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Industry with National Productivity Measures**

by

W. Erwin Diewert

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DEPARTMENT OF ECONOMICS
THE UNIVERSITY OF BRITISH COLUMBIA
VANCOUVER, CANADA V6T 1Z1

<http://www.econ.ubc.ca>

The Treatment of Indirect Taxes and Margins and the Reconciliation of Industry with National Productivity Measures

W. Erwin Diewert,¹
Discussion Paper 05-06,
Department of Economics,
University of British Columbia,
Vancouver, B.C.,
Canada, V6T 1Z1.
Email: diewert@econ.ubc.ca

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Abstract

The paper looks at the problems involved in defining margins in Input Output tables. It also looks at the problems involved in consistently aggregating industry measures of output that are suitable for productivity measurement purposes into economy wide measures of output at final demand prices. Our main result is a set of conditions under which real GDP that is constructed by aggregating over the components of final demand is exactly equal to real GDP that is constructed by aggregating over the components of each industry's gross outputs less intermediate inputs, taking into account the complications raised by the existence of indirect taxes. The paper also stresses the importance of tabling indirect taxes by industry and by commodity so that the deadweight loss of indirect taxes that fall within the production sector can be calculated.

Key Words

Index numbers, Fisher ideal index, input output analysis, margins, indirect taxes by industry and commodity, industry sources of aggregate GDP growth, deadweight loss.

Journal of Economic Literature Classification Codes

C8, C43, C67, D24, D61, E62, H21.

1. Introduction

It is well known² that nominal GDP can in theory be calculated in three equivalent ways:

- By summing final demand expenditures;
- By summing value added³ over all industries and
- By summing over all sources of income received.

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² See for example Hicks (1952).

³ Value added is defined as the value of gross outputs produced over the reference period minus the value of intermediate inputs used during the period. An intermediate input is defined as an input that has been produced by some other domestic or foreign producer.

In principle, measures of real GDP can be obtained by deflating each of the above value aggregates by an appropriate price index.

Estimates of real GDP can be obtained by deflating each measure of nominal GDP by an appropriate index number of the prices of the goods and services that go into each of the three value aggregates. However, many years ago, Morris Copeland⁴ realized that the deflated final expenditures aggregate would generally show a faster rate of growth than the deflated income or input aggregate due to *productivity growth*.⁵ Thus in general, we cannot expect the first two output based definitions of real GDP to equal the third input based definition of real GDP.

Intuitively, we would expect the first two measures of real GDP to be equal: the first measure looks at deliveries to final demand from the viewpoint of purchasers of finally demanded goods and services while the second measure looks at these same deliveries from the viewpoint of the industry suppliers. However, there are several factors that may lead us to doubt that this equality between the first two measures of real output holds:

- The average final demand prices that purchasers pay for a particular commodity may be different from the average selling price that an industrial supplier of the commodity receives.
- Final demand prices include indirect taxes that fall on purchases of a commodity but for the purpose of measuring industry productivity, these indirect taxes are usually excluded from the supplying industry's selling price.
- Imports and exports primarily flow through the production sector of an economy and it is not immediately clear how these transactions can be reconciled in the two sets of real accounts.

We will not deal with the complications posed by the existence of exports and imports in this paper but we will address the first two sets of factors that may prevent the equality of the final demand and industry supply based measures of real GDP. Our main result is a set of conditions under which *real GDP that is constructed by aggregating over the components of final demand is exactly equal to real GDP that is constructed by aggregating over the components of each industry's gross outputs less intermediate inputs*.

⁴ "Income derived from an area may be deflated to show changes in the physical volume of services of labor and wealth employed by the economic system from time to time. If we may neglect net income from abroad as relatively small, the deflated distributive shares may be compared with the deflated consumed and saved income to show changes in the efficiency of operation of the economic system." Morris A. Copeland (1937; 31).

⁵ Jorgenson and Griliches (1967) showed that under certain circumstances (including constant returns to scale in production and neglecting the complications posed by indirect taxes), the primal definition of productivity growth (output growth minus input growth) was equal to the dual definition of productivity growth (the rate of growth of input prices minus the rate of growth of output prices). See also Christensen and Jorgenson (1969) (1970). The BLS productivity program is based on the pioneering work of Jorgenson and Griliches (1967) (1972); see the Bureau of Labor Statistics (1983) and Dean and Harper (2001).

It should be noted that Bureau of Economic Analysis economists have derived analogous results under stronger conditions; see Moyer, Reinsdorf and Yuskavage (2004) and Reinsdorf and Yuskavage (2004).⁶ Before proceeding to our own results, we discuss their results in some detail.

When the BEA calculates the rate of growth of GDP using a chained Fisher ideal index, it also provides a sources of growth decomposition; i.e., it provides an additive decomposition of the overall growth rate into a number of subcomponents or contributions of the subcomponents to the overall growth rate. Thus the growth contributions of $C + I + G + X - M$ add up to the overall growth of GDP.⁷ However, many analysts are interested in the contributions to overall GDP growth of *particular industries* as opposed to the contributions of particular components of final demand. The index number equivalence result derived by Moyer, Reinsdorf and Yuskavage (2004) means that *industry contributions to growth can be calculated that will exactly add up to total GDP growth*, provided that some conditions hold.

What are the authors' conditions for their equivalence result to hold? Some of the more important conditions are:

- The Laspeyres, Paasche or Fisher (1922) ideal formula must be used in order to construct the real quantity aggregates.⁸
- Accurate industry value data on gross outputs and intermediate inputs that sum up to the components of final demand in value terms must be available for the two periods in the index number comparison.
- For each commodity produced or used as an intermediate input in the economy, the price faced by final demanders and by suppliers of that commodity must be the same for all demanders and suppliers.
- Commodity taxes are small enough in magnitude that they can be ignored.

The first condition is not restrictive, since the Fisher index is a very good formula to use. The authors note that in practice, the second condition listed above is not satisfied for various reasons. We will not focus our discussion on this particular assumption since the focus of their paper and the present paper is more theoretical. However, we will relax their third and fourth assumptions: we will attempt to find a counterpart to the Moyer, Reinsdorf and Yuskavage equivalence result when indirect taxes are large and

⁶ These authors also ignore the complications due to the existence of exports and imports.

⁷ The particular Fisher decomposition formula being used by the BEA is due originally to Van IJzeren (1987; 6). This decomposition was also derived by Dikhanov (1997), Moulton and Seskin (1999; 16) and Ehemann, Katz and Moulton (2002). An alternative additive decomposition for the Fisher index was obtained by Diewert (2002) and Reinsdorf, Diewert and Ehemann (2002). This second decomposition has an economic interpretation; see Diewert (2002). However, the two decompositions approximate each other fairly closely; see Reinsdorf, Diewert and Ehemann (2002).

⁸ When calculating Fisher, Laspeyres or Paasche price or quantity indexes of value added for an industry, all prices are entered as positive numbers but the corresponding quantities are positive or negative numbers depending on whether the particular commodity is being produced as an output (entered as a positive quantity) or being used as an input (entered as a negative quantity).

commodity prices are *not* constant across demanders and suppliers of a particular commodity. In section 2, we assume that there are no commodity taxes to worry about but in section 3, we again attempt to find a counterpart to the authors' equivalence result when there are commodity taxes on final outputs and possibly also on intermediate inputs. Section 4 concludes by looking at some of the implications of our results for statistical agencies and their data collection and presentation strategies.

