac{d\ln S_i}{dt} \right)
\]

(A3.5)

This shows that in this framework, the difference between the traditional MFP growth measure and the measure including the natural capital stock, depends on the difference between the growth rate in use in the natural capital and produced capital services and the share of natural capital rents in GDP. This equation is used to calculate the adjusted MFP growth measure for countries where the user cost of capital is calculated as residual, i.e. Chile, South Africa, Mexico and Russia.

APPENDIX 4

1. The long-term growth scenarios developed in Johansson et al. (2013) are based on a Cobb-Douglas production function with constant returns to scale featuring produced physical capital, human capital, labour and Harrod-neutral technical progress according to:

\[ Y = K^{\alpha} (AhL)^{1-\alpha} \]

(A4.1)

where \( Y, K, A, h \) and \( L \) denote output, physical capital, the productivity level, human capital per worker and employment. The share of capital is set equal to \( 1/3 \). Scenarios until 2060 for all factor inputs and for \( A \) are then developed as described in Johansson et al. (2013). A long-term scenario for GDP is then derived with these elements and the production function described in A4.1.

2. To develop long-term growth scenarios taking copper production explicitly into account, the notion of the capital stock is extended to include both produced capital, \( K \), and the use of the natural capital stock, \( S \).

\[ Y = K^{\alpha-\beta} S^\beta (AhL)^{1-\alpha} \]

(A4.2)

where \( S \) is the use of the natural capital stock for a given period and \( \beta \) is the share of natural capital rents in GDP. In the scenarios presented here for Chile \( S \) corresponds to copper production and \( \beta \) to the share of copper rents in GDP. The World Bank data is updated with copper production, price and unit cost data from the Chilean Copper Commission, Cochilco. Since Cochilco’s unit cost data displays much higher unit cost inflation then the World Bank data in the 2000s, which has been derived by assuming cost increases in line with the general consumer price inflation, the World Bank unit cost data was recalculated starting with the year 2000 by assuming unit cost increases in line with Cochilco’s data after that.

3. The share of copper rents was relatively stable until 2004 around 3% and increased substantially thereafter to an average of more than 10% over 2005-2011. Therefore, two different assumptions were used for the scenarios. One assumption is that \( \beta \) remains stable at 3.2%, the average share of the copper
rent in GDP before 2005. Another assumption is that there is a structural break in 2005, with $\beta$ jumping to the post-2005 average of the copper share in GDP of 10.85%. A constant share of copper rents seems a reasonable assumption. While prices for copper should be expected to rise substantially, should scarcities arise in the future, so would unit costs, as extraction becomes more difficult and costlier. Thus, assuming a constant unit rent, that is prices net of extraction costs, seems reasonable, whether or not considerable scarcities are expected over the horizon for projections.

4. To derive new scenarios that take the hypothetical developments for copper explicitly into account, the scenarios for labour, human capital per capita and the produced capital stock are taken from Johansson et al. (2013). A new level for $A$ is derived by solving equation A4.2 for $A$ and using the data from Johansson et al. (2013) to derive a new time series for years until 2011.

\[
A = \frac{1}{K^{1-\alpha} L^{1-\alpha}} \frac{Y^{1-\sigma}}{\alpha-\beta}
\]  

5. The productivity series is then projected forward to 2060 by using the productivity growth rates implied in the series derived in Johansson et al. (2010). This seems sensible, because productivity scenarios in that exercise were derived with a convergence equation that specifies the speed of convergence of actual productivity to its country-specific frontier. Both the speed of convergence and the country-specific frontier depend on institutions, such as the stringency of product market regulation and the openness of an economy (Johansson, 2013). While this is a sound analytical framework, it does not take into account that traditional MFP measures might also be influenced by the developments of natural capital inputs into production. Therefore, it seems reasonable to use the productivity growth series derived in Johansson et al. (2013) for long-term scenarios where natural capital input developments would not affect the residual that measures TFP, because natural capital inputs are taken into account by integrating them explicitly as a production factor into the production function.

6. Different scenarios for copper production are then considered. In a first scenario, copper production would grow at its average growth rate observed since 1970, 4.98%, which is much higher than what has been observed over the past few years. In a second scenario, copper production would also resume growth starting in 2013 so that production reaches its expected capacity based on current investment plans in 2020. Copper production would then start to decline, first slowly and then more rapidly. As a result, copper production would reach a level in 2060 last seen in the mid-1990s.

7. These copper production scenarios, along with the scenario for productivity, $A$, described above and scenarios for other input series taken from Johansson et al. (2013) are then used to derive a scenario for long-term GDP developments. Results are discussed in Box 1 in the main text.
BIBLIOGRAPHY


