

## Participatory Sub-sector Analysis

### ANALYSIS OF MACRO ECONOMICS

#### NATIONAL INCOME ACCOUNTS

##### What is National Income Accounting?

National income accounting is a term which is applied to the description of the various types of economic activities that are taking place in the community in a certain institutional framework. In national income accounting, we are concerned with statistical classification of the economic activity so that we are able to understand easily and clearly the operation of the economy as a whole. In national income accounting the following distinctions are drawn between:

- (a) forms of economic activity, namely, production, consumption, and accumulation of wealth;
- (b) sectors or institutional division of the economy; and
- (c) types of transactions, such as sales and purchases of goods and services, gifts, taxes, and other current transfers.

In national income accounting, a transactor is supposed to keep a set of three accounts in which transactions are recorded:

- (i) In the first account, incomes and outgoings relating a productive activity of the transactor are brought together. The difference between the two shows the profit or gain.

(ii) The second account seeks to show how this profit and any other income that accrues to the transactor are allocated to different uses. The excess of income over outlay is saving.

(iii) The third account shows how this saving and any other capital funds are used to finance the capital expenditure or to give loans to other transactors.

Since in an economy, there are numerous transactors, therefore, they are grouped into sectors. In a sector, accounts of a same type are consolidated. The 'sector accounts' form the units in a system of national income accounting.

*Comparison of National Income Accounting and Individual Income Accounting:*

(a) **Double entry book-keeping:** Both national income accounting system and individual income accounting system are based on the method of double-entry book-keeping. For example, under individual income accounting, a cash sale is recorded as a debit in Cash Account and as a credit in Sales Account. Whereas, in national income accounting, the cash transactions are not separately presented. Cash balances are recorded in the capital transaction account. The difference is that the national income accounting does not record the second entry in detail.

(b) **Individual vs. collective individuals:** Individual income accounts or private accounts relate to an individual businessman or a corporate firm.

Whereas, the national income accounts are closely related to all the businessmen or corporate firms in the community.

(c) **Profit and loss account:** Individual income accounts are usually presented in the form of a Profit and Loss Account or Income Statement which shows the flow of income and its allocation during a year. The Balance Sheet shows the stock of assets and liabilities at the end of the year. The Profit and Loss Account of a private businessman resembles in national income accounting to what is called the Appropriation Account. The only difference is that in private accounting, the profit often includes some elements of costs such as depreciation on plant and machinery and fees paid to the directors of the company. On the other hand, in national income accounting, these incomes are shown net. There is no counterpart at all of a Balance Sheet in national income accounting since there is a great difficulty in collecting such a huge bank of data accurately and completely especially on uniform basis.

**Uses of National Income Accounting:**

(a) **Clear picture of the economy:** The national income accounts or social accounts give a clear picture of the economy regarding the GDP, national income, per capita income, saving ratio, production, consumption, disposable income, capital expenditure, etc. It gives a clear view of the health of the economy and the way in which it functions. It also gives a view on the living standard of the people.

(b) **Promotion of efficiency and stability of the economy:** To foster the economic growth, any government has to see what she has achieved in the past and what has to be done in the future. For this purpose, the preparation of national income accounts is quite inevitable for the promotion of economic efficiency and stability. It helps the government to set the national priorities, such as education, inflation, unemployment, defence, social development, and industrialisation, etc., in long-term and medium-term planning. It also helps the planner to set the economic objectives to be achieved in the near future. Thus it serves the purpose of planning and controlling tool for public administrators.

(c) **Measurement of economic welfare:** Measurement of economic welfare is another purpose of the preparation of social accounts. Through social accounting, we can know at a glance to what extent the masses are better off than at the time when planning started.

(d) **Interrelationship of different sectors of the economy:** Through the study of national income accounts, the reader is in a position to inter-relate different sectors of the economy. For example, through the study of national income accounts, we can know that Pakistan's industrial sector is largely dependant on agriculture sector, because most of the raw materials like cotton, silk, leather, sugarcane, milk, poultry, etc. are supplied from agriculture.

(e) **Monetary, fiscal and trade policies:** The national income accounts are very essential for the statesmen, governments, and politicians, because they help them to efficiently formulate different economic policies, including monetary policy, fiscal policy and trade policy. In the absence of national income accounts, the economic planning would be disastrous.

Gross National Product (GNP):

GNP is the basic national income accounting measure of the total output or aggregate supply of goods and services. It has been defined as the total value of all final goods and services produced in a country during a year. GNP is a 'flow' variable, which measures the quantity of final goods and services produced during a year. For calculating GNP accurately, all goods and services produced in any given year must be counted once, but not more than once.

Approaches of Measuring GNP/GDP:

The primary purpose of national accounts is to provide a coherent and comprehensive picture of the economy. To be concise, these estimates tend to answer questions such as:

- (a) What is the output of the economy, its size its composition, and its uses? And
- (b) What is the economic process by which this output is produced and distributed? These questions are addressed below in relation to estimation of GDP/GNP and final uses of the GNP.

The gross national product (GNP) is the market value of all final goods and services, produced in the economy during a year. GNP is measured in Rupee terms rather than in physical units of output. Gross domestic product (GDP) is a better idea to visualize domestic production in the economy. GDP may be derived in three ways or in combination of them.

(i) **Production Approach**: It measures the contribution to output made by each producer. It is obtained by deducting from the total value of its output the value of goods and services it has purchased from other producers and used up in producing its own output, i.e.:

**VA = value of output – value of intermediate consumption.**

Total value added by all producers equals GDP.

(ii) **Income/Cost Approach**: In this approach, consideration is given to the costs incurred by the producer within his own operation, the income paid out to employees, indirect taxes, consumption of fixed capital, and the operating surplus. All these add up to value added.

(iii) **Expenditure Approach**: This approach looks at the final uses of the output for private consumption, government consumption, capital formation and net of imports & exports. According this approach, GDP is the sum of following four major components:

- Personal consumption expenditure on goods and services,
- Gross private domestic investment,
- Government expenditure on goods and services, and
- Net export to the rest of the world.

The concepts of expenditure approach and cost approach have been illustrated in the following diagram of circular flow of a simplified two-sector economy:

## COMMUNITY ECONOMIC ANALYSIS



**Figure 1** – Circular flow of a two-sector economy

In the above diagram, the upper loop represents the 'expenditure' side of the economy. Through this loop, all the products flow from business sector to household sector. Each year the nation consumes a wide variety of final goods and services: goods such as bread, apples, computers, automobiles, etc.; and services such as haircuts, health, taxis, airlines, etc. But we include only the value of those products that are bought and consumed by the consumers. In our 'two-sector economy' illustration, we have excluded the investment expenditure, government expenditure and taxes from GDP calculation.

The lower loop represents the 'cost or revenue' side of the economy. Through this loop, all the costs of doing business flow. These costs include wages paid to labour, rent paid to land, profits paid to capital, and so forth. But these business costs are revenues that are received by households in exchange of supplying factors of production to the business sector.

## COMMUNITY ECONOMIC ANALYSIS

### REFERENCES

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