In summary: the main contribution of this paper is to indicate a consistent treatment of indirect taxes so that national estimates of real output and productivity growth are equal to the sum of industry measures of real output and productivity growth plus an adjustment for the treatment of indirect taxes.⁹ As a byproduct of our treatment of indirect taxes, we provide a consistent theoretical framework for the treatment of margin type industries in the system of national accounts.

2. Input Output Accounts with No Commodity Taxes

In this section, we will address some of the problems associated with the construction of input output tables for an economy, both in real and nominal terms. We will defer the problems that the existence of commodity taxes causes until the next section. However, in the present section, we will allow for a complication that makes the construction of input output tables somewhat difficult and that is the existence of *transportation margins*. The problem occurs when real input output tables are constructed. Moyer, Reinsdorf and Yuskavage (2004) note that the industry method for constructing real GDP will coincide with the usual final demand method for constructing real GDP, provided that the deflator for any commodity is the same wherever that commodity is used or produced. In fact, in their empirical work, they make use of this assumption since independent deflators for all of the cells of the use and make matrices are generally not available and hence final demand deflators or selected gross output deflators are used as proxy deflators throughout the input output tables. However, when an industry produces a commodity, its selling price will be less than the purchase price for the same commodity from final and intermediate demanders of the good, due to the costs of shipping the good from the factory gate to the geographic location of the purchasing unit. In addition, there may be various marketing and selling costs that need to be added to the manufacturer's factory gate price.

In the present section, we will address the problem of accounting for transportation margins in the simplest possible model of industry structure where there will be one industry (Industry M) that produces a good (commodity 1), one industry (Industry S) that produces a service (commodity 2) and one industry (Industry T) that transports the good to final demanders¹⁰ or to the service industry.¹¹ The transportation service will be

⁹ We note that the proposed new architecture for the US system of accounts has no proposals for the treatment of indirect taxes in the *real* industry accounts; see Jorgenson and Landefeld (2004).

¹⁰ In this highly simplified model, we will have only one final demand sector and we neglect the problems posed by imported goods and services. The transportation industry can be thought of as an aggregate of the transportation, advertising, wholesaling and retailing industries.

¹¹ Service industries generally require some materials in order to produce their outputs.

regarded as commodity 3. We assume that the service output does not require transportation inputs to be delivered to purchasers of services.

Table 1 below combines the make and use matrices for the value flows in this highly simplified economy into a single input output table. The Industry M, S and T columns list the sales of goods and services (plus signs are associated with sales) and the purchases of intermediate inputs (minus signs are associated with purchases) for each of the three inputs. The *final demand column* gives the total of the industry sales less industry intermediate input purchases for rows 1 to 4 over the three industries in the economy. Row 5 in Table 1 sums all of the transactions in the industry M, S and T columns and thus is equal to *industry value added* (the value of gross outputs produced less the value of intermediate inputs used by the industry). The entry in row 5 of the final demand column is nominal GDP and it is equal to both the sum of the final demands above it and to the sum of the industry M, S and T value added along the last row of the table.¹²

Table 1: Detailed Input Output Table in Current Dollars with no Taxes

R	Industry M	Industry S	Industry T	Final Demand
1	$p_1^{MS} q_1^{MS} + p_1^{MF} q_1^{MF}$		$-p_1^{MS} q_1^{MS} - p_1^{MF} q_1^{MF}$	
2			$(p_1^{MF} + p_3^{MF}) q_1^{MF}$	$(p_1^{MF} + p_3^{MF}) q_1^{MF}$
3		$-(p_1^{MS} + p_3^{MS}) q_1^{MS}$	$(p_1^{MS} + p_3^{MS}) q_1^{MS}$	
4	$-p_2^{SM} q_2^{SM}$	$p_2^{SM} q_2^{SM} + p_2^{SF} q_2^{SF}$		$p_2^{SF} q_2^{SF}$
5	$p_1^{MS} q_1^{MS} + p_1^{MF} q_1^{MF}$ $-p_2^{SM} q_2^{SM}$	$p_2^{SM} q_2^{SM} + p_2^{SF} q_2^{SF}$ $- (p_1^{MS} + p_3^{MS}) q_1^{MS}$	$p_3^{MF} q_1^{MF} + p_3^{MS} q_1^{MS}$	$(p_1^{MF} + p_3^{MF}) q_1^{MF}$ $+ p_2^{SF} q_2^{SF}$

Rows 1 to 3 of Table 1 lists the transactions involving the manufactured good, commodity 1. We will explain these transactions and the associated notation row by row. In the Industry M, row 1 entry, we list the value of manufactured goods sold to the service sector, $p_1^{MS} q_1^{MS}$, where q_1^{MS} is the number of units sold to the service sector and p_1^{MS} is the average sales price.¹³ Also in the Industry M, row 1 entry, we list the value of manufactured goods sold to the final demand sector, $p_1^{MF} q_1^{MF}$, where q_1^{MF} is the number of units sold to the final demand sector and p_1^{MF} is the corresponding average sales price. Note that p_1^{MS} will usually not equal p_1^{MF} ; i.e., for a variety of reasons, the average selling price of the manufactured good to the two sectors that demand the good will usually be different.¹⁴ Now $p_1^{MS} q_1^{MS} + p_1^{MF} q_1^{MF}$ is the total revenue received by Industry M during the period under consideration but it will not be the total cost paid by the receiving sectors due to the existence of transport costs. Thus in row 1 of Table 1, we show the transportation industry as purchasing the goods from Industry M, which explains the entry $-p_1^{MS} q_1^{MS} - p_1^{MF} q_1^{MF}$. The sum of the row one entries across the three

¹² A blank entry in any row of the table signifies a 0 entry.

¹³ Hence this price will be a unit value price over all sales of commodity 1 to the service sector.

¹⁴ Even if there is no price discrimination on the part of Industry M at any point in time, the price of good 1 will usually vary over the reference period and hence if the proportion of daily sales varies between the two sectors, the corresponding period average prices for the two sectors will be different.

entries is 0 and so the row 1 entry for the final demand column is left empty and corresponds to a 0 entry. Turning now to the row 2 entries, the row 2, Industry T entry shows the transportation industry selling commodity 1 to the final demand sector and getting the revenue $(p_1^{MF} + p_3^{MF})q_1^{MF}$ for this sale. This revenue consists of the initial cost of the goods delivered at the manufacturer's gate, $p_1^{MF}q_1^{MF}$, plus revenue received by the transportation sector for delivering good 1 from the manufacturing plant to the final demand sector, $p_3^{MF}q_1^{MF}$. Thus we are measuring the quantity of transportation services in terms of the number of goods delivered to the final demand sector, q_1^{MF} , and the corresponding average delivery price is p_3^{MF} , which can be interpreted as a transportation markup or margin rate.¹⁵ Turning now to the row 3 entries, the row 3, Industry T entry shows the transportation industry selling commodity 1 to the service sector and getting the revenue $(p_1^{MS} + p_3^{MS})q_1^{MS}$ for this sale. This revenue consists of the initial cost of the goods delivered at the manufacturer's gate, $p_1^{MS}q_1^{MS}$, plus revenue received by the transportation sector for delivering good 1 from the manufacturing plant to the service sector, $p_3^{MS}q_1^{MS}$. Thus we are measuring the quantity of transportation services in terms of the number of goods delivered to the services sector, q_1^{MS} , and the corresponding average delivery price is p_3^{MS} , which again can be interpreted as a transportation markup or margin rate. There is no reason to expect the transportation margin rates p_3^{MS} and p_3^{MF} to be identical since the costs of delivery to the two purchasing sectors could be very different.

Row 4 of Table 1 lists the transactions involving services, commodity 2. The Industry S, row 4 entry, $p_2^{SM}q_2^{SM} + p_2^{SF}q_2^{SF}$, lists the value of services output delivered to the manufacturing industry, $p_2^{SM}q_2^{SM}$, plus the value of services output delivered to the final demand sector, $p_2^{SF}q_2^{SF}$. The quantities delivered to the two sectors are q_2^{SM} and q_2^{SF} and the corresponding average prices are p_2^{SM} and p_2^{SF} . As usual, there is no reason to expect that these two service prices should be identical. The term $\square p_2^{SM}q_2^{SM}$ appears in row 4 of the Industry M column, since this represents the cost of services to the M sector. Similarly, the term $p_2^{SF}q_2^{SF}$ appears in row 4 of the Final Demand column, since this represents the value of services delivered to the Final Demand sector and this amount is also equal to the sum of the M,S and T entries for row 4.

Note that every transaction listed in rows 1-4 of Table 1 has a separate purchaser and seller and so the principles of double entry bookkeeping are respected in this table.¹⁶

The entries in row 5 for the M,S and T columns are the simple sums of the entries in rows 1-4 for each column and are equal to the corresponding industry value added. Thus the industry M value added is equal to $p_1^{MS}q_1^{MS} + p_1^{MF}q_1^{MF} - \square p_2^{SM}q_2^{SM}$, the value of manufacturing output at factory gate prices less purchases of services. The industry S

¹⁵ Actually, p_3^{MF} should be interpreted more broadly as a combination of transport costs and selling costs, which would include retailing and wholesaling margins.

¹⁶ Our notation is unfortunately much more complicated than the notation that is typically used in explaining input output tables because we do not assume that each commodity trades across demanders and suppliers at the same price. Thus our notation distinguishes 3 superscripts or subscripts instead of the usual 2: we require 2 superscripts to distinguish the selling and purchasing sectors and one additional subscript to distinguish the commodity involved in each transaction. This type of setup was used in Diewert (2004b).

value added is equal to $p_2^{SM} q_2^{SM} + p_2^{SF} q_2^{SF} - (p_1^{MS} + p_3^{MS}) q_1^{MS}$, the value of services output less the value of materials purchases but at prices that include the transportation margins. The industry T value added is equal to $p_3^{MF} q_1^{MF} + p_3^{MS} q_1^{MS}$, which is product of the transportation margin rate times the amount shipped, summed over the deliveries of transport services to the final demand sector, $p_3^{MF} q_1^{MF}$, and to the services sector, $p_3^{MS} q_1^{MS}$. Finally, the entry in row 5 of the last column is equal to both the sum of industry value added over industries or to the sum of commodity final demands, $(p_1^{MF} + p_3^{MF}) q_1^{MF} + p_2^{SF} q_2^{SF}$. Note that the final demand price for the good (commodity 1) is $p_1^{MF} + p_3^{MF}$, which is equal to industry M's factory gate price, p_1^{MF} , plus the transportation margin rate, p_3^{MF} ; i.e., the final demand price for the good has imbedded in it transportation (and other selling) costs.

Looking at Table 1, it can be seen that there are three ways that we could calculate a Laspeyres quantity index of net outputs for the economy that the table represents:

- Look at the nonzero cells in the 4 by 3 matrix of input output values of outputs and inputs for the economy represented by rows 1-4 and columns M,S and T and sum up these nonzero cells into 10 distinct $p_n q_n$ transactions.
- Look at the row 5, column M,S and T entries for the industry value added components and sum up these cells into 8 distinct $p_n q_n$ transactions.
- Look at rows 1-4 of the final demand column and sum up the nonzero cells into 2 distinct $p_n q_n$ transactions.¹⁷

Denote the 10 dimensional p and q vectors that correspond to the first detailed cell method of aggregating over commodities listed above as p^{IO} and q^{IO} respectively, denote the 8 dimensional p and q vectors that correspond to the second value added method of aggregating over commodities listed above as p^{VA} and q^{VA} respectively and denote the 2 dimensional p and q vectors that correspond to the third aggregation over final demand components method of aggregating over commodities listed above as p^{FD} and q^{FD} respectively.¹⁸ Add a superscript t to denote these vectors evaluated at the data pertaining to period t . Then it is obvious that the inner products of each of these 3 period t price and quantity vectors are all equal since they are each equal to period t nominal GDP; i.e., we have:

$$(1) p^{IOt} \cdot q^{IOt} = p^{VA t} \cdot q^{VA t} = p^{FD t} \cdot q^{FD t}; \quad t = 0, 1.$$

What is not immediately obvious is that the inner products of the three sets of price and quantity vectors are also equal if the price vectors are evaluated at the prices of one period and the corresponding quantity vectors are evaluated at the quantities of another period; i.e., we also have, for periods 0 and 1, the following equalities:¹⁹

$$(2) p^{IO1} \cdot q^{IO0} = p^{VA1} \cdot q^{VA0} = p^{FD1} \cdot q^{FD0};$$

$$(3) p^{IO0} \cdot q^{IO1} = p^{VA0} \cdot q^{VA1} = p^{FD0} \cdot q^{FD1}.$$

¹⁷ The first $p_n q_n$ is $(p_1^{MF} + p_3^{MF}) q_1^{MF}$ and the second $p_n q_n$ is $p_2^{SF} q_2^{SF}$.

¹⁸ All prices are positive but if a quantity is an input, it is given a negative sign.

¹⁹ The proof follows by a set of straightforward computations.

Laspeyres and Paasche quantity indexes that compare the quantities of period 1 to those of period 0 can be defined as follows:

$$(4) \begin{aligned} Q_L^{IO}(p^{IO0}, p^{IO1}, q^{IO0}, q^{IO1}) &\equiv p^{IO0} \cdot q^{IO1} / p^{IO0} \cdot q^{IO0}; \\ Q_L^{VA}(p^{VA0}, p^{VA1}, q^{VA0}, q^{VA1}) &\equiv p^{VA0} \cdot q^{VA1} / p^{VA0} \cdot q^{VA0}; \\ Q_L^{FD}(p^{FD0}, p^{FD1}, q^{FD0}, q^{FD1}) &\equiv p^{FD0} \cdot q^{FD1} / p^{FD0} \cdot q^{FD0}; \end{aligned}$$

$$(5) \begin{aligned} Q_P^{IO}(p^{IO0}, p^{IO1}, q^{IO0}, q^{IO1}) &\equiv p^{IO1} \cdot q^{IO1} / p^{IO1} \cdot q^{IO0}; \\ Q_P^{VA}(p^{VA0}, p^{VA1}, q^{VA0}, q^{VA1}) &\equiv p^{VA1} \cdot q^{VA1} / p^{VA1} \cdot q^{VA0}; \\ Q_P^{FD}(p^{FD0}, p^{FD1}, q^{FD0}, q^{FD1}) &\equiv p^{FD1} \cdot q^{FD1} / p^{FD1} \cdot q^{FD0}. \end{aligned}$$

Using (1) and (3) and definitions (4), it can be seen that all three Laspeyres indexes of real output are equal; i.e., we have

$$(6) Q_L^{IO}(p^{IO0}, p^{IO1}, q^{IO0}, q^{IO1}) = Q_L^{VA}(p^{VA0}, p^{VA1}, q^{VA0}, q^{VA1}) = Q_L^{FD}(p^{FD0}, p^{FD1}, q^{FD0}, q^{FD1}).$$

Using (1) and (2) and definitions (5), it can be seen that all three Paasche indexes of real output are equal; i.e., we have

$$(7) Q_P^{IO}(p^{IO0}, p^{IO1}, q^{IO0}, q^{IO1}) = Q_P^{VA}(p^{VA0}, p^{VA1}, q^{VA0}, q^{VA1}) = Q_P^{FD}(p^{FD0}, p^{FD1}, q^{FD0}, q^{FD1}).$$

Since a Fisher ideal quantity index is the square root of the product of a Laspeyres and Paasche quantity index, it can be seen that (6) and (7) imply that all three Fisher quantity indexes, constructed by aggregating over Input Output table cells or by aggregating over industry value added components or by aggregating over final demand components, are equal; i.e., we have:

$$(8) Q_F^{IO}(p^{IO0}, p^{IO1}, q^{IO0}, q^{IO1}) = Q_F^{VA}(p^{VA0}, p^{VA1}, q^{VA0}, q^{VA1}) = Q_F^{FD}(p^{FD0}, p^{FD1}, q^{FD0}, q^{FD1}).$$

The above results extend to more complex input output frameworks provided that all transactions between each pair of sectors in the model are accounted for in the model. Thus we have extended the results of Moyer, Reinsdorf and Yuskavage to input output models where prices are not constant across industries.²⁰

It is well known that the Laspeyres and Paasche quantity indexes are consistent in aggregation. Thus if we construct Laspeyres indexes of real value added by industry in the first stage of aggregation and then use the resulting industry prices and quantities as inputs into a second stage of Laspeyres aggregation, then the resulting two stage Laspeyres quantity index is equal to the corresponding single stage index, $Q_L^{IO}(p^{IO0}, p^{IO1}, q^{IO0}, q^{IO1})$. Similarly, if we construct Paasche indexes of real value added by industry in the first stage of aggregation and then use the resulting industry prices and quantities as inputs into a second stage of Paasche aggregation, then the resulting two

²⁰ The exact index number results (8) were also derived by Diewert (2004b; 497-507) in an input output model with no commodity taxes but with transportation margins and hence unequal prices.

stage Paasche quantity index is equal to the corresponding single stage index, $Q_P^{IO}(p^{100}, p^{101}, q^{100}, q^{101})$. Unfortunately, the corresponding result does not hold for the Fisher index. However, the two stage Fisher quantity index usually will be quite close to the corresponding single stage index, $Q_F^{IO}(p^{100}, p^{101}, q^{100}, q^{101})$.²¹

We are not quite through with Table 1. In the remainder of this section, we provide some consolidations of the entries in Table 1 and derive some alternative input output tables that could be useful in applications.

Table 2 represents a consolidation of the information presented in Table 1. First, we sum the entries in rows 1 to 3 of Table 1 for each industry column. Recall that the entries in rows 1 to 3 represent the transactions involving the output of industry M. Secondly, we separate out from the sum of the entries over rows 1-3, all of the transactions involving the transportation price p_3 and put these entries in a separate row, which is row 3 in Table 2. The sum of the row 1-3 entries in Table 1 less row 3 in Table 2 is row 1 in Table 2. Row 2 in Table 2 is equal to row 4 in Table 1 and gives the allocation of the service commodity across sectors.

Table 2: Consolidated Current Dollar Table with Transportation Detail

R	Industry M	Industry S	Industry T	Final Demand
1	$p_1^{MS} q_1^{MS} + p_1^{MF} q_1^{MF}$	$\square p_1^{MS} q_1^{MS}$		$p_1^{MF} q_1^{MF}$
2	$\square p_2^{SM} q_2^{SM}$	$p_2^{SM} q_2^{SM} + p_2^{SF} q_2^{SF}$		$p_2^{SF} q_2^{SF}$
3		$\square p_3^{MS} q_1^{MS}$	$p_3^{MS} q_1^{MS} + p_3^{MF} q_1^{MF}$	$p_3^{MF} q_1^{MF}$

Table 2 resembles a traditional input output table. Rows 1 to 3 correspond to transactions involving commodities 1-3 respectively and each industry gross output is divided between deliveries to the other industries and to the final demand sector. Thus the industry M, row 1 entry in Table 2 gives the value of goods production delivered to the service sector, $p_1^{MS} q_1^{MS}$, plus the value delivered to the final demand sector, $p_1^{MF} q_1^{MF}$. Note that these deliveries are at the prices actually received by industry M; i.e., transportation and selling margins are excluded. Similarly, the industry S, row 2 entry gives the value of services production delivered to the goods sector, $p_2^{SM} q_2^{SM}$, plus the value delivered to the final demand sector, $p_2^{SF} q_2^{SF}$. Finally, the industry T, row 3 entry gives the value of transportation (and selling) services delivered to the services sector, $p_3^{MS} q_3^{MS}$, plus the value delivered to the final demand sector, $p_3^{MF} q_3^{MF}$. If we summed the entries in rows 1-3 for each column in Table 2, we would obtain row 5 in Table 1, which gives the value added for columns M,S and T and GDP for the last column. Thus the new Table 2 does not change any of the industry value added aggregates listed in the last row of Table 1.

Although Table 2 looks a lot simpler than Table 1, there is a cost to working with Table 2 compared to Table 1. In Table 1, there were 2 components of final demand,

²¹ See Diewert (1978; 889).

$(p_1^{MF} + p_3^{MF})q_1^{MF}$, and $p_2^{SF}q_2^{SF}$. These two components are deliveries to final demand of goods at final demand prices (which include transportation margins) and deliveries of services to final demand. In Table 2, the old goods deliveries to final demand component is broken up into two separate components, $p_1^{MF}q_1^{MF}$ (deliveries of goods to final demand at factory gate prices), and $p_3^{MF}q_1^{MF}$, the transport costs of shipping the goods from the factory gate to the final demander. Thus Table 2 requires that information on transportation margins be available; i.e., information on both producer prices and margins be available whereas GDP could be evaluated using the last column in Table 1, which required information only on final demand prices.²²

Looking at Table 2, it can be seen that it is unlikely that commodity prices are constant along the components of each row. This is unfortunate since it means that *in order to construct accurate productivity statistics for each industry, it generally will be necessary to construct separate price deflators for each nonzero cell in the input output tables.*

Table 2 allows us yet another way that real GDP for the economy can be constructed. For this fourth method for constructing Laspeyres, Paasche and Fisher output indexes for the economy, we could use the 9 nonzero p_nq_n values that appear in the nonzero components of rows 1-3 and the M,S and T columns of Table 2 and use the corresponding p and q vectors of dimension 9 as inputs into the Laspeyres, Paasche and Fisher quantity index formulae. It is easy to extend the string of equalities (6), (7) and (8) to cover these new indexes. Thus we have a fourth method for constructing a Fisher output index that will give the same answer as the previous 3 methods.

The *real* input output table that corresponds to the *nominal value* input output Table 2 is Table 3 below.

Table 3: Consolidated Constant Dollar Table with Transportation Detail

R	Industry M	Industry S	Industry T	Final Demand
1	$q_1^{MS} + q_1^{MF}$	$\square q_1^{MS}$		q_1^{MF}
2	$\square q_2^{SM}$	$q_2^{SM} + q_2^{SF}$		q_2^{SF}
3		$\square q_1^{MS}$	$q_1^{MS} + q_1^{MF}$	q_1^{MF}

The entries in row 1 of Table 3 are straightforward: the total production of goods by industry M, $q_1^{MS} + q_1^{MF}$, is allocated to the intermediate input use by industry S (q_1^{MS}) and to the final demand sector (q_1^{MF}). Similarly, the entries row 2 of Table 3 are straightforward: the total production of services by industry S, $q_2^{SM} + q_2^{SF}$, is allocated to the intermediate input use by industry M (q_2^{SM}) and to the final demand sector (q_2^{SF}). However, the entries in row 3 of Table 3 are a bit surprising in that they are essentially the same as the entries in row 1. This is due to the fact that we have measured

²² Of course, in order to evaluate *all* of the cells in the input output tables represented by Tables 1 or 2, we would require information on transportation margins in any case.

transportation services in quantity units that are equal to the number of units of the manufactured good that are delivered to each sector.

We conclude this section by providing a further consolidation of the nominal input output Table 2. Thus in Table 4 below, we aggregate the transportation industry with the goods industry and add the entries in row 3 of Table 2 to the corresponding entries in row 1; i.e., we aggregate the transportation commodity with the corresponding good commodity that is being transported.

Table 4: Consolidated Current Dollar Table with No Transportation Detail

R	Industry M+T	Industry S	Final Demand
1	$(p_1^{MS} + p_3^{MS})q_1^{MS} + (p_1^{MF} + p_3^{MF})q_1^{MF}$	$\square(p_1^{MS} + p_3^{MS})q_1^{MS}$	$(p_1^{MF} + p_3^{MF})q_1^{MF}$
2	$\square p_2^{SM} q_2^{SM}$	$p_2^{SM} q_2^{SM} + p_2^{SF} q_2^{SF}$	$p_2^{SF} q_2^{SF}$
3	$(p_1^{MS} + p_3^{MS})q_1^{MS} + (p_1^{MF} + p_3^{MF})q_1^{MF} \square p_2^{SM} q_2^{SM}$	$p_2^{SM} q_2^{SM} + p_2^{SF} q_2^{SF} \square (p_1^{MS} + p_3^{MS})q_1^{MS}$	$(p_1^{MF} + p_3^{MF})q_1^{MF} + p_2^{SF} q_2^{SF}$

Row 1 in Table 4 allocates the good across the service industry and the final demand sector. Thus the value of goods output produced by industry M+T is $(p_1^{MS} + p_3^{MS})q_1^{MS} + (p_1^{MF} + p_3^{MF})q_1^{MF}$ and hence purchasers' prices are used in valuing these outputs. The value of deliveries to the services and final demand sectors are (including transportation margins) $(p_1^{MS} + p_3^{MS})q_1^{MS}$ and $(p_1^{MF} + p_3^{MF})q_1^{MF}$ respectively. The row 2 entries in Table 4, which allocate the service sector outputs across demanders) are the same as the row 2 entries in Table 2. Row 3 in Table 4 gives the sum of the entries in rows 1 and 2 for each column. Thus the row 3, column 1 entry gives the value added of the combined goods producing and transportation industries while the row 3, industry S entry gives the value added for the services industry. The final demand entry in row 3 of Table 4 is the nominal value of GDP, as usual.

Looking at Table 4, it can be seen that it is unlikely that commodity prices are constant along the components of each row. Again, this is unfortunate since it means that *in order to construct accurate productivity statistics for each industry, it generally will be necessary to construct separate price deflators for each nonzero cell in the input output tables.*

Table 4 allows us yet another way that real GDP for the economy can be constructed. For this fifth method for constructing Laspeyres, Paasche and Fisher output indexes for the economy, we could use the 6 nonzero $p_n q_n$ values that appear in rows 1 and 2 and columns 1 and 2 of Table 4 and use the corresponding p and q vectors of dimension 6 as inputs into the Laspeyres, Paasche and Fisher quantity index formulae. It is easy to extend the string of equalities (6), (7) and (8) to cover these new indexes. Thus we have a fifth method for constructing a Fisher output index that will give the same answer as the previous 4 methods.

The organization of production statistics that is represented by Table 4 is convenient for some purposes, in that outputs are valued consistently at final demand prices. However, it has the disadvantage that the transportation, retailing and wholesaling industries have disappeared, which means that these margins have to be imputed to the goods producing industries. Moreover, the primary inputs that are used by the transportation, retailing and wholesaling industries would also have to be allocated to goods producing industries. It is unlikely that users of industry production statistics would welcome these changes. Thus we conclude that organizing production statistics according to the layout in Table 2 would be preferable for most purposes.

In the following section, we introduce commodity taxes into our highly simplified model of the industrial structure of the economy.

3. Input Output Tables when there are Commodity Taxes

Although governments in the United States do not impose very large commodity taxes on production as compared to many European countries, U.S. commodity taxes are large enough so that they cannot be ignored.

We return to the production model that corresponds to Table 1 in the previous section but we now assume that there is the possibility of a commodity tax falling on the output of each industry. In order to minimize notational complexities, we assume that each producing industry collects these commodity taxes and remits them to the appropriate level of government. Thus industry M collects the tax revenue $t_1^{MS}q_1^{MS}$ on its sales of goods to industry S and the tax revenue $t_1^{MF}q_1^{MF}$ on its sales to the final demand sector so that t_1^{MS} and t_1^{MF} are the specific tax rates that are applicable (across all levels of government) on sales of goods to the service industry and to the final demand sector respectively.²³ Similarly, industry S collects the tax revenue $t_2^{SM}q_2^{SM}$ on its sales of services to industry M and the tax revenue $t_2^{SF}q_2^{SF}$ on its sales to the final demand sector. Finally, industry T collects the tax revenue $t_3^{MS}q_1^{MS}$ on its sales of transportation services to industry S and the tax revenue $t_3^{MF}q_1^{MF}$ on its sales of transportation services to the final demand sector.

We now add the commodity taxes collected by each industry to the old industry revenues that appeared in Table 1. Thus the old revenue received by industry M listed in row 1 of Table 1, $p_1^{MS}q_1^{MS} + p_1^{MF}q_1^{MF}$, is replaced by $(p_1^{MS} + t_1^{MS})q_1^{MS} + (p_1^{MF} + t_1^{MF})q_1^{MF}$ in row 1 of Table 5. Similarly, the old revenue received by industry S listed in row 4 of Table 1, $p_2^{SM}q_2^{SM} + p_2^{SF}q_2^{SF}$, is replaced by $(p_2^{SM} + t_2^{SM})q_2^{SM} + (p_2^{SF} + t_2^{SF})q_2^{SF}$ in row 4 of Table 5. The old revenue received by industry T for its deliveries of goods shipped to the final demand sector listed in row 2 of Table 1, $(p_1^{MF} + p_3^{MF})q_1^{MF}$, is replaced by $(p_1^{MF} + t_1^{MF})q_1^{MF} + (p_3^{MF} + t_3^{MF})q_1^{MF}$ in row 2 of Table 5. The term $(p_1^{MF} + t_1^{MF})q_1^{MF}$ is equal to

²³ Ad valorem tax rates can readily be converted into specific taxes that are collected for each unit sold.

Usually, tax rates are lower for sales to industry purchasers compared to sales to final demand but this is not always the case since exports are generally taxed at zero rates. In any case, usually t_1^{MS} will not be equal to t_1^{MF} . If sales to a particular sector are not taxed, then simply set the corresponding tax rate equal to zero. Product specific subsidies can be treated as negative commodity taxes.

$p_1^{MF} q_1^{MF}$ (the revenue that the manufacturer gets for its sales of goods to the final demand sector) plus $t_1^{MF} q_1^{MF}$ (the amount of commodity taxes collected by the manufacturing sector on its sales of goods to the final demand sector). The term $(p_3^{MF} + t_3^{MF}) q_1^{MF}$ reflects the additional charges that final demanders of the good pay for delivery of the good to the final demand sector and this term is equal to the sum of $p_3^{MF} q_1^{MF}$ (the transportation sector's revenue for shipping goods to the final demand sector) plus $t_3^{MF} q_1^{MF}$ (the amount of taxes collected by the transportation sector that fall on shipping services to the final demand sector). Finally, the old revenue received by industry T for its deliveries of goods shipped to the services sector listed in row 3 of Table 1, $(p_1^{MS} + p_3^{MS}) q_1^{MS}$, is replaced by $(p_1^{MS} + t_1^{MS}) q_1^{MS} + (p_3^{MS} + t_3^{MS}) q_1^{MS}$ in row 3 of Table 5. The term $(p_1^{MS} + t_1^{MS}) q_1^{MS}$ is equal to $p_1^{MS} q_1^{MS}$ (the revenue that the manufacturer gets for its sales of goods to the services sector) plus $t_1^{MS} q_1^{MS}$ (the amount of commodity taxes collected by the manufacturing sector on its sales of goods to the services sector). The term $(p_3^{MS} + t_3^{MS}) q_1^{MS}$ reflects the additional charges that service sector demanders of the good pay for delivery of the good to the service sector and this term is equal to the sum of $p_3^{MS} q_1^{MS}$ (the transportation sector's revenue for shipping goods to the services sector) plus $t_3^{MS} q_1^{MS}$ (the amount of taxes collected by the transportation sector that fall on shipping services to the services sector). With the addition of the commodity tax terms, it can be seen that the first 4 rows of Table 5 are exact counterparts to the first 4 rows of Table 1.

Table 5: Detailed Input Output Table in Current Dollars with Commodity Taxes

R	Industry M	Industry S	Industry T	Final Demand
1	$(p_1^{MS} + t_1^{MS}) q_1^{MS}$ $+ (p_1^{MF} + t_1^{MF}) q_1^{MF}$		$\square (p_1^{MS} + t_1^{MS}) q_1^{MS}$ $\square (p_1^{MF} + t_1^{MF}) q_1^{MF}$	
2			$(p_1^{MF} + t_1^{MF}) q_1^{MF}$ $+ (p_3^{MF} + t_3^{MF}) q_1^{MF}$	$(p_1^{MF} + t_1^{MF}) q_1^{MF}$ $+ (p_3^{MF} + t_3^{MF}) q_1^{MF}$
3		$\square (p_1^{MS} + t_1^{MS}) q_1^{MS}$ $\square (p_3^{MS} + t_3^{MS}) q_1^{MS}$	$(p_1^{MS} + t_1^{MS}) q_1^{MS}$ $+ (p_3^{MS} + t_3^{MS}) q_1^{MS}$	
4	$\square (p_2^{SM} + t_2^{SM}) q_2^{SM}$	$(p_2^{SM} + t_2^{SM}) q_2^{SM}$ $+ (p_2^{SF} + t_2^{SF}) q_2^{SF}$		$(p_2^{SF} + t_2^{SF}) q_2^{SF}$
5	$\square t_1^{MS} q_1^{MS}$ $\square t_1^{MF} q_1^{MF}$	$\square t_2^{SM} q_2^{SM}$ $\square t_2^{SF} q_2^{SF}$	$\square t_3^{MF} q_1^{MF}$ $\square t_3^{MS} q_1^{MS}$	
6	$p_1^{MS} q_1^{MS} + p_1^{MF} q_1^{MF}$ $\square p_2^{SM} q_2^{SM}$ $\square p_2^{SF} q_2^{SF}$	$p_2^{SM} q_2^{SM} + p_2^{SF} q_2^{SF}$ $\square (p_1^{MS} + t_1^{MS}) q_1^{MS}$ $\square (p_3^{MS} + t_3^{MS}) q_1^{MS}$	$p_3^{MF} q_1^{MF} + p_3^{MS} q_1^{MS}$	$(p_1^{MF} + t_1^{MF}) q_1^{MF}$ $+ (p_3^{MF} + t_3^{MF}) q_1^{MF}$ $+ (p_2^{SF} + t_2^{SF}) q_2^{SF}$

Row 5 in Table 5 is a new row which has been added to the rows of Table 1 and it lists (with negative signs) the commodity tax revenues raised by the industry on their sales of products to final demand and other industries. These tax payments to the government are costs and hence are listed with negative signs.

The cells in row 6 of Table 5 are the sums down each column of the entries in rows 1 to 5. Thus the entries in row 6 list the *value added* of each industry for industries M, S and

T.²⁴ The row 6 entry for the Final Demand sector is simply the sum of final demand purchases for goods, including all tax and transportation margins, $(p_1^{MF} + t_1^{MF} + p_3^{MF} + t_3^{MF})q_1^{MF}$, plus final demand purchases of services, including indirect taxes on services, $(p_2^{SF} + t_2^{SF})q_2^{SF}$.

We now come to an important difference between Table 1 and Table 5: the sum of the industry M, S and T value added (the entries along row 6 of Table 5) is no longer equal to the sum of the final demands down rows 1 to 4 of the Final Demand column: we need to add the commodity tax payments made by the three industries to the industry value added sum in order to get the sum of final demands at final demand prices. It is worth spelling out this equality in some detail. Thus define the industry M, S and T value added, v^M , v^S and v^T respectively, as follows:

$$(9) v^M \equiv p_1^{MS} q_1^{MS} + p_1^{MF} q_1^{MF} - p_2^{SM} q_2^{SM} - t_2^{SM} q_2^{SM};$$

$$(10) v^S \equiv p_2^{SM} q_2^{SM} + p_2^{SF} q_2^{SF} - (p_1^{MS} + t_1^{MS}) q_1^{MS} - (p_3^{MS} + t_3^{MS}) q_1^{MS};$$

$$(11) v^T \equiv p_3^{MF} q_1^{MF} + p_3^{MS} q_1^{MS}.$$

Notice that for each industry, outputs are valued at producer prices that exclude the commodity taxes collected by the industry but intermediate inputs are valued at prices that the industry faces; i.e., the intermediate input prices include the commodity taxes paid by the supplying industries. In summary, the prices for outputs and intermediate inputs that are in definitions (9)-(11) are the prices actually faced by the respective industry. This is the set of prices that is best suited to a set of productivity accounts.²⁵ Finally, define the value of final demands, v^F , and the value of commodity taxes, v^\square , as follows:

$$(12) v^F \equiv (p_1^{MF} + t_1^{MF} + p_3^{MF} + t_3^{MF}) q_1^{MF} + (p_2^{SF} + t_2^{SF}) q_2^{SF};$$

$$(13) v^\square \equiv t_1^{MS} q_1^{MS} + t_1^{MF} q_1^{MF} + t_2^{SM} q_2^{SM} + t_2^{SF} q_2^{SF} + t_3^{MF} q_1^{MF} + t_3^{MS} q_1^{MS}.$$

Using definitions (9) to (13), it is straightforward to verify that the following identity holds:

²⁴ Note that our definition of industry value added is the value of outputs sold at purchasers' prices less the value of intermediate inputs at purchasers' prices less commodity taxes collected for the government by that industry. The usual definition of industry value added does not net off industry commodity tax remittances to the government; i.e., the usual definition of value added does not subtract off row 5 but rather adds these commodity tax remittances to primary input payments. The problem with this latter treatment of industry commodity tax payments is that it does not provide a suitable framework for measuring industry productivity growth performance. Thus our suggested treatment of indirect commodity taxes in an accounting framework that is suitable for productivity analysis follows the example set by Jorgenson and Griliches who advocated the following treatment of indirect taxes: "In our original estimates, we used gross product at market prices; we now employ gross product from the producers' point of view, which includes indirect taxes levied on factor outlay, but excludes indirect taxes levied on output." Dale W. Jorgenson and Zvi Griliches (1972; 85). Put another way, commodity tax payments to the government cannot readily be regarded as a payment for the services of a primary input.

²⁵ As noted earlier, these are the prices that were recommended by Jorgenson and Griliches (1972; 85) for productivity accounts.

$$(14) v^M + v^S + v^T = v^F - v^T;$$

i.e., the sum of industry M, S and T value added equals GDP (or the value of final demands at purchasers' prices) less the value of commodity taxes that fall on outputs and intermediate inputs.

In addition to adding row 5 (the industry commodity tax payments to the government) to the rows of Table 1, Table 5 has another important difference compared to Table 1: the principles of double entry bookkeeping are not respected in the present version of Table 5. The problem is that the industry tax payments listed in row 5 of Table 5 are not transferred to another column in the table. However, this deficiency could be corrected by creating a Government "industry" column where the industry tax payments could be received. A more complete model of the economy would decompose final demand into a government sector as well as the other traditional C + I + X - M final demand sectors.

Table 6 is the counterpart to Table 2 in the previous section and it represents a consolidation of the information presented in Table 5. The industry M, row 1 entry in Table 6 is the sum of the row 1 and row 5 entries in Table 5 (this consolidation nets out the commodity taxes on the manufacturing output) and the industry M, row 2 entry in Table 6 is equal to the industry M, row 4 entry in Table 5 (the services intermediate input allocation to industry M remains unchanged). The industry S, row 3 entry in Table 5 is split between rows 1 and 3 in Table 6 (this splits the total intermediate input cost for industry S into a goods component and a transportation component). The industry S, row 2 entry in Table 6 is equal to the sum of the industry S, rows 4 and 5 entries in Table 5 (this consolidation nets out the commodity taxes on the service sector outputs). The industry T, row 3 entry in Table 6 is the sum of rows 1-5 for industry T in Table 5. The Table 5 final demand entry for row 2 is split into goods and transportation services components, which are allocated to rows 1 and 3 of Table 6. The final demand for services entry in row 4 of Table 5 is switched to row 2 of the final demand column in Table 6.

Table 6: Consolidated Input Output Table in Current Dollars with Commodity Taxes

R	Industry M	Industry S	Industry T	Final Demand
1	$p_1^{MS} q_1^{MS} + p_1^{MF} q_1^{MF}$	$-(p_1^{MS} + t_1^{MS}) q_1^{MS}$		$(p_1^{MF} + t_1^{MF}) q_1^{MF}$
2	$-(p_2^{SM} + t_2^{SM}) q_2^{SM}$	$p_2^{SM} q_2^{SM} + p_2^{SF} q_2^{SF}$		$(p_2^{SF} + t_2^{SF}) q_2^{SF}$
3		$-(p_3^{MS} + t_3^{MS}) q_1^{MS}$	$p_3^{MF} q_1^{MF} + p_3^{MS} q_1^{MS}$	$(p_3^{MF} + t_3^{MF}) q_1^{MF}$

Thus row 1 of Table 6 allocates the production of goods across the sectors of the economy, row 2 allocates the flow of services and row 3 allocates the flow of transportation services. If we summed down each column of Table 6, we would obtain the value added of industry M, v^M defined by (9), the value added of industry S, v^S defined by (10), the value added of industry T, v^T defined by (11), and (nominal) GDP, v^F

defined by (12). The constant dollar input output table that corresponds to the nominal input output Table 6 is still Table 3 in the previous section.

Looking at Table 6, it can be seen that the existence of commodity tax wedges means it is unlikely that commodity prices are constant along the components of each row. Again, this is unfortunate since it means that *in order to construct accurate productivity statistics for each industry, it generally will be necessary to construct separate price deflators for each nonzero cell in the input output tables.*

We conclude this section by again seeing if we can obtain a counterpart to the Moyer, Reinsdorf and Yuskavage exact index number result in this more complicated model where there are commodity tax wedges. Looking at the identity (14), it can be seen that since nominal GDP is not equal to the sum of industry value added if the value of commodity tax revenue v^{\square} is not equal to zero, we will not be able to get an exact result unless we add a government commodity tax revenue “industry” to the M, S and T industries. Thus we now define the value added of the commodity tax “industry” as v^{\square} and we rewrite the identity (14) as follows:

$$(15) v^F = v^M + v^S + v^T + v^{\square}.$$

Now we can repeat the analysis in the previous section with a few obvious modifications. Thus looking at (15) and Table 6, it can be seen that there are three ways that we could calculate a Laspeyres GDP quantity index for the economy that the table represents:

- Look at the nonzero cells in the 3 by 3 matrix of input output values of outputs and inputs for the economy represented by rows 1-3 and columns M,S and T of Table 6 and sum up these nonzero cells into 9 distinct $p_n q_n$ transactions. Add to these 9 $p_n q_n$ transactions the 6 $t_n q_n$ tax transactions that are defined by the right hand side of (13), which gives us 15 distinct price times quantity transactions in all.
- Look at the row 5, column M,S and T entries for the industry value added components listed in Table 5 and sum up these cells into 8 distinct $p_n q_n$ transactions. Add to these 8 $p_n q_n$ transactions the 6 $t_n q_n$ tax transactions that are defined by the right hand side of (13), which gives us 14 distinct price times quantity transactions in all.
- Look at rows 1-3 of the final demand column in Table 6 and sum up the nonzero cells into 2 distinct $p_n q_n$ transactions.²⁶

Denote the 15 dimensional p and q vectors that correspond to the first detailed cell method of aggregating over commodities listed above as p^{IO} and q^{IO} respectively, denote the 14 dimensional p and q vectors that correspond to the second value added method of aggregating over commodities listed above as p^{VA} and q^{VA} respectively and denote the 2 dimensional p and q vectors that correspond to the third aggregation over final demand components method of aggregating over commodities listed above as p^{FD} and q^{FD}

²⁶ The first $p_n q_n$ is $(p_1^{MF} + t_1^{MF} + p_3^{MF} + t_3^{MF}) q_1^{MF}$ and the second $p_n q_n$ is $(p_2^{SF} + t_2^{SF}) q_2^{SF}$.

respectively. Add a superscript t to denote these vectors evaluated at the data pertaining to period t . Then it is obvious that the inner products of each of these 3 period t price and quantity vectors are all equal since they are each equal to period t nominal GDP; i.e., we have:

$$(15) p^{IOt} \cdot q^{IOt} = p^{VA_t} \cdot q^{VA_t} = p^{FDt} \cdot q^{FDt}; \quad t = 0, 1.$$

Now the rest of the analysis can proceed as in the previous section; see equations (2)-(8) and repeat this analysis in the present context. As in section 2, it can be shown that all three Fisher quantity indexes, constructed by aggregating over Input Output table cells or by aggregating over industry value added components or by aggregating over final demand components, are equal; i.e., we have:

$$(16) Q_F^{IO}(p^{IO0}, p^{IO1}, q^{IO0}, q^{IO1}) = Q_F^{VA}(p^{VA0}, p^{VA1}, q^{VA0}, q^{VA1}) = Q_F^{FD}(p^{FD0}, p^{FD1}, q^{FD0}, q^{FD1}).$$

Thus we have extended the results of Moyer, Reinsdorf and Yuskavage to input output models where commodity tax distortions are present.²⁷ The usual BEA Fisher contributions to growth methodology can be used in order to decompose overall GDP growth into industry growth contributions plus a commodity tax change contribution (this is the contribution to GDP growth of the artificial commodity tax industry).

4. Conclusion

There are a number of important implications that emerge from the above discussion:

- With appropriate adjustments for commodity taxes, a Fisher index of value added growth by industry can be used to construct an independent estimate of real GDP growth.
- The existence of transportation and selling margins and commodity taxes means that the assumption that a *single* price deflator can be used for productivity measurement purposes to deflate all of the value cells long the row of an input output table is likely to be a very rough approximation at best. In principle, each nonzero cell in a nominal input output table will require its own separate deflator.²⁸
- The existence of commodity taxes that fall within the production sector poses special problems for statistical agencies. These taxes need to be identified by cell

²⁷ Results analogous to (16) were derived by Diewert (2004a; 479-484) under more restrictive assumptions; i.e., each sector was assumed to face the same vector of commodity prices except for the commodity tax distortions.

²⁸ In the very simple model considered in the previous two sections, there was no aggregation bias in each cell of the various input output tables that were constructed. However, in a real life input output table, we will not be able to classify commodities down to a very fine level of detail. Hence, there will be a mix of related commodity transactions in each cell of an empirical input output table. Due to the differing mixes of micro commodities in each cell, it can be seen that each cell will require its own deflator and moreover, the entries along any row of the resulting deflated real input output table will not in general add up to the corresponding total in the final demand column. Thus forcing constant dollar input output tables to add up along rows will generally impose errors on the data.

position in the input output tables instead of just reported as a single sum for the industry as is done at present.

The last point requires a bit more explanation. Looking at Table 6, it can be seen that row 2 entry for industry M is $\square (p_2^{SM} + t_2^{SM})q_2^{SM}$, which is (minus) the value of service intermediate inputs used by industry M, including the commodity tax portion, $t_2^{SM}q_2^{SM}$. Similarly, the row 1 entry for industry S is $\square (p_1^{MS} + t_1^{MS})q_1^{MS}$, which is minus the value of materials intermediate inputs used by industry S, including the commodity tax portion, $t_1^{MS}q_1^{MS}$. The row 3 entry for industry S is $\square (p_3^{MS} + t_3^{MS})q_1^{MS}$, which is (minus) the value of transportation services purchased by industry S, including the commodity tax on transport services, $t_3^{MS}q_1^{MS}$. It can be shown that the existence of these commodity tax distortions on intermediate input purchases by the private production sector leads to a loss of overall productive efficiency. Thus even though industry M and industry S are operating efficiently so that they are on the frontiers of their production possibilities sets, the consolidated production sector is not operating efficiently. The explanation for this phenomenon was given by Gerard Debreu (1951; 285):²⁹ there is a loss of system wide output (or waste, to use Debreu's term) due to the imperfection of economic organization; i.e., different production units, while technically efficient, face different prices for the same input or output, and this causes net outputs aggregated across production units to fall below what is attainable if the economic system as a whole, were efficient. In other words, a condition for system wide efficiency is that all production units face the same price for each separate input or output that is produced by the economy as a whole. Thus, the existence of commodity taxes that fall on intermediate inputs causes producers to face different prices for the same commodity and if production functions exhibit some substitutability, then producers will be induced to jointly supply an inefficient economy wide net output vector. The overall size of the loss of productive efficiency depends on the magnitudes of elasticities of substitution and on the size of the commodity tax distortions, t_2^{SM} , t_1^{MS} and t_3^{MS} .³⁰ In order to obtain empirical estimates of this loss of productive efficiency, it is necessary to estimate production functions or dual cost or profit functions for each industry in the economy. Thus for the economy represented by Table 6, it would be necessary to estimate 3 sectoral production functions (or their dual equivalents) and hence a time series of the price quantity data in each cell of the input output table would need to be collected. For the econometric estimation, it would not be necessary for the statistical agency to provide information on the tax wedges, i.e., only prices that include the tax wedges (along with the associated quantities) would need to be provided by the statistical agency.³¹ However, in order to *calculate* the loss of productive efficiency induced by the tax wedges, t_2^{SM} , t_1^{MS} and t_3^{MS} , the statistical agency would have to provide information on the size of these wedges.

The loss of productive efficiency due to the existence of taxes that fall within the production sector of the economy is of course not the total loss of efficiency that can be

²⁹ See also Diamond and Mirrlees (1971).

³⁰ To the accuracy of a second order approximation, the size of the loss will grow quadratically in the tax rates t_2^{SM} , t_1^{MS} and t_3^{MS} ; see Diewert (1983; 171).

³¹ For examples of econometric studies that estimate sectoral production functions or their dual equivalents, see Jorgenson (1998) or Diewert and Lawrence (1994) (2002).

attributed to indirect tax wedges: there are additional losses of efficiency that are due to the taxes that fall on the components of final demand. Thus if we look down the three rows of the final demand column in Table 6, we see that each final demand price has a tax wedge included in it: t_1^{MF} is the final demand tax wedge for commodity 1 (the good), t_2^{SF} is the final demand tax wedge for commodity 2 (the service) and t_3^{MF} is the final demand tax wedge for commodity 3 (the transport service).³² Each of these three tax wedges creates some additional losses of overall efficiency in the economy. In order to obtain empirical estimates of these efficiency losses or excess burdens, it will be necessary to estimate household preferences in addition to the production functions mentioned in the previous paragraph. For econometric estimation purposes, it is sufficient for the statistical agency to provide final demand prices and quantities demanded where the prices include the commodity tax wedges; i.e., only the total prices, including commodity taxes, are required for econometric estimation. However, in order to calculate the deadweight loss generated by these commodity taxes, it will be necessary to have estimates of the tax wedges; i.e., tax researchers will require estimates of t_1^{MF} , t_2^{SF} and t_3^{MF} .³³ This information is required not only so that total excess burdens can be estimated but also so that *marginal excess burdens* of each tax can be estimated. The marginal excess burden of a tax rate is an estimate of the efficiency loss generated by a small increase in the tax rate divided by the extra revenue that the increase in the tax rate generates. If reasonably accurate information on marginal excess burdens could be made available to policy makers, this information would be very valuable in evaluating the consequences of either increasing or decreasing existing tax rates.³⁴ However, as indicated in this paragraph and the preceding one, it will not be possible to calculate estimates of these marginal excess burdens unless the statistical agency makes available information on the tax wedges and the associated quantities for each major indirect tax in the economy.

Thus for purposes of modeling the effects of indirect commodity taxes, our conclusion is that the new architecture for an expanded set of U.S. accounts that is outlined in Jorgenson and Landefeld (2004) is not quite adequate to meet the needs of taxation economists. In addition to the tables that are presented in Jorgenson and Landefeld, we need an additional table that gives tax rates and the associated quantities (or revenues) for each cell where the tax appears. In terms of Table 6, we need not only price and quantity information for each of the nonzero cells in the table, but we also need price and quantity information for the 6 tax revenue flows in our model, namely t and q information for the tax flows $t_1^{MS} q_1^{MS}$, $t_1^{MF} q_1^{MF}$, $t_2^{SM} q_2^{SM}$, $t_2^{SF} q_2^{SF}$, $t_3^{MF} q_1^{MF}$ and $t_3^{MS} q_1^{MS}$. An additional benefit of making this information available is that this information is also required in order to reconcile the industry productivity accounts with the economy's final demand GDP accounts.

³² Note that these 3 tax rates plus the 3 that appeared as taxes on intermediate inputs in the input output Table 6 add up to the 6 commodity tax wedges in our model of the economy.

³³ For additional material on measuring deadweight losses, see Diewert (1981) (1983).

³⁴ For examples of studies that estimate marginal excess burdens, see Jorgenson and Yun (2001) or Diewert and Lawrence (1994) (1995) (2002).

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