Essentials of
National Accounting [Unit 5]

‘System of National Accounting: SNA’

[Book **2**]

SPECIFICALLY DESIGNED FOR ADVANCED LEVEL – **2025/26** EXAMS

FOR THE PURPOSES OF **‘RAPID REVISION’** & **‘THEORY RECAP’**

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'Theory' Practice Questions [TPQs]

Learning Key [3]

[18] Briefly explain the basis of the **'Income Approach of National Accounting.'**

- Production resources are employed or used in the process of producing goods and services, thus a payment for such factors is incurred.

- Such payments become an income earned for the factors of production participating in each production process.

- The income approach focusses on the 'Total Income' which is generated by all factors of production, who contribute towards an economy's domestic production process, during a given period of time.

- This total income value can be referred to as **'Gross Domestic Income'** of the economy **(i.e., income generated by contributing to produce the domestic product)**

- Essentially: the value of the **income flow** derived from a production process is **equal** to the **value** of the **goods and services flow** resulting from the said production process.

Types of **Income Sources**

Secondary Income

- Purely **nonproduction related**, inflows and outflows of money, to and from institutional units, during a given financial year.

- These are merely '**Monetary Transfers**', thus fail to represent any value addition, and are completely **disregarded** in estimating **GDP.**

Primary Income [PI]

- Income earned because of intuitional units engaging in the production process or by owning assets required for production.

- ∑PI is equal to the ∑GVA or GDP at Market Price. PI consists of four (4) sources:
  - **Compensation of Employees** (CS)
  - **Operating Surplus (OS)**
  - **Mixed Income** (MI)
  - **Net Tax** on **Production; Imports** (t-s)

[19] **Briefly distinguish** between **'Primary Income'** and **'Secondary Income',** in the context of income approach.

- The income from domestic product is practically estimated and evaluated by considering the concept of 'Primary Income', while secondary incomes are disregarded.

- Primary Income (PI) is the income earned because of intuitional units by engaging in the production process or by owning assets required for production.

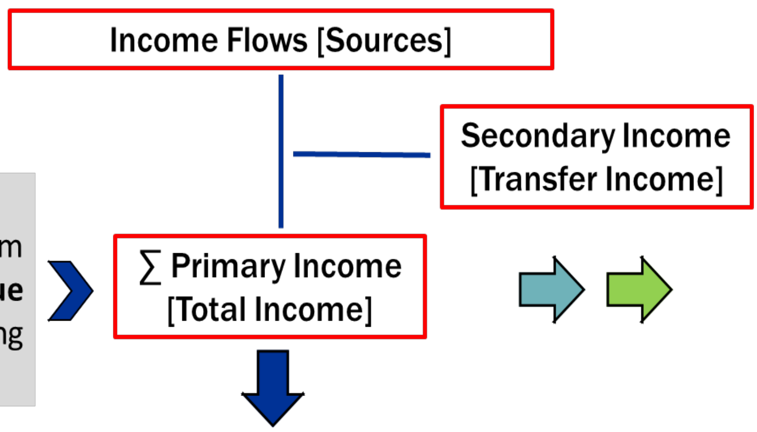
- The sum of all primary sources of incomes is equal to the **Gross Domestic Income** or **Product (GDI or GDP)** or aggregate value of **Gross Value Added** (at MP**),** generated through an economy's production process, during a given financial year. Primary income consists of four (4) components or sources:

  - ✓ Compensation of Employees (**CE**)
  - ✓ Gross Operations Surpluses (G**OS**)
  - ✓ Gