# 7.0 Income and Capital Accounts (Module 7)

## 7.1 Session I. Introduction – External Transaction and SNA Sequence of Accounts

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			* *RoW* Account
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In module 4**,** we have seen how the measure of domestic production, *GDP*, of an economy is related to income (*GNI*) and disposable income (*GNDI*) of its residents. Also recall that the difference between *GDP* and *GNI* is brought about by inflow and outflow of primary income to and from *RoW*. Again, the difference between *GNI* and *GNDI* is brought about by inflow and outflow of current transfers to and from *RoW*.

While net primary income and current transfers have a determining role in GNI and GNDI, exports and imports of goods and services are the other kind of external transactions that have direct bearing on the relationship between domestic production of goods & services and expenditure-side aggregates. In fact, these constitute the principal transactions with the rest of the world. Lastly, the capital transfers from and to the *RoW* bring about changes in the resources available for investment.

For national accounts, most of the economy-level estimates of external transactions are taken from the Balance of Payment (BoP) Statistics compiled and published by the Central Banks of the respective economies. These are usually supplemented by data from other sources to compile institutional accounts in the national accounts.

Thus, we will discuss the RoW accounts and the BoP in some detail as well as the income accounts and the capital account in this module. First, we will discuss the RoW transactions and BoP and establish the correspondence between the two in this session.

**External Transactions**

All transactions taking place between a resident and a non-resident institutional unit constitute *external transactions* of an economy. In the SNA, external transactions are also called transactions with the rest of the world (*RoW*).

The *RoW* in respect of an economy is composed of all non-resident units carrying out transactions with the residents of the economy. It, therefore, comprises all non-resident units that

* sell their products to the residents or buys products produced by the residents or
* pays wages and salaries to or receives wages & salaries from the residents or
* pays property income to or receives property income from the residents or
* make transfer payments to or receive transfers from the residents.

All these transactions are reflected in the flows of funds between the economy and the RoW resulting in changes in financial assets and liabilities of the economy.

**Kinds of transactions with the *RoW***

Broadly, the transactions with the RoW can be classified into the following four categories:

1. Transactions in goods & services
2. Payment and receipts of primary income
3. Payment and receipts of transfers
4. Transactions in financial assets and liabilities.

*Transactions in goods & services*: This category consists of all exports and imports of goods and services between residents and non-residents. In the SNA sequence of accounts, these are recorded explicitly in the goods and services account.

*Payment and receipts of primary income*: This category consists of (i) payment of compensation of employees to *RoW*, (ii) receipts of compensation of employees from the *RoW*, (iii) payment of property income to the *ROW* and (iv) receipts of property income from the *RoW*. These get included in following aggregates in the sequence of accounts:

|  |  |  |
| --- | --- | --- |
| category |  | SNA account |
| (i) | → | COE on uses side of Generation of Income  |
| (ii) | → | COE on resources side of Allocation of primary Income |
| (iii) | → | Property income on uses side of Allocation of primary Income |
| (iv) | → | Property income on resources side of Allocation of primary Income |

*Payment and receipts of transfers*: This category consists of (i) payments and receipts of current transfers to and from the RoW and (ii) payment and receipts of capital transfers to and from the RoW. In the SNA sequence of accounts, the first category is included in respectively the uses and resources side of the Secondary Distribution of Income accounts. The both the payments and receipts in the second category are included on the resources side of the Capital account, with opposite signs.

*Transactions in financial assets and liabilities*: This category consists of all flows of financial assets and liabilities. These are included in the Financial accounts of the SNA sequence of accounts.

***RoW* Account**

In the *SNA*, the RoW accounts are not presented separately. But, the entries for the flows involving the RoW are necessary to balance each of the *income accounts* in the sequence of accounts. For example, the difference between GDP and GNI results from transactions of primary income between the residents and the RoW, which are included in both uses- and resources-sides of *allocation of primary income account*. There are no entries for flows involving RoW in the *production account* because the use made of the goods and services in the RoW is not relevant for the domestic economy. For the same reason, there are no entries involving the RoW for intermediate or final consumption or for fixed capital formation (except in rare cases for acquisition and disposal of non-produced assets).

*Example 7.1* is a summarised simple version of aggregated account, in which the all transactions are clubbed into four categories corresponding to the four kinds of external transactions.

|  |
| --- |
| ***Example 7.1*: Transactions with *RoW*** |
| **Transaction category** | NFC | FC | GG | HH | NPISHs | Total economy | *RoW* | total |
| **Resources**  |
| 1. Sold products
 | 847 | 155 | 7 | 248 | 2 | **1259** | **256** | **1515** |
| 1. Received income
 | 131 | 75 | 26 | 157 | 11 | **400** | **65** | **465** |
| 1. Received transfers
 | 0 | 0 | 3 | 0 | 1 | **4** | **2** | **6** |
| *Sub-total: non-financial* | 978 | 230 | 36 | 405 | 14 | **1663** | **323** | **1986** |
| 1. Change in liabilities
 | 92 | 57 | 27 | 4 | 4 | **184** | **51** | **235** |
| Total (= *sub-total* + item 4) | 1070 | 287 | 63 | 409 | 18 | 1847 | 374 | 2221 |
| **Uses**  |
| 1. Bought products
 | 707 | 112 | 23 | 392 | 1 | **1235** | **280** | **1515** |
| 1. Paid income
 | 215 | 151 | 29 | 7 | 2 | **404** | **61** | **465** |
| 1. Paid transfers
 | 2 | 1 | 0 | 2 | 0 | **5** | **1** | **6** |
| *Sub-total: non-financial* | 924 | 264 | 52 | 401 | 3 | **1644** | **342** | **1986** |
| 1. Change in financial assets
 | 146 | 23 | 11 | 8 | 15 | **203** | **32** | **235** |
| Total (= *sub-total* + item 4) | 1070 | 287 | 63 | 409 | 18 | 1847 | 374 | 2221 |
| Note that NFC: non-financial corporations; FC: financial corporations; GG: general government HH: households; NPISHs: non-profit institutions serving households |

The rest of the world (*RoW*) account covers transactions between resident and non-resident institutional units. This is presented from the viewpoint of the rest of the world. In *Example 1*, ‘sold products’ of the *RoW* represent imports of goods and services (256) to the domestic economy and a resource for the *RoW*. Likewise, ‘bought products’ of the *RoW* (284) represent exports of the domestic economy and a use of *RoW*.

For an economy, the RoW consists of all institutional units that are resident abroad and have some transaction with the residents. The ‘total economy’ consists of all the institutional units which are resident of the economy. In the accounting structure, the *RoW* is treated as if it is another institutional sector. Thus, a resource for the *RoW* is a use for the total economy and *vice versa*. Thus, ‘paid income’ and ‘paid transfers’ of the *RoW* are respectively ‘received income’ and ‘received transfers’ of the domestic economy. *Example1* shows that the following three identities relating to non-financial transactions, viz.

1. Value of products sold + imports ≡ Value of products purchased + exports
2. Primary income receivable from domestic units & *RoW*

 ≡ Primary income payable to domestic units & *RoW*

1. Transfers payable from domestic units & *RoW*

 ≡ Transfers receivable to domestic units & *RoW*

are satisfied for the total economy. These hold good for the individual sectors as well, only they cannot be verified from the information given in the table.

The following are the RoW-related entries normally appearing in the *SNA* sequence of accounts:

* Entries for imports and exports form part of the *goods and services account*.
* Entries for transactions of primary income - compensation of employees and property income – in the *allocation of primary income* *account*.
* Entries for transfers: current transfers in the *secondary distribution of income account* and capital transfers in the *capital account*.
* Entries for transactions in financial assets and liabilities in the *financial account*.

In the *SNA* sequence of transaction accounts, there is no place for recording balancing items of the RoW account. But, two of the balancing items of *Balance of Payment* accounts (BPM6) are inbuilt in the *SNA* sequence of accounts. They are:

* + *external balance of goods and services* (also called *external trade balance*), which is the difference between imports and exports.
	+ *current external balance* which is the sum of all resources from RoW less all uses going to RoW, including imports and exports. This corresponds to *savings* of the RoW in the *use of income accounts*.

*Points to note*:

* For national accounts, most of the economy-level estimates of external transactions are taken from the *BoP* statistics compiled and published by the Central Banks.
* All transactions taking place between a resident and a non-resident institutional unit constitute *external transactions* of an economy.
* All resident-non-resident transactions relating to (i) goods & services, (ii) primary income and (iii) transfers are reflected in the flows of funds between the economy and the RoW.
* The entries in the *summarised account* of total economy and *RoW* are in accordance with the transaction identity relating to flow of products.
* For an economy, *external trade balance* or *external balance of goods and services*

= value of products sold *minus* value of products purchased.

* Payments of compensation of employees to *RoW* are included in the COE on the uses side of the *Generation of Income* account.
* Receipts of compensation of employees from *RoW* are included in the COE on resources side of *Allocation of Primary Income*.
* Receipts of property income from *RoW* and payments of property income to Row are included respectively in the resources and uses side of *Allocation of Primary Income*.
* Value of products sold + imports ≡ Value of products purchased + exports
* Primary income receivable from domestic units & *RoW*

 ≡ Primary income payable to domestic units & *RoW*

* Transfers payable from domestic units & *RoW*

 ≡ Transfers receivable to domestic units & *RoW*.

* Entries for current transfers from or to non-residents are made in the *secondary distribution of income account* and capital transfers in the *capital account*.
* Entries for transactions in financial assets and liabilities between residents and non-residents are made in the *financial account*.
* In the *SNA*, the uses-side of the transaction identity is distributed over different transaction accounts.
* Goods and services produced in an economy must be (finally) consumed, used for capital formation or exported.
* All goods and services used within the economy must be produced in the economy or imported.
* The goods and services account is usually compiled for the total economy.
* Regrouping of non-financial transactions within the resources- and uses-sides does not bring about any change in the balance of non-financial transactions.

## 7.2 Balance of Payments and ROW Accounts

The concepts of the Balance of Payment (BoP) accounts are harmonized with the System of National Accounts (SNA), so they can be compared or aggregated with other macroeconomic statistics.

As in the SNA, the entries in the BoP accounts are either flows or stocks. But, in the BoP, *stocks* are called *positions*.

**Flows and Positions in the BoP**

The concept of *flow* as used in the SNA and BoP is exactly the same. *Flows* refer to economic actions and effects of events within an accounting period. In the BoP, *positions* refer to a level of assets or liabilities at a point in time. As in the SNA, flows are classified into (i) transactions and (ii) other flows in the BoP.

There is a close correspondence between the accounts of the SNA and the BoP. The framework for macroeconomic statistics used in the SNA and international accounts of *BPM6* is shown in *Figure 7.1*

***Figure 7.1***

***System of National Accounts* and Balance of Payment**



Note that the shaded accounts do not appear in the BoP. The arrows represent the contributions of assets to production and income generation.

In the BoP, *positions* refer to the level of financial assets or liabilities at a point in time. They are recorded in the *international investment position* (IIP), which is a balance sheet of external financial assets and liabilities. While the *balance sheet* of the SNA shows the assets and liabilities of domestic economy, IIP of the BoP consists of only the financial assets and liabilities of the domestic economy with respect to the RoW. Generally, IIP are shown at the beginning and end of an accounting period. The IIP at the two time points are linked to the financial flows between the domestic economy and the RoW during that period.

**BoP Accounting Structure**

The BoP accounting structure comprises only those categories of accounts necessary to capture full range of transactions between the total economy and the rest of the world. The table shows the correspondence between SNA and BoP accounting structure:

|  |  |
| --- | --- |
| **SNA RoW Account** | **Corresponds to BOP and IIP** |
| External Accounts of goods and services | BOP current account: goods and services(including FISIM) |
| External accounts of primary incomes and secondary income | BOP current account: primary and secondary income |
| *External accumulation accounts* |
| Capital Account | BOP capital and financial account: capital account |
| Financial account | BOP capital and financial account: financial account  |
| Other changes in volume of assets account | IIP column for other changes in volume |
| Revaluation Account | IIP columns for other price changes and exchange rate changes |
| External assets and liabilities account | IIP |

|  |
| --- |
| *Example 7.2*: Balance of payments |
|   | Current account | Credits | Debits | Balance |
|   |  |  Goods | 462 | 392 | 70 |
|   |  |  Services | 78 | 107 | -29 |
|   |  | Goods and services | ?? | ?? | ?? |
|   |  |  Compensation of employees | 6 | 2 |   |
|   |  |  Interest | 13 | 21 |   |
|   |  |  Distributed income of corporations | 36 | 17 |   |
|   |  |  Reinvested earnings | 14 | 0 |   |
|   |  | Primary income | ?? | ?? | ?? |
|   |  |  Current taxes on income, wealth, etc. | 1 | 0 |   |
|   |  |  Net nonlife insurance premiums | 2 | 11 |   |
|   |  |  Net nonlife insurance claims | 12 | 3 |   |
|   |  |  Current international transfers | 1 | 31 |   |
|   |  |  Miscellaneous current transfers | 1 | 10 |   |
|   |  |  Secondary income | 17 | 55 | -38 |
|   |  |  Current account balance |  |  | ?? |
|   | Capital account |   |   |   |
|   |  |  Acquisitions/disposals of nonprod. assets | 0 | 0 |   |
|   |  |  Capital transfers | 1 | 4 |   |
|   |   | Capital account balance |   |   | ?? |
|   | Net lending (+) / net borrowing (-) (from current and cap. accounts) | ?? |

 Note that the sum of current account balance and capital account balance is the amount the economy lends to or borrows from the RoW. The financial account given below shows how the lending and borrowings are made during the accounting period.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|   | Financial account (by functional category) | Net acquisition of financial assets | Net incurrence of liabilities | Balance |
|   |  |  Direct investment | -4 | 8 |   |
|   |  |  Portfolio investment | 17 | 7 |   |
|   |  | Financial derivatives (other than reserves) and ESOs | 3 | 0 |   |
|   |  |  Other investment | 42 | 22 |   |
|   |  |  Reserve assets | 8 |   |   |
|   |  | Total changes in assets/liabilities | ?? | ?? |   |
|   | Net lending(+) / net borrowing(-) (from financial account) |  |  | ?? |
|   | Net errors and omissions |   |   | 0 |

**The Rest of the World Accounts in SNA and the Balance of Payments**

|  |
| --- |
| *Example 7.3:* Correspondence of SNA and BoP accounts  |
| **SNA**  | **BoP** |
| **Uses** | **Resources** |  | **Credit** | **Debit** |
| **External account of goods and services** | **Current Account**  | **626** | **594** |
| Exports of goods and services | 540 | Imports of goods and services | 499 | 1. Goods & Services
 | ?? | ?? |
|  |  |  |  | 1. Goods
 | 462 | 392 |
| *Balance of Goods & services* | ?? |  |  | 1. services
 | 78 | 107 |
| **External account of primary incomes and current transfers** | **Income** | **86** | **95** |
| *Allocation of Primary Income (RoW)* | **B. Primary Income**  | ?? | ?? |
| Compensation of Employees | 6 | Compensation of Employees | 2 |  Compensation of Employees | 6 | 2 |
| Property Income | 63 | Property Income  | 38 | Investment income | 63 | 38 |
| *Secondary Distribution of Income (RoW)* | **C. Secondary income** | ?? | ?? |
| Current taxes on income & wealth | 1 | Current taxes on income & wealth | 0 |  Taxes on income | 1 | 0 |
| Other secondary income  | 16 | Other secondary income  | 55 |  **o**ther | 16 | 55 |
| ***Current external balance*** | ?? |  |  |  |  |  |
| **SNA Accumulation Accounts** | **Capital and Financial Account**  |  |  |
| **Changes in assets** | **Changes in liabilities & net worth** |  | **debit** | **credit** |
| *Capital Account* |  |  |  | **D. Capital Account** | 1 | 4 |
|  |  | Capital transfers receivable | 4 |  Capital transfers | 1 | 4 |
|  |  | Capital transfers payable | -1 |  others | 0 | 0 |
| **Net lending (+) /Net****Borrowing** | ?? | **Changes in net worth due** **to saving and capital transfers** | **-29** |  |  |  |

Note that in (sum of credit-side of Current account & Capital and financial account) *minus* (sum of debit of Current account & Capital and financial account) = Net lending (+) / Net Borrowing (-) = ……………. .

*Points to note*:

* The concept of *flow* as used in the SNA and the BoP is exactly the same.
* As in the SNA, flows are classified into (i) transactions and (ii) other flows in the BoP.
* In the BoP, *positions* refer to a level of financial assets or liabilities at a point in time.
* The levels of financial assets or liabilities at a point in time are recorded in the *international investment position* (IIP), which is a balance sheet of external financial assets and liabilities.
* For an institutional unit / institutional sector / the total economy, the difference between sums of resources- and uses-side of non-financial transactions is always equal to *net borrowing / lending*.
* For an institutional unit / institutional sector / the total economy, *net borrowing / lending* is always equal to change in financial assets *minus* change in financial liabilities.
* Since, all financial transactions are also monetary transactions, *net borrowing / lending* of an economy is determined only by monetary transactions. The estimate of *net borrowing / lending* is not affected by estimates of non-monetary transactions.
* In national accounts, the estimates of non-monetary transactions are often called ‘notional’ or ‘imputed’ values, since, being non-observable, they cannot be obtained directly from any statistical survey or administrative sources. These do not affect the balancing item *net borrowing / lending* of the economy.
* The *SNA* recommends alternative methods of working out estimates of ‘notional’ or ‘imputed’ aggregates.
* The *CFC*, for instance, is recommended to be estimated by *perpetual inventory method* [discussed later], though values of depreciation are usually presented in the annual accounts of the companies. The figures for depreciation quoted in the company accounts, being based on book value and not the current market value, do not represent the *CFC*.
* In general, every intra-unit transaction, except the *CFC*, affects two entries of the transaction accounts – one in the resources-side and other on the uses-side or on the same side with different signs. For example,
	+ output of ‘for own use’ production is recorded once on the resources-side (of the *production account*) and next in the uses-side of either the *use of income account* or under changes in assets in the *capital account*.
	+ use of raw materials drawn from an unit’s own inventory, is recorded once in the uses-side as intermediate consumption and next under changes in assets in the *capital account*.
* Like the product taxes, import duties are included in the resources-side of the production account, since it is not included in the value of imports, valued at *fob*, but forms part of use, valued at purchasers’ prices.

**Module 7, Session – I: Transaction and SNA Sequence of Accounts**

**Test Your Knowledge**

**Exercise – 7.1**

1. Which of the following are included in *BoP?*

1. Exports.
2. Domestic production.
3. Income Generation.
4. Compensation of employees
5. Property income
6. Current transfers
7. Savings
8. Capital transfers
9. GFCF.
10. Current account balance.
11. Capital account balance
12. Total changes in assets/liabilities.

 Ans.:

2. Which of the following are TRUE*?*

1. For national accounts, most of the economy-level estimates of external transactions are taken from the *BoP* statistics compiled and published by the Central Banks.
2. All transactions taking place between a resident and a non-resident institutional are not considered as *external transactions* of an economy.
3. For an economy, *external trade balance* or *external balance of goods and services*

= value of products sold *minus* value of products purchased.

1. Payments of compensation of employees to *RoW* are included in the COE on the resources side of the *Generation of Income* account.
2. Receipts of compensation of employees from *RoW* are included in the COE on uses side of *Allocation of Primary Income*.
3. Receipts of property income from *RoW* and payments of property income to Row are included respectively in the resources and uses side of *Allocation of Primary Income*.
4. Value of products sold + imports ≡ Value of products purchased + exports

1. Entries for all transfers from or to non-residents are made in the *secondary distribution of income account*.
2. The goods and services account is usually compiled for each institutional sector.

1. The concept of *flow* as used in the SNA and the BoP is exactly the same.

1. In the BoP, *positions* refer to a level of financial assets or liabilities at a point in time.
2. The levels of financial assets or liabilities at a point in time are recorded in the *international investment position* (IIP).
3. The difference between sums of resources- and uses-side of non-financial transactions is always equal to *net borrowing / lending*.
4. The estimate of *net borrowing / lending* is affected by estimates of non-monetary transactions.
5. Construct the following accounts using data for accounting year 2015 of your country*?*

|  |  |  |  |
| --- | --- | --- | --- |
| **Transaction category** | Total economy | *RoW* | total |
| **Resources**  |
| 1. Sold products
 |  |  |  |
| 1. Received income
 |  |  |  |
| 1. Received transfers
 |  |  |  |
| *Sub-total: non-financial* |  |  |  |
| 1. Change in liabilities
 |  |  |  |
| Total (= *sub-total* + item 4) |  |  |  |
| **Uses**  |
| 1. Bought products
 |  |  |  |
| 1. Paid income
 |  |  |  |
| 1. Paid transfers
 |  |  |  |
| *Sub-total: non-financial* |  |  |  |
| 1. Change in financial assets
 |  |  |  |
| Total (= *sub-total* + item 4) |  |  |  |

Using the entries in the above account, establish the following identities:

1. Value of products sold + imports ≡ Value of products purchased + exports

[Note that value of products sold = sum of GVO at producers’ prices of all industries.

and imports = imports at fob + import duties.]

1. Primary income receivable from domestic units & *RoW*

 ≡ Primary income payable to domestic units & *RoW*

1. Transfers payable from domestic units & *RoW*

 ≡ Transfers receivable to domestic units & *RoW*

## **7.3 Session II. Allocation of Primary Income Account**

## **Contents**

Primary Income and its distribution

 Allocation of Primary Income Account

* + - * Entrepreneurial income
			* Property income
			* Contracts, Leases and Licenses

### 7.3.1 Primary income and its distribution

Having discussed the *production account* and *generation of income account* in *Module 4*, we will now turn to other income accounts. As discussed in *Module 4*, there are two main accounts in the system relating to distribution of income and one main account relating to use of income. In this and the following two sessions, we will attempt the following:

* Introduce other accounts relating to distribution and use of income and explain their relation to the main group of accounts in the SNA. These are: *Redistribution of income in kind account* and *Use of adjusted disposable income account*. Their places in the system of accounts are indicated in *Module 4*.
* Discuss the main entries and balancing items of all the distribution and use of income accounts and the purposes they usually serve in understanding the functioning of an economy.
* Most of the main entries in these accounts have already been introduced in earlier modules. Here we will focus on how the various categories of transactions are recorded in the income accounts.

As we have seen earlier, the *production* and *generation of income* accounts provide a description of productive activity and income generated in the process of production. These, however, do not provide information on who receives this income generated or to which institutional units this income flow. The *allocation of primary income* and *secondary distribution of income* accounts, largely correspond to the transaction categories relating to flow of (primary) income and (current) transfers of the *summarised accounts* mentioned in *Session I* of this module and provide information on flow of income generated by destination. Next, the *use of disposable income* account reflects the use of these claims made by the institutional units for *final consumption*, i.e. direct satisfaction of their needs and wants.

***Box 7.1***

**Applicability of Distribution and Use of Income Accounts**

 The distribution and use of income accounts as a group describe the various processes by which the fruits of productive activities are allocated over institutional units and how these units allocate the resulting disposable income between consumption and saving. Recall that the *production* and *generation of income* accounts are relevant only for units carrying out production. Thus, the *production* and *generation of income* accounts can be compiled separately for specific group of economic activities (as per ISIC). On the other hand, the distribution and use of income accounts can be compiled only for the institutional sectors but not for industrial sectors.

 Take for example, a company with separate manufacturing, trading and transportation units and the head office. The company, as an institutional unit, receives and pays property income, such as interest from bank, dividends to shareholders and pays corporate taxes to the government. All these are not carried out by the individual units. Thus, the distribution and use of income accounts cannot be compiled for individual establishments of multi-establishment enterprises. Further, since the establishments belong to different industrial sectors, these accounts cannot be produced separately for industrial sectors.

### 7.3.2 Allocation of primary income account

Claims on value added can arise in a number of ways. The claims which are most directly related to production activities are recorded in the *generation of income* and the *allocation of* *primary income* *accounts*. But, the *generation of income account* specifies only how the *GVA* is disbursed (paid) to the government, employees, providers of non-produced and financial assets and the entrepreneur, respectively in the form of taxes (less subsidies) on production, compensation of employees and operating surplus / mixed income. This account does not show the receipt of the income by the institutional units.

The *allocation of* *primary income* *account*, on the other hand, records the receipts of these flows, excluding those to the *RoW* and including those from the *RoW*. For example, compensation of employees (***CE***), which is recorded in the uses-side of the *generation of income* account and in resources-side of the *allocation of* *primary income* *account*, differs between the two accounts owing to cross-border flow of ***CE***.

The opening entry *allocation of primary income* is ‘operating surplus’ or ‘mixed income’. The balancing item is called ‘balance of primary incomes’ for the sectors and ‘national income’ for the total economy. This account is based on income-side identity

This can be rewritten as

*GNI ≡ GDP* + Compensation of employees receivable from non-resident producers

 - Compensation of employees payable to non-resident employees

 + Property income receivable from non-residents

 - Property income payable to non-residents

*Production & import taxes less subsidies* on the resources-side of the account occurs only in the institutional sector of the government and total economy. The subsidies are recorded with a negative sign. This includes all taxes and subsidies on production, imports and exports. Note that this does not include taxes on income & wealth and capital taxes.

*Example 7.1: Generation of Income and Allocation of Primary Income Accounts*

Following are the accounts relating to generation and allocation of primary income of an economy during an accounting period.

|  |  |
| --- | --- |
| **Uses**  | **Resources** |
| **Generation of Income Account** |
| 153 | Compensation of employees (***CE***) | ***B.1 NDP*** | 445 |
| 130 | Production (*t-s*) & import duties |  |  |
| ?? | ***B.2 OS + B.3 MI*** *(net)* |  |  |
| **Allocation of Primary Income** |
|  |  | ***B.2 OS + B.3 MI*** *(net)* | 162 |
|  |  | Compensation of employees (***CE***) | 152 |
| 121 | Property income | Property income | 118 |
|  |  | Production (*t-s*) & import duties | 130 |
| ?? | ***B.5 NNI*** |  |  |

**59** from *RoW*

**60** to *RoW*

Note that the difference of 1 between the ***CE*** figures in the two accounts. This, as you can see, is caused by the flow of ***CE*** from and to the *RoW*. Thus, in the *allocation of primary income* *account* for the total economy what we present against CE is in fact *net* of ***CE*** payable to *RoW*.

*Compensation of employees*, one of the main entries of this account, is relevant only for the household sector and the total economy. As discussed in *Module 2A*, it consists of (i) wages and salaries in cash and kind and (ii) social insurance contributions payable by the employers.

 Recording of compensation of employees in the SNA is done differently for

* resident employees of resident employers,
* resident employees of non-resident employers, and
* non-resident employees of resident employers.

For resident employees of resident employers: ***CE*** is recorded in the

* uses-side of the *generation of income account* of the employer’s sector and
* resources-side of the *allocation of primary income account* of households.

For resident employees of non-resident employers: ***CE***is recorded in the

* uses-side of the external transactions account (i.e. transactions with *RoW*) and
* resources-side of the allocation of primary income account of households.

For non-resident employees of resident employers: ***CE*** is recorded in the

* uses-side of the *generation of income account* of the employer’s sector and
* resources-side in the external transactions account.

The *allocation of primary income account* also records receipts and payments of property income, which is the income receivable or payable for use of financial assets or non-produced non-financial assets (such as land). The payment of property income, especially those relating to financial assets, is not necessarily made only by the production units out of its *GVA*. For instance, both interest on business loans and interest on consumer credit are recorded in the *allocation of primary income account*.

Also recall that rentals are payments for the use of produced assets (such as buildings, cars, etc.) owned by other institutional units and are treated as services. However, rental contract under *financial leasing*, the payments made by the user of the goods are treated as interest and debt repayment, instead of payments for a service. Thus, *financial leasing* is treated as the provision of a loan rather than as a productive activity by the legal owner of the leased good.

[Under financial leasing all the risks and rewards of ownership of the rented item (say an aircraft) are *de facto* transferred from the legal owner (say a bank) of the rented item to the user (borrower airlines company) of the rented item.]

**Entrepreneurial income**

The concept of entrepreneurial income is close to the concept of profit/loss in business accounting. It is measured before the payment of dividends and withdrawals of income from quasi-corporations. In the case of unincorporated enterprises, the assets and liabilities of enterprises should be separated from those of the owners. Entrepreneurial income thus includes any dividends that the enterprise pays out in the recording period.

The Allocation of primary income account is further partitioned into

* Entrepreneurial income account and
* Allocation of other primary income account.

The balancing item of the *entrepreneurial income account* is called *entrepreneurial income*.

Entrepreneurial income is a concept that is only relevant for market enterprises, i.e. non-financial and financial corporations and households and is defined as:

 Entrepreneurial income = Operating surplus or mixed income

*plus* property income receivable on assets owned by the enterprise

*minus*interest and rent payable by the enterprise.

We will not discuss this account in detail here.

**Property income**

In the resources-side of allocation of income account, the entry against *property income* represents the incomes receivable by institutional units for ownership of financial or non-financial non-produced assets (land and sub-soil assets) from the institutional units using them in the production process. On uses-side, it shows the incomes payable to creditors, shareholders and landowners.

*Property income* includes [refer *Session III* of *Module 2A*]

* Interest (only the SNA interest and not the *allocated* *FISIM*, which is treated as *IC* or final consumption expenditure)
* distributed income from corporations in form of dividends
* withdrawals from income of quasi-corporations,
* reinvested earnings of FDI,
* rent on land, and
* property income attributed to insurance policy holders.

*Withdrawals from income of quasi-corporations*: This consists of that part of *distributable income that the owner withdraws from the quasi-corporation*. Take for example a business run by a household which is treated as a quasi-corporate (i.e. for this unit complete set of accounts is available). The money that the household takes from the income of the business is treated similar to the income withdrawn from corporations by paying out dividends to their shareholders. It is therefore treated as property income accruing to the owners of quasi-corporations. Note that if the business is run by the household is not treated as quasi-corporation, then the withdrawal of income is treated as *mixed income*.

*Reinvested earnings of FDI*: The FDI enterprises usually distribute a part of its income in form of dividends and retain the rest with themselves (shown as savings in business accounts). If the FDI enterprise is wholly owned by a single foreign direct investor (for example, a branch of a foreign enterprise), the whole of the retained earnings is treated as

* income of the investor which is
* reinvested by the investor.

If there are more than one foreign investors, the retained earnings is assumed to be distributed among them in proportion to their shares of equity owned. Thus, the entire retained earning of a FDI enterprise is treated as property income of the foreign shareholders.

The component *property income attributed to insurance policy holders* refers to the income earned by insurance companies from investments made in the financial markets. This is discussed in some detail later in this lesson.

The following are NOT included in *Property income*

* payments to the owners of produced assets
* receipts for renting out produced assets
* receipts and payments for sale and purchase of assets
* leases and licenses treated as assets
* *FISIM*
* premiums and contributions to social insurance schemes
* benefits and claims from social insurance schemes
* taxes.

**Contracts, Leases and Licenses**

The 2008 SNA introduces this concept of ‘natural resource lease’. This is an agreement between the legal owner of a natural resource – land, sub-soil assets etc. - and a lessee in return for ***rent***. These are regular payments and are often described as *royalties*, but they are treated as *rent* in the SNA. For example, if a company has to make regular payment for using a plot of land owned by another institutional unit, the payment made is treated as *rent*.

However, if the payment of license / permit fee made is a large up-front payment for an indefinite or very long period (not part of a regular payment) then it is treated as an acquisition of asset and not payment of *rent*. For example, when a company makes an agreement of mineral extraction from a mine for 25 years, it is treated as purchase of an asset under (the new sub-category of non-produced non-financial assets defined in the 2008 SNA) ***contracts, leases or licenses***.

Only those contracts, leases and licenses are treated as assets, which provide price advantage to the holders and the holder is legally permitted to realize the advantage.

The payments made to government that are not for use of an asset are treated as **tax**. Permission to use a produced asset owned by government is treated as an operating or financial lease as appropriate.

*Points to note*:

* The *production* and *generation of income* accounts are relevant only for units carrying out production.
* The distribution and use of income accounts can be compiled only for the institutional sectors but not for industrial sectors.
* Receivable and payable primary incomes are recorded in *allocation of primary income* account.
* The *allocation of* *primary income* *account*, on the other hand, records the receipts of these flows, excluding those to the *RoW* and including those from the *RoW*.
* *GNI ≡ GDP* + Compensation of employees receivable from non-resident producers

 - Compensation of employees payable to non-resident employees

 + Property income receivable from non-residents

 - Property income payable to non-residents

* The *allocation of primary income account* records receipts and payments of property income.
* The payment of property income, especially those relating to financial assets, is not necessarily made only by the production units out of its *GVA*.
* *Withdrawals from income of quasi-corporations* treated as property income accruing to the owners of quasi-corporations.
* The entire retained earning of a FDI enterprise is treated as property income of the foreign shareholders.
* Reinvestment earnings of FDI of a domestic company is treated as its property income.
* Allocation of FISIM is necessary before final compilation of income accounts.
* Similarly, estimates of investment income of the insurance agencies and pension funds are necessary for compiling income accounts of all other institutional sectors.
* In the SNA framework, none of the receipts and payments from / to RoW are treated as *social transfers in kind*.
* Only the SNA interest component of the (bank) interest is included in property income.
* Large up-front payment for a long-period use of natural assets is NOT treated as **rent**.
* Like the product taxes, import duties are included in the resources-side of the production account, since it is not included in the value of imports, valued at *fob*, but forms part of use, valued at purchasers’ prices.
* Like the product taxes, import duties are included in the resources-side of the production account, since it is not included in the value of imports, valued at *fob*, but forms part of use, valued at purchasers’ prices.

**Module 7, Session – II: Allocation of Primary Income Account**

**Test Your Knowledge**

**Exercise – 7.2:**

1. Which of the following are included in *Allocation of Primary Income?*

1. GDP/ NDP.
2. Production taxes net subsidies.
3. Payments of compensation of employees
4. Receipts of compensation of employees
5. Payments of Property income
6. Receipts of Property income
7. GNI/ NNI
8. Current transfers

 Ans.:

2. *Which of the following are TRUE?*

1. The *production* and *generation of income* accounts can be compiled for individual production units as well as industrial sectors.
2. The distribution and use of income accounts can be compiled only for the institutional sectors but not for industrial sectors.
3. The *allocation of* *primary income* *account* records all primary incomes payable to the RoW
4. The *allocation of* *primary income* *account* records all primary incomes receivable from the RoW.
5. *GNI ≡ GDP* + compensation of employees and property income receivable from non-residents – compensation of employees and property income payable to non-residents.
6. The payment of property income is made only by the production units out of its *GVA*.
7. When a household proprietary business is treated as a quasi-corporation, its *withdrawals from income* of the business is treated as property income of the household.
8. The reinvestment earnings of FDI of a domestic company of economy **A** in a country **B**, is treated as its property income of country **B**.
9. Some transfers from *RoW* are treated as *social transfers in kind*.
10. The entire amount of bank interest receivable by a household is included in its property income.
11. Construct the following accounts using data for accounting year 2015 of your country*?*

|  |  |
| --- | --- |
| **Uses**  | **Resources** |
| **Generation of Income Account** |
|  | Compensation of employees (***CE***) |  ***NDP*** |  |
|  | Production (*t-s*) & import duties |  |  |
|  |  ***OS + B.3 MI*** *(net)* |  |  |
| **Allocation of Primary Income** |
|  |  |  ***OS + MI*** *(net)* |  |
|  |  | Compensation of employees (***CE***) |  |
|  | Property income | Property income |  |
|  |  | Production (*t-s*) & import duties |  |
|  |  ***NNI*** |  |  |

## **7.4 Session 3. Secondary Distribution of Income account**

## **Contents**

Secondary distribution of income account

* + - * Current taxes on income and wealth
			* Social Contributions and Social Benefits other than social benefits in kind
			* Other current transfers
				+ Rerouting of insurance related transactions

**Secondary distribution of income account**

The opening entry of secondary distribution of income account is *balance of primary income* for an institutional sector and *GNI* for the economy. It records current transfers between institutional units, except social transfers in kind. Main categories of transactions recorded in the secondary distribution of income accounts are

* current taxes on income and wealth,
* social contributions & social benefits (other than social transfers in kind), and
* other current transfers (which include net non-life insurance premiums & claims and current international cooperation).

The balancing item of the account is *disposable income* – ***GNDI*** / ***NNDI*** – which, being the main source for consumption expenditure, is a particularly relevant aggregate for the analysis of the household sector. It is also significant for the general government and NPISHs. This account is based on income-side identity

*GNDI ≡* *GNI* + (net) current transfers from *RoW* + (net) taxes on income & wealth from *RoW*

All transactions recorded in the secondary distribution of income account are current transfers. Transfers in cash are payments of currency or transferable deposits by one unit to another without counterpart. Transfers in kind are transfer of ownership of a good or provision of a service.

[All transfers not classified as capital transfers are *Current transfers. Capital transfer* is one where ownership of an asset is transferred or obliges one or both parties to acquire or dispose of an asset]

Social transfers in kind are NOT recorded in this account. The examples of social transfers in kind are education and health services provided by the general government and NPISHs to households free, or at prices that are not economically significant. The expenditure for these are recorded as final consumption expenditure of the general government and the NPISHs, but are actually consumed by the households. These are treated separately in two different accounts of the SNA [discussed later].

**Current Taxes on Income & Wealth**

These are compulsory, unrequited payments, in cash or in kind, made by institutional units to government units. These include taxes on incomes of households, taxes on profits of corporations, and taxes on wealth, payable regularly every tax period. Government provides nothing directly in return to the unit paying the tax. Current taxes on income, wealth, etc. were described as “direct taxes” in the past (1968 SNA).

There are several forms of transfers that belong to the transaction category “current taxes of income and wealth”. The basic common features are:

There should be an obligation to pay;

There is no economic value rendered in return;

They are charged on income or periodically (mostly annually) on property.

This includes

taxes on income: taxes on individual or household income, taxes on the income of corporations or corporate taxes,

taxes on capital gains, taxes on winnings from lotteries or gambling,

current taxes on capital, such as those on land & buildings, on net wealth, on other assets, not used for production,

[when paid for assets used for production purpose, the taxes paid should be treated as ‘other production tax’ and NOT ‘current taxes on income & wealth].

expenditure taxes, payments by households for licenses, taxes on international transactions.

Besides, there is also a category of payments for certain licences which are borderline cases between the payment of taxes and fees. An example is the periodic payment for a pollution licence. If the permit is delivered in return for payment without any further activity of the authorities involved, it should be recorded as a current tax. But, if there is a certain control activity related to the issuing of the licence and the fee payable relates to the costs incurred by the control activity, the payment is the purchase of a service and should be classified as a fee and is part of households’ final consumption.

**Social Contributions and Social Benefits** *(other than social benefits in kind)*

These are the payments by and receipts of households related to social security and social insurance schemes. The *premiums payable*, and *claims receivable*, under individual policies taken out under a social insurance scheme are recorded in secondary distribution of income account as *social contributions* *and social insurance benefits*. Households receive the benefits or *claims receivable* and these are payable by the employers (who could be corporations, general government and NPISHs) or general government. Premiums are paid by the households and are receivable of the employers. This also includes benefits under social assistance schemes.

***Box 7.2***

**Social Benefits**

Social benefits are (current) transfers receivable by the households from the general government or from the employers. Social benefits mainly accrue from social insurance schemes. Individuals participating in the scheme are paid benefits (social benefits), under certain specific conditions adversely affecting their welfare.

The SNA distinguishes four different sources of social benefits:

* **Social security**: social insurance schemes – may be pension or non-pension schemes - operated by Governmentrequiring participation by the beneficiaries, who are mostly employees but may also be self-employeds and unemployeds. Pensions are mostly routed through social security schemes.
* **Social Insurance schemes**: other than social security schemes, mainly employment-related social insurance schemes. [not discussed in detail in this lesson]
* **Social assistance**: does not require participation and mostly restricted to a group.
* **Social transfer in kind**: same as social assistance only its beneficiaries are not restricted to a group. These include the health and education services provided free or at prices not economically significant by the general government or NPISHs.



Social benefits consist of ‘social insurance benefits’ and ‘social assistance benefits’. Social *insurance benefits* are those provided by social insurance schemes. The main financial source of social insurance schemes are contributions paid by employers, or the protected persons themselves, in order to secure entitlement on benefits in case the social risk or need (old age, sickness, etc.) materializes.

Social security schemes are a form of socials insurance schemes, namely those imposed and controlled by government, and covering the whole population or at least large sections of the population. *Social assistance benefits* are transfers made by government units or NPISH to households to meet the same kinds of needs as social insurance benefits, but outside of any social insurance scheme. Social assistance is mainly financed through taxes.

Examples of social security and social insurance schemes:

* Pension to retired personnel and their family,
* Health insurance schemes in which participation is obligatory by law or employment condition, such as national health insurance scheme run (directly or through an agency) by the national government, contributory health services schemes run by the employer for the employees and their families. These provide entitlement to benefits for the contributors, their dependents or survivors, covering the events requiring medical care, occupational injuries, old age, survivors, invalidity, unemployment, education.
* Schemes covering involuntary unemployment due to temporary lay-offs, sickness, accidents and child birth etc.
* Group insurance schemes

The practices vary from country to country.

This category of transactions excludes

* payments by government for production activities of a household (should be treated as subsidies in the production account),
* uniforms or small tools, such as scissors for hairdressers or bicycles for delivering mail, provided to the employees by the employer for
	+ carrying out their duties, when it is treated as intermediate consumption of the employer or
	+ employees own use, when it is included in compensation of the employees,
* transfers in cash or in kind made in response to natural disasters such as drought, floods or earthquakes (these are recorded separately under other current transfers).

**Other current transfers**

Other Current Transfers may be classified into four broad categories

* 1. transfers which occur as the essential functions of non-life insurance: In the SNA, the term ‘non-life insurance’ covers
	+ insurance schemes against various events or accidents resulting in damage to property or harm to persons as a result of natural or human calamities
	+ insurance schemes to guard against financial losses resulting from events such as sickness, unemployment, accidents, etc.

Such policies are taken out by enterprises, government units, NPISHs or individual households.

The entire amount of non-life insurance premiums actually paid and claims actually accruing are not recorded as current transfers in the secondary distribution of income account. Only the net premiums and adjusted claims are recorded.

[‘net premiums’ and ‘adjusted claims’ are discussed under *Rerouting of insurance related transactions* below.]

* 1. current transfers within general government: transfers between the different sub-sectors of general government (excluding taxes, subsidies, investment grants and other capital transfers);
	2. current international co-operation: all transfers in cash or in kind between general government and governments or international organizations in the rest of the world (excluding investment grants and other capital transfers); and
	3. miscellaneous current transfers: taking palace between resident institutional units or between resident and non-resident units.

*Rerouting of insurance related transactions*

The insurance agencies always have at their disposal an amount (consisting of premiums paid by the policy holders for future periods and unpaid claims) for investment. The income earned by the insurance agency by investing a part of this amount, called ‘investment income’, actually belongs to the policy holders. Thus, the investment income is treated as property income of the policy holders. However, since the insurance agencies actually do not pay this to the policy holders, these are treated as additional contribution of the policy holders to the insurance agency. These are called ‘*premium supplements*’ in case of non-life insurance and ‘*contribution supplements*’ in case of funded social insurance schemes. [For unfunded social insurance schemes, there is no contribution supplements.]

Recall that the output of the insurance agencies is considered as being consumed by the policy holders (either as intermediate consumption or final consumption). These are treated as service charges paid by the policy holders to the insurance agency. But, the policy holders are not required to pay these explicitly to the insurance agencies. Thus, in aggregate, net premium (or net social contribution) that the insurance agency gets is defined as

actual premiums earned

*plus* premium supplements

*minus* (implicit) service charges

constitutes current transfers and are recorded in the secondary distribution of income account.

*Example 1: Entries relating to non-life insurance in SNA sequence of accounts*

* A corporate body ***X*** makes pays a premium of **150** as for insurance against natural calamity.
* Total output of the insurance company is 2000. This amount is considered to be used by all policy holders (either as final consumption or intermediate consumption) as service charges.
* A prorated amount of **10** is attributed as service charges to the corporate body ***X***.
* Total investment income of the insurance company is 10,000.
* Of this, a prorated amount of **100** is attributed to the corporate body ***X***.

For these, the entries in accounts of ***X*** are as follows: [only the relevant part of the accounts shown]

|  |  |
| --- | --- |
| **Uses**  | **Resources** |
| **Production Account** |
|  |  | ***GVO*** |  |
| **??** | Intermediate consumption |  |  |
|  | ***B.4g GVA*** |  |  |
| **Allocation of Primary Income Account** |
|  |  | ***B.2g OS*** (gross) |  |
|  | Property income payable |  |  |
|  |  | Property income receivable | **??** |
|  | ***B.4g GNI*** |  |  |
| **Secondary Distribution of Income Account** |
|  |  | *Balance of primary incomes*  |  |
|  | Current taxes on income & wealth, etc.  |  |  |
|  | Social benefits (excl. in kind)  |  |  |
| **??** | Other current transfers  | Other current transfers  |  |
|  |  ***B.6g GNDI*** |  |  |

For the insurance company, the entries corresponding to the transactions with ***X*** will be:

|  |  |
| --- | --- |
| **Uses**  | **Resources** |
| **Production Account** |
|  |  | ***GVO*** | **??** |
|  | ***B.4g GVA*** |  |  |
| **Allocation of Primary Income Account** |
|  |  | ***B.2g OS*** (gross) |  |
| **??** | Property income payable |  |  |
|  |  | Property income receivable | **??** |
|  | ***B.4g GNI*** |  |  |
| **Secondary Distribution of Income Account** |
|  |  | *Balance of primary incomes*  |  |
|  | Current taxes on income & wealth, etc.  |  |  |
|  | Social benefits (excl. in kind)  |  |  |
|  | Other current transfers  | Other current transfers  | **??** |
|  |  ***B.6g GNDI*** |  |  |

Note that the uses-side of *other current transfers* of ***X*** is ….. + ….. – ….. = …. . The same amount is shown in the resources-side of *other current transfers* of the insurance company.

*Example 7.2: Entries relating to social contribution in SNA sequence of accounts*

* For an employee, its employer ***X*** makes a social contribution of **100** to a funded scheme.
* The employee also contributes **50**.
* Assume that the service charges prorated to the employee’s household is **15**.
* The investment income prorated to the household is assumed as **150**.

For these, the entries in accounts of ***X*** are as follows: [only the relevant part of the accounts shown]

|  |  |
| --- | --- |
| **Uses**  | **Resources** |
| **Generation of Income Account** |
|  |  | ***GVA*** |  |
| **??** | Compensation of employees |  |  |
|  | ***B.3g Mixed Income*** *(gross)* |  |  |

And the accounts for the employee’s household would be

|  |  |
| --- | --- |
| **Uses**  | **Resources** |
| **Allocation of Primary Income Account** |
|  |  | ***B.3g Mixed Income*** *(gross)* |  |
|  | Property income payable | Compensation of employees | **??** |
|  |  | Property income receivable | **??** |
|  | *Balance of primary incomes*  |  |  |
| **Secondary Distribution of Income Account** |
|  |  | *Balance of primary incomes*  |  |
|  | Current taxes on income & wealth, etc.  |  |  |
| **??** | Social contribution (excl. in kind)  |  |  |
|  | Other current transfers  | Other current transfers  |  |
|  |  ***B.6g GNDI*** |  |  |
| **Use of Disposable Income** |
|  |  | ***B.6g GNDI*** |  |
| **??** | ***FCE*** |  |  |
|  | ***B.8g Gross savings*** |  |  |

For the pension fund, the entries corresponding to the transactions with the employee’s household will be:

|  |  |
| --- | --- |
| **Uses**  | **Resources** |
| **Production Account** |
|  |  | ***GVO*** | **??** |
|  | ***B.4g GVA*** |  |  |
| **Allocation of Primary Income Account** |
|  |  | ***B.2g OS*** (gross) |  |
| **??** | Property income payable |  |  |
|  |  | Property income receivable | **??** |
|  | ***B.4g GNI*** |  |  |
| **Secondary Distribution of Income Account** |
|  |  | *Balance of primary incomes*  |  |
|  | Current taxes on income & wealth, etc.  |  |  |
|  |  | Social contributions  | **??** |
|  | Other current transfers  | Other current transfers  |  |
|  |  ***B.6g GNDI*** |  |  |

Note that uses-side entry of social contribution of the household = resources-side entry of social contribution of the pension fund. The value of output prorated to the household is treated as the final consumption expenditure of the household.

***Box 7.3***

**Social Contributions and their Components**

*Social contributions* are the payments made by the households may be *actual* or *imputed*. Social Contributions may be made by employers, employees, or self employed and unemployed persons. Employers’ social contributions first appear in the generation of income account. Employees’ social contributions appear in secondary distribution of income account. Social contributions by self-employed and non-employed persons also appear in secondary distribution of income account.

*Employers’ actual social contributions*: This consists of the payments made by employers for the benefit of their employees to insurers (social security funds and private funded schemes). These payments cover statutory, conventional, contractual and voluntary contributions in respect of insurance against social risks or needs. Although paid directly by employers to the insurers, these employers’ contributions are treated as a component of the compensation of employees, who are then deemed to pay them over to the insurers.

*Employers’ imputed social contribution*: This represents counterpart to unfunded social benefits paid directly by employers to their employees or former employees and other eligible persons. They do not involve an insurance enterprise or autonomous pension fund and no special fund or segregated reserve is created for this purpose. These are included in the compensation of employees since the costs of these benefits form part of employers’ labour costs and are thus equal to the benefits paid out.

*Households’ actual social contributions*: These are the contributions (such life insurance premiums, pension contribution etc.) payable on their own behalf by the employees, self-employed or non-employed persons to social insurance schemes. They are recorded on an accrual basis. For those in work, this is at the times when the work that gives rise to the liability to pay the contributions is carried out.

*Households’ social contribution supplements*: These consist of the property income earned by the households, but do not actually receive, during the accounting period on the stock of pension and non-pension entitlements. This amount is payable by the administrators of pension funds to households and thus are included in the allocation of primary income account. But, since they are not actually paid, they are treated in national accounts as notionally receipt of property income of the households who in turn makes an additional contribution of the same amount to the administrators of pension funds.

*Points to note:*

* The opening entry of secondary distribution of income account is *balance of primary* income for an institutional sector and *GNI* for the economy.
* It records current transfers between institutional units, except social transfers in kind.
* The balancing item of the account is disposable income – GNDI / NNDI.
* Receivable and payable current transfers are recorded in secondary distribution of income account.
* Social contributions are partitioned and the component of current transfer is recorded in the recorded in *secondary distribution of income* account.
* Social benefits (other than social transfers in kind) are recorded in *secondary distribution of income* account.
* Similarly, non-life insurance premiums are partitioned into insurance services and transfers and the latter is recorded in the recorded in *secondary distribution of income* account.
* The insurance services component of non-life insurance premiums is recorded either in the *production* account (as ***IC***) or in *use of disposable income* account (as final consumption).
* Similarly, estimates of investment income of the insurance agencies and pension funds are necessary for compiling income accounts of all other institutional sectors.
* Social transfers in kind are NOT recorded in *secondary distribution of income* account.
* Transfers relating to social insurance schemes (such as life insurance, pension etc.) are treated as *social contributions* *and social insurance benefits*.
* Transfers related to non-life insurance schemes are included in *other current transfers*.
* Employers’ social contributions are rerouted.
* Income earned by insurance company from investment of reserve funds is treated as property income of the policy holders.

**Module 7, Session – III: Secondary Distribution of Income Account**

**Test Your Knowledge**

**Exercise – 7.3:**

1. Which of the following are included in *Secondary Distribution of Income Account?*

1. GNI/ NNI
2. Production taxes net subsidies
3. Income & wealth taxes
4. Social contributions
5. Payments of other current transfers
6. Payments of property income
7. Receipts of other current transfers
8. Receipts of property income
9. Social transfers in kind
10. GNDI/ NNDI

 Ans.:

2. *Which of the following are TRUE?*

1. The opening entry of *secondary distribution of income* account is *balance of primary* *income* for an institutional sector and *GNI* for the economy.
2. The *secondary distribution of income* includes *social transfers in kind*.
3. The balancing item of the *secondary distribution of income* account is disposable income – GNDI / NNDI.
4. Only payable current transfers are recorded in secondary distribution of income account.
5. Only receivable current transfers are recorded in secondary distribution of income account
6. Social contributions are partitioned and the component of current transfer is recorded in the recorded in *secondary distribution of income* account.
7. Non-life insurance premiums are partitioned into insurance services and transfers in compilation of SNA sequence of accounts.
8. The entire amount of non-life insurance premiums is recorded in the *secondary distribution of income* account.
9. The insurance services component of non-life insurance premiums is recorded either in the *production* account (as ***IC***) or in *use of disposable income* account (as final consumption
10. Social transfers in kind are recorded in *secondary distribution of income* account.
11. Transfers related to non-life insurance schemes are included in *other current transfers*.
12. Income earned by insurance company from investment of reserve funds is treated as property income of the policy holders.

## **7.5 Session 4. Redistribution of Secondary Income and Use of Income accounts**

## **Contents**

Secondary Distribution and Redistribution of Income

* + - * Redistribution of income in kind account
			* Use of Income Accounts

**Secondary distribution and redistribution of income**

The second type of claims on value added originates from *current transfers*, i.e., current transactions without a particular *quid pro quo*.

[The expression ‘*quid pro quo*’ is used very often while defining transfers and exchange. It means “something that is done or given in exchange for something else.”]

The related resources and uses are specified in the *secondary distribution of income account*. The important transaction categories included in this account are

* gifts, donations & voluntary contributions
* taxes on income & wealth, such as individual income tax, corporate tax etc.
* social contributions, social benefits other than social transfers in kind,
* non-life insurance premiums (net of insurance services), and
* non-life insurance claims.

We have seen in *Module 4*, *social transfer in kind* is another kind of claims on value added. This redistribution of income in kind, we have already seen, brings about the difference between consumption expenditure and actual consumption of households, government and the NPISHs.

The *redistribution of income in kind account* records *social transfers in kind* as resources for households and uses of government and NPISHs. Thus, the disposable income of the household sector is adjusted upwards and those of the general government and NPISHs sectors are adjusted downwards by the same amount. Thus, for these three sectors of the economy, the *disposable income* differs from *adjusted disposable income*. For the economy as a whole, however, these two are equal by definition, since the SNA framework does not admit receipts and payments of *social transfers in kind* from / to RoW.

The result of the entire processes of income distribution is captured in the balancing item *disposable income* of the secondary distribution of income account. The allocation of disposable income between *consumption* and *saving* is recorded in the *use of income accounts*.

In fact, there are two versions of use of income accounts:

* one excluding the *social transfers in kind*, and
* the other including the *social transfers in kind*.

By convention, non-financial and financial corporations do not engage in final consumption.

The *use of disposable income account* that we are already familiar with is the one that does not take account of redistribution of income in kind. The effect of redistribution of income in kind is captured in *use of adjusted disposable income* *account*. Recall that the *use of disposable income account* starts with the balancing item – *disposable income* – of *secondary distribution of income* in its resources-side. Following the same design, the *use of adjusted disposable income* *account* starts with the balancing item – *adjusted disposable income* – of the *redistribution of income in kind account*.

With these two additional accounts presenting the results of *social transfers in kind*, the sequence of distribution and use of income accounts looks as:

Allocation of primary income account

Secondary distribution of Income account

Redistribution of income in kind account

Use of disposable income account

Use of adjusted disposable income account.

The arrows indicate the links between the accounts. The balancing item of both the use of income account is *savings*. The balancing items remain the same for all the institutional sectors, since the *social transfer in kind* gets cancelled out in the set of accounts the *redistribution of income in kind* and *use of adjusted disposable income*.

* For the households, *social transfer in kind* is
* recorded in the resources-side of *redistribution of income in kind account* and
* included in *actual final consumption* recorded in the uses-side of *use of adjusted disposable income*
* For the general government and NPISHs, *social transfer in kind* is
* recorded in the uses-side of *redistribution of income in kind account* and
* excluded from *actual final consumption* recorded in the uses-side of *use of adjusted disposable income*.

The relationship between these accounts for the institutional sectors is discussed in the next two sections. A summarised structure of the distribution and use of income accounts for the economy as a whole is presented below.

***Example 7.3*: Redistribution of Income account and Use of Adjusted Disposable account for the economy as a whole.** [The figures are taken from 2008 SNA, pages 564 - 569]

|  |  |
| --- | --- |
| **Uses**  | **Resources** |
| **Allocation of Primary Income Account** |
|  |  | ***B.2g OS*** / ***B.3g MI*** (gross) | **513** |
| 391 | Property income payable | Compensation of employees(net of payable to RoW) | 1154 |
|  |  | Property income receivable | 397 |
|  |  | Production & import Taxes  | 235 |
|  |  | Subsidies (-)  | - 44 |
| **??** | ***B.4g GNI*** |  |  |
| **??** | ***B.4n NNI*** |  |  |
| **Secondary Distribution of Income Account** |
|  |  | *Balance of primary incomes* (***GNI***)  | **??** |
| 212 | Current taxes on income & wealth, etc.  | Current taxes on income & wealth, etc.  | 204 |
| 333 | Net Social contributions  | Net Social contributions  | 333 |
| 384 | Social benefits (excl. in kind)  | Social benefits (excl. in kind)  | 384 |
| 283 | Other current transfers  | Other current transfers  | 244 |
| **??** |  ***B.6g GNDI*** |  |  |
| **??** | ***B.6n NNDI*** |  |  |
| **Redistribution of Income in Kind Account** |
|  |  | ***B.6g GNDI*** | **??** |
| 215 | Social transfers in kind | Social transfers in kind | 215 |
| **??** | ***B.7g Adjusted GNDI*** |  |  |
| **??** | ***B.7n Adjusted NNDI*** |  |  |
| **Use of Disposable Income** |
|  |  | ***B.6g GNDI*** | **??** |
| 1399 | ***FCE*** |  |  |
| 11 | Adjustments for changes in pension entitlements | Adjustments for changes in pension entitlements | 11 |
| **??** | ***B.8g Gross savings*** |  |  |
| **??** | ***B.8n Net savings*** |  |  |
| **Use of Adjusted Disposable Income** |
|  |  | ***B.7g Adjusted GNDI*** | **??** |
| 1399 | Actual ***FCE*** |  |  |
| 11 | Adjustments for households’ pension funds | Adjustments for households’ pension funds | 11 |
| **??** | ***B.8g Gross savings*** |  |  |
| **205** | ***B.8n Net savings*** |  |  |

Note that the balancing items *GNDI* and *adjusted GNDI* are the same in this table, since these are for the total economy. For the individual institutional sectors of households, general government and NPISHs, these are not the same; they differ by the magnitude of *social transfers in kind*. The same is true for other entries like *FCE* and actual *final consumption*, as we have seen in *Module 4*.

*Points to note*:

* The disposable income of the household sector is adjusted upwards by the social transfers in kind to obtain adjusted disposal income.
* The disposable income the general government and NPISHs sectors is adjusted downwards by the same amount.
* For the economy as a whole, disposal income and adjusted disposal income are equal by definition.
* The SNA framework does not admit receipts and payments of *social transfers in kind* from / to RoW.

**Redistribution of income in kind account**

The redistribution of income in kind account records *social transfers in kind* as resources for households and uses of government and NPISHs. It serves the following purposes:

* Gives a clearer picture of the role of government as the provider of goods and services to individual households.
* Provides a more complete measure of household income.
* Facilitates international and over time comparisons households’ consumption over time when economic and social arrangements differ or change.
* Gives a more complete view of the redistribution process between sub-sectors or other groupings of households.

A part of the final consumption expenditures of government agencies and NPISHs – social transfers in kind – are made on providing products free, or almost free, to the households. Thus, as discussed in *Module 4*, the final consumption expenditure of the households does not present a complete picture of the actual final use of products by the households. The redistribution of income in kind account provides for arriving at the actual final consumption of the households.

The balancing item of the redistribution of income account is appropriately labelled *adjusted disposable income*. The adjusted disposable income of a household represents the maximum value of final consumption of goods and services that the household can consume in the current period without having to reduce its financial or non-financial assets, or to increase its liabilities, for that purpose.

We have already noted that *adjusted disposable income* for the household sector is higher than *disposable income* by *social transfers in kind*. On the other hand, *adjusted disposable income* for the government and NPISHs sectors is higher than *disposable income* by the same amount. *Example 7.2* illustrates how the accounts are related for household, government and NPISHs sectors.

***Example 7. 4: Distribution and redistribution of income accounts for households and government.***

The following is the Secondary distribution of income account of the household sector of an economy.

|  |
| --- |
| **Household Sector** |
| **Uses**  | **Resources** |
| **Secondary Distribution of Income Account** |
|  |  | *Balance of primary incomes* (*gross*)  | **880** |
| 90 | Current taxes on income & wealth, etc.  |   |  |
| 12 | Net Social contributions  |  |  |
|  |  | Social benefits (excl. in kind)  | 30 |
| 8 | Other current transfers  | Other current transfers  | 20 |
| **??** |  ***B.6g GNDI*** |  |  |
| **??** | ***B.6n NNDI*** |  |  |

Assuming that the summary expenditure and revenue statement of general government given in *Box 4.3* of *Module 4* is that of the same economy, we can do the distribution of income accounts of general government as follows:

|  |
| --- |
| **General Government Sector** |
| **Uses**  | **Resources** |
| **Allocation of Primary Income Account** |
|  |  | ***B.2g OS*** / ***B.3g MI*** (gross) | **3** |
| 10 | Property income payable | Compensation of employees(net of payable to RoW) | x |
|  |  | Property income receivable | 12 |
|  |  | Production & import Taxes  | 15 |
|  |  | Subsidies (-)  | 0 |
| **??** | ***B.4g Balance of primary income****(gross)* |  |  |
| **??** | ***B.4n Balance of primary income****(net)* |  |  |
| **Secondary Distribution of Income Account** |
|  |  | *Balance of primary incomes* (*gross*)  | **??** |
|  |  | Current taxes on income & wealth, etc.  | 135 |
|  | Net Social contributions  | Net Social contributions  |  |
| 22 | Social benefits (excl. in kind)  | Social benefits (excl. in kind)  |  |
| 5 | Other current transfers  | Other current transfers  | 10 |
| **??** |  ***B.6g GNDI*** |  |  |
| **??** | ***B.6n NNDI*** |  |  |
| **Redistribution of Income in Kind Account** |
|  |  | ***B.6g GNDI*** | **??** |
| 40 | Social transfers in kind |  |  |
| **??** | ***B.7g Adjusted GNDI*** |  |  |
| **??** | ***B.7n Adjusted NNDI*** |  |  |

Social transfers in kind = GVO of individual non-market activity (20) + other benefits in kind (20).

Also assume that the NPISHs sector of the economy has an output of **5.** The redistribution of income account for the household sector will be

|  |
| --- |
| **Household Sector**  |
| **Uses**  | **Resources** |
| **Redistribution of Income in Kind Account** |
|  |  | ***B.6g GNDI*** | **??** |
|  | Social transfers in kind | Social transfers in kind | 45 |
| **??** | ***B.7g Adjusted GNDI*** |  |  |
| **??** | ***B.7n Adjusted NNDI*** |  |  |

 Note that the social transfers in kind are recorded in the uses-side for the general government is less by **5** than that in the resources-side for the households. This is because of NPISHs’ contribution of **5** in the social transfer in kind.

## 7.5.1 Use of Income accounts

The *use of income accounts* record final consumption of households, government and NPISHs. These show how disposable income is divided between final consumption and saving.

The SNA distinguishes between expenditure on *final consumption* and *actual final consumption*. *Final consumption expenditure* is the amount of expenditure made by the institutional units on consumption of goods & services. The *actual* *final consumption* measures the amount of goods & services acquired by the institutional units.

The *final consumption* is recorded in the *Use of disposable income* account, which is an account that opens with *disposable income* and closes with the balancing item ‘saving’. The *actual final consumption* is recorded in the *Use of adjusted disposable income* account. This account opens with *adjusted disposable income* and closes with the same balancing item ‘saving’.

The *use of disposable income account* contains only three entries:

* Individual consumption expenditure,
* Collective consumption expenditure, and
* Adjustment for the change in pension entitlements.

This account is based on the expenditure-side identity:

*Gross savings ≡* *GNDI* – PFCE - GFCE

It is relevant for only three institutional sectors – government, NPISHs and households – and has the balancing item as Gross/Net Saving.

Saving can be positive or negative. If saving is positive the non-spent income is used for the acquisition of assets or for paying off liabilities. If saving is negative, certain assets are liquidated or certain liabilities increase. Saving is a resulting item from current transactions and establishes the link with accumulation.

 *Use of Adjusted Disposable Income account*

The opening entry in the *use of disposal income* account is *GNDI* / *NNDI* and that of the *use of* *adjusted disposal income* is *adjusted GNDI*/ NNDI for household, government and NPISHs sectors as well as for the economy as a whole. The balancing entry for each of these accounts, however, is the same – *gross/ net savings*. The inclusion of *social transfer in kind* has no effect on the SNA accounts for the total economy.

Example 7.3 illustrates how are the *use of disposal income* and *use of* *adjusted disposal income* accounts related to each other.

*Example 7.3*: Use of disposal and adjusted disposal income accounts

Let us again consider the accounts of the household sector of the economy given in *Example 2*. Also assume that the households’ final consumption expenditure is **700** and ‘adjustments for changes in pension entitlements’ during the period is **5**. [The latter amount is recorded in the resources-side of the use of disposable income account of the financial sector.]

|  |
| --- |
| **Household Sector** |
| **Uses**  | **Resources** |
| **Use of Disposable Income** |
|  |  | ***B.6g GNDI*** | **820** |
| 700 | ***HFCE*** |  |  |
|  |  | Adjustments for changes in pension entitlements | 5 |
| **??** | ***B.8g Gross savings*** |  |  |
| **??** | ***B.8n Net savings*** |  |  |
| **Use of Adjusted Disposable Income** |
|  |  | ***B.7g Adjusted GNDI*** | **??** |
| 745 | Actual ***FCE*** |  |  |
|  |  | Adjustments for households’ pension funds | 5 |
| **??** | ***B.8g Gross savings*** |  |  |
| **??** | ***B.8n Net savings*** |  |  |

Recall that ***GVO*** of the general government is **110** [refer to page 10 of Lesson IV], of which own-account capital formation is **10**. Also note that the receipts from sale of goods & services is **15** (=10 + 5) and the expenditure for other benefits in kind (government purchases of goods and services to be distributed free to households and reimbursement for households' expenditures on goods and services) is **20**. Thus,

***GFCE*** = 110 – 10 – 15 + 20 = 105.

|  |
| --- |
| **General Government Sector** |
| **Uses**  | **Resources** |
| **Use of Disposable Income** |
|  |  | ***B.6g GNDI*** | **138** |
| 105 | ***GFCE*** |  |  |
| **??** | ***B.8g Gross savings*** |  |  |
| **??** | ***B.8n Net savings*** |  |  |
| **Use of Adjusted Disposable Income** |
|  |  | ***B.7g Adjusted GNDI*** | **98** |
| 65 | Actual ***FCE*** |  |  |
| **??** | ***B.8g Gross savings*** |  |  |
| **??** | ***B.8n Net savings*** |  |  |

Thus, we see that for the three individual institutional sectors – households, general government and NPISHs – disposable income and use of adjusted disposable income could be quite different. Also, the final consumption expenditure and actual final consumption are different for all the three sectors. But, for the total economy

Use of Disposable Income = Use of Adjusted Disposable Income

Final consumption expenditure = Actual final consumption

 GNDI – Final consumption = Gross saving.

*Points to note*:

* *Social transfers in kind* are recorded in *redistribution of secondary income* account.
* *Social transfers in kind* do not appear in *redistribution of secondary income* account of the corporate sectors.
* The opening entry in the *use of disposal income* account is *GNDI* / *NNDI*.
* The opening entry in the *use of* *adjusted disposal income* is *adjusted GNDI*/ NNDI for household, government and NPISHs sectors as well as for the economy as a whole..
* The inclusion of *social transfer in kind* has no effect on the SNA accounts for the total economy.
* Use of income accounts is relevant for only three institutional sectors – government, NPISHs and households – and the total economy.
* Final consumption expenditure of the general government and NPISHs is defined in the same way.
* Actual final consumption of the general government and NPISHs is also defined in the same way.
* Individual consumption expenditure is in fact the *social transfers in kind*.
* Balancing item of both the *use of income* accounts is *savings*.
* In the *use of income* account, the change in pension entitlements is recorded in the resources-side for the households and in the uses-side for the units responsible for paying pension.

**Module 7, Session – IV: Redistribution of Secondary Income and Use of Income Accounts**

**Test Your Knowledge**

**Exercise – 7.4:**

1. Which of the following are included in *Redistribution of Secondary Income* account for households*?*

1. GNDI/ NNDI
2. Income & wealth taxes
3. Social contributions
4. Payments of other current transfers
5. Receipts of other current transfers
6. Social transfers in kind
7. Final consumption expenditure
8. Actual final consumption
9. Adjusted GNDI/ Adjusted NNDI
10. Savings

 Ans.:

2. Which of the following are included in *Use of Adjusted Disposable Income* account for households*?*

1. GNDI/ NNDI
2. Income & wealth taxes
3. Social contributions
4. Payments of other current transfers
5. Receipts of other current transfers
6. Social transfers in kind
7. Final consumption expenditure
8. Actual final consumption
9. Adjusted GNDI/ Adjusted NNDI
10. Savings

 Ans.:

3. *Which of the following are TRUE?*

1. Individual consumption expenditure of the government and the NPISHs

= *social transfers in kind*.

1. The disposable income of the household sector is adjusted downward by the social transfers in kind to obtain adjusted disposable income.
2. The disposable income the government and NPISHs sectors is adjusted downward by the social transfers in kind to obtain adjusted disposal income.
3. The inclusion of *social transfer in kind* affects the balancing items of SNA accounts for the total economy.
4. For the economy as a whole, the difference between disposable income and adjusted disposable income is social transfers in kind.
5. *Social transfers in kind* do not appear in *redistribution of secondary income* account of the corporate sectors.
6. The opening entry in the *use of disposal income* account is *GNDI*/ *NNDI*.
7. The opening entry in the *use of* *adjusted disposal income* is *adjusted GNDI*/ NNDI for household, government and NPISHs sectors.
8. Use of income accounts is relevant for all the institutional sectors.
9. Final consumption expenditure of the general government and NPISHs is defined in the same way.
10. Actual final consumption of the general government and NPISHs is also defined in the same way.
11. Balancing item of both the *use of income* accounts for all the institutional sectors is *savings*.

## **7.6 Session 5. Capital accounts**

## **Contents**

Capital account

* Capital and Financial Accounts – Main Features
* Capital Account (Capital transfers, Changes in net worth, Net lending/borrowing)

**Capital Account**

Capital account and financial account are the last two among the transaction accounts. We have discussed all the other current transaction accounts in the earlier modules. In this session, we will attempt the following:

* Explain how the *capital* and *financial accounts* are related to each other as well as their links with the other transaction accounts in the SNA. Their places in the system of accounts are indicated in *Module 2A*. We have seen that these accounts have the same balancing item – net lending / net borrowing. We will see why.
* Most of the main entries in these accounts have already been introduced in earlier lessons. Here we will focus on how the entries are made in these two accounts.

### 7.6.1 Capital and Financial Accounts – Main Features

As discussed in the earlier modules, the *balance sheets* and *accumulation accounts* are the main expression of the stock-flow consistency in the SNA. These links between the *balance sheets* and the *accumulation accounts* reflect the widely varying economic processes and *net worth* (stock of assets *less* liabilities) of the economy and its sectors, which help in understanding their economic behaviour. What is more important for a compiler of national accounts is that these links are the main tools for checking the validity of estimates, which are usually based on very diverse source material.

The Capital and Financial Accounts are the *accumulation accounts* of the system and record transactions in balance sheet items, i.e., in both financial and non-financial assets and liabilities. The other economic flows that bring about changes in the balance sheet items are captured in *Other changes in assets account* and *Revaluation account*. The present course does not cover these accounts. Here, we will focus on only the *accumulation transaction accounts*, i.e. capital account and financial account.

**+**

**=**

What is important to note is that *accumulation accounts* and *balance sheets* are concerned with **ownership**. While the balance sheets specify the ownership of assets and liabilities to other units at given *points* in time, the *accumulation accounts* show the changes in assets and liabilities during an accounting period.

Thus, the two sides of the *capital* and *financial accounts* are labelled ‘*changes in assets*’, and ‘*changes in liabilities and net worth*’, instead of ‘uses’ and ‘resources’ as in the *production account* and *distribution and use of income accounts*.

Example 7.4 gives summarised versions of the capital and financial accounts.

|  |
| --- |
| *Example 7.4:*  Basic Structure of Capital Account and Financial Account The entries under the RoW correspond to BoP accounts [refer Session I of this module].The Capital Account opens with *net saving* (for the total economy) and the *current external balance* (for the RoW account). Recall that ‘savings’, which is the balancing item of Use of Disposable Income Account. The balancing item ‘net lending / borrowing’ results from Gross Capital Formation, net CFC, given the resource at hand, which is ‘ Changes in *net worth* due to savings & capital transfers’. This is reflected in the financial account in its two components on the two different sides.  |
| **Changes in assets** | **Changes in liability &** **net worth** |
| *RoW* | Total economy | Transaction / balancing item | Transaction / balancing item / total  | Total economy | *RoW* |
| **Capital Account** |
|  |  |  | ***B.8 Net savings*** | 33 |  |
|  |  |  | ***B.12 current external balance*** |  | 19 |
|  |  |  | Capital transfers receivable | 1 | 0 |
| x | 23 | Gross Capital formation | Capital transfers payable | -2  | 0 |
|  | - 10 | *CFC* | **Changes in *net worth* due to savings & capital transfers** | **??** | **??** |
| **??** | **??** | ***B.9 Net lending / borrowing*** |  |  |  |
| **Financial Account** |
|  |  |  | ***B.9 Net lending / borrowing*** | **??** | **??** |
| 32 | 203 | Net acquisition of financial assets | Net incurrence of liabilities | 184 | 51 |

Note that since there is nothing called non-financial liabilities, the net incurrence of liabilities appear only in the financial account. Also note that the balance of (or difference between) *net acquisition of financial assets* and *net incurrence of liabilities* in the financial account is equal to net lending / borrowing. This, as we can see from the table, is true for RoW as well as total economy. This holds good for an individual institutional unit or an institutional sector as well.

This table is an expanded form of these two accounts contained in *Table 3.5* (*Lesson III*), with additional columns for external transactions and two additional items on the right-hand side of the Capital accounts. The additional items are:

* *Current external balance*: this is the balancing item corresponding to *savings* for the RoW. [refer *Session I of the module*]
* *Changes in net worth due to savings & capital transfers*: this is the total of the right-hand side of the capital account, and NOT a balancing item.

These are discussed in some more detail later in this session.

The balancing item *savings* is the net result of all current transactions and represents the accumulation of wealth of an institutional unit / sector / economy. For the RoW account, the corresponding balancing item is called the *current external balance*. Capital account starts with these on the right-hand side, i.e. ‘changes in liabilities & net worth’. All transactions of goods and services of non-financial assets and capital transfers are recorded in this account.

The financial account records all transactions of financial assets. In the SNA framework, the balance of transactions in financial assets is by definition equal to the balancing item of the capital account, i.e. net lending / borrowing. Let us see why?

These two accounts reflect four basic types of flow relating to acquisition and disposal of assets, namely:

* additions to assets,
* reductions in assets,
* additions to liabilities, and
* reductions in liabilities.

However, only two net categories are shown:

* net additions to assets on the left-hand side of the account and
* net additions to liabilities on the right-hand side of the account.

*Points to note*:

* Capital and financial accounts can be compiled only for institutional units / sectors and the entire economy. They cannot be compiled for establishments of multi-establishment enterprises.
* The Capital and Financial Accounts record transactions in balance sheet items, i.e., in both financial and non-financial assets and liabilities.
* Both these accounts are concerned with changes in ownership of assets – financial and non-financial.
* The labels of the two sides of these accounts are ‘*changes in assets*’, and ‘*changes in liabilities and net worth*’
* In the capital account for the *RoW* the opening item is *Current external balance*, which is the balancing item corresponding to *savings* for the Row.
* *Changes in net worth due to savings & capital transfers* is the total of the right-hand side of the capital account, and NOT a balancing item.
* All changes in non-financial assets are recorded in the capital account, while all changes in financial assets are recorded in the financial account.
* The balance of transactions in financial assets is by definition equal to the balancing item of the capital account, i.e. net lending / borrowing.
* The balance of *real* transactions is equal to net acquisition of financial assets less net incurrence of liabilities.
* Net incurrence of liabilities *less* net acquisition of financial assets is equal in value, with the opposite sign, to net lending/borrowing, the balancing item in the capital account.
* Most financial assets are financial claims.
* All financial transactions have counterpart transactions - other financial or non-financial transactions.
* Many transactions (those NOT involving non-financial transactions) take place entirely within the financial account.
* Net lending/net borrowing is NOT affected by
	+ exchange of one financial asset for another or
	+ when a liability is repaid with an asset.

**Capital account**

The purpose of the Capital account is to record the values of the non-financial assets that are acquired or disposed of by institutional units by engaging in transactions, and to show the change in net worth due to saving and capital transfers. The latter is a measure of the funds available for capital formation with institutional units. Further, it makes it possible to determine the extent to which acquisitions *less* disposals of non-financial assets have been financed out of saving and by capital transfers. Finally, it shows a net lending corresponding to the amount available to a unit or a sector or the economy for financing, or a net borrowing corresponding to the amount which a unit or a sector or the economy is obliged to borrow from other units or sectors.

This is founded on the identity:

*Net lending/ borrowing ≡*

 *Gross Savings + (net) Capital transfer receivable*

 *minus* (*GFCF + CII + acquisition less disposal of valuables*)

 *- acquisition less disposal of non-produced non-financial assets*

The two sides of the capital account show

* changes in net worth due to saving and capital transfers and
* acquisition of non-financial assets account.

*Example 7. 5:* Capital Account

The figures presented here are those for the total economy.

[These are taken from 2008 SNA, pages 570 - 572]

|  |  |
| --- | --- |
| **Changes in assets** | **Changes in liabilities & net worth** |
| **Capital Account** |
|  |  | ***B.8g Savings*** (net) | **205** |
| 376 | Gross fixed capital formation | Capital transfers receivable | 62 |
| *359* | *Acquisition less disposal of fixed assets* | Capital transfers payable | -65 |
| *17* | *Costs of ownership transfers on non-produced assets* |  |  |
| 28 | Changes in Inventories |  |  |
| 10 | Acquisition less disposal of valuables |  |  |
| -222 | ***CFC*** |  |  |
| 0 | Acquisition less disposal of non-produced assets |  |  |
|  |  | **Changes in *net worth* due to savings & capital transfers** | **??** |
| **??** | ***B.9 net lending/borrowing*** |  |  |

The capital transfers (such as capital taxes, investment grants and the like) are recorded on the change in liabilities side. The sum of these items gives the total change in liabilities regarding change in net worth due to saving and capital transfers. Note that change in net worth is only relevant for the national economy, so, for the ROW the resulting balancing item on this account has no specific analytical value.

On the *change in assets* side, the details of actual investments are recorded. These consist of fixed capital formation, change in inventories, “acquisitions less disposals of valuables” and “acquisitions less disposals of non-produced non-financial assets”. The last two items are recorded on a net basis. A negative value represents, on balance, a net export of the involved commodities.

*Capital transfers*

Capital transfers could be in the form of investment grants which are capital transfers in cash or in kind made by governments or by the RoW to other resident or non-resident institutional units to finance all or part of the costs of their acquiring fixed assets; or other capital transfers that do not themselves redistribute income but redistribute wealth among the different sectors or sub-sectors of the economy or the rest of the world. Capital taxes such as capital levies and taxes on capital transfers are also capital transfers. In contrast to current transfers the capital transfers do not affect the *saving*.

The 2008 SNA clarifies that exceptional payments from government to public quasi-corporations should be treated as capital transfers.

Similarly, exceptional payments from public corporations should be recorded as withdrawals from equity.These should be recorded in the financial account accordingly.

*Changes in net worth*

The total of the resources, on the right side of the account, is explicitly shown and described as *changes in net worth* due to saving and net capital transfers.  It is not a balancing item.  It represents the positive or negative amount available to the unit or sector for the acquisition of non-financial and financial assets.

Change in the net worth due to saving and capital transfers account appearing on the right hand side of the capital account determines the change in net worth due to saving and capital transfers, which corresponds to net saving plus capital transfers receivable, minus capital transfers payable. It is the total of the resources - changes in the net worth due to the saving and net capital transfers and is not a balancing item. It represents the positive or negative amount available to the unit or sector for the acquisition of non-financial and financial assets

*Net lending or borrowing*

 Net lending or borrowing, the balancing item of capital account is defined as

net saving

plus capital transfers receivable

minus capital transfers payable

*minus* value of acquisitions less disposals of non-financial assets,

less *CFC*.

*Points to note*:

* The two broad classes of non-financial assets are: produced and non-produced non-financial assets. In 2008 SNA, there is no classification as intangible produced assets.
* *Net worth* is defined to be equal to the value of a unit’s assets less the value of its liabilities.
* The *change in assets* consists of capital formation and “acquisitions less disposals of non-produced non-financial assets”.
* The gross capital formation consists of fixed capital formation, change in inventories, acquisitions less disposals of valuables.
* GFCF is mainly of two types: acquisitions *less* disposals of fixed assets and costs of ownership transfers on non-produced assets.
* Costs of ownership transfer and land improvements are included in GFCF.
* CII includes change in inventories of raw materials, finished goods, work-in-progress and goods for resale.
* There three main types of *non-produced non-financial assets* (2008 SNA): natural resources, *contracts, leases and licences* and *Goodwill and marketing assets*.
* Goodwill and marketing assets are only recognized as assets in the SNA when they are evidenced by a sale.
* Exceptional payments from government to public quasi-corporations should be treated as capital transfers.

**Module 7, Session – V: Capital Account**

**Test Your Knowledge**

**Exercise – 7.5:**

1. Which of the following are included in *Capital Account?*

1. GDP/ NDP.
2. Savings
3. Current transfers
4. Capital transfer payable
5. Capital transfer receivable
6. Receipts of Property income
7. GFCF
8. CII
9. PFCE
10. Acquisition less disposal of fixed assets
11. Acquisition less disposal of valuables
12. Acquisition less disposal of non-produced assets
13. Acquisition less disposal of financial assets
14. Changes in net worth due to savings & capital transfers
15. Net lending/ borrowing

 Ans.:

2. Which of the following are *TRUE?*

1. The balancing item of *capital account* for the total economy is net lending / borrowing from the *RoW*.
2. Only the receivable capital transfers are recorded under “*Changes in liabilities & net worth*” and the payable capital transfers are recorded under “change in assets” of the Capital account.
3. The two broad classes of non-financial assets are: tangible produced and intangible produced assets.
4. *Net worth* is defined to be equal to the value of a unit’s assets less the value of its liabilities.
5. The *change in assets* consists of capital formation and “acquisitions less disposals of non-produced non-financial assets”.
6. The gross capital formation consists of GFCF, CII and acquisitions less disposals of valuables.
7. GFCF = acquisitions *less* disposals of fixed assets and intellectual property products + costs of ownership transfers on non-produced assets.
8. Costs of land improvements are NOT included in GFCF.
9. CII includes change in inventories of raw materials, finished goods, work-in-progress and goods for resale.
10. The value of *contracts, leases and licences* are NOT included in *non-produced non-financial assets*.
11. *Goodwill and marketing assets* are only recognized as assets in the SNA when they are evidenced by a sale.
12. Construct the Capital account using data for accounting year 2015 of your country*?*

|  |  |
| --- | --- |
| **Changes in assets** | **Changes in liabilities & net worth** |
| **Capital Account** |
|  |  | ***B.8g Savings*** (net) |  |
|  | Gross fixed capital formation | Capital transfers receivable |  |
|  | *Acquisition less disposal of fixed assets* | Capital transfers payable |  |
|  | *Costs of ownership transfers on non-produced assets* |  |  |
|  | Changes in Inventories |  |  |
|  | Acquisition less disposal of valuables |  |  |
|  | ***CFC*** |  |  |
|  | Acquisition less disposal of non-produced assets |  |  |
|  |  | **Changes in *net worth* due to savings & capital transfers** |  |
|  | ***B.9 net lending/borrowing*** |  |  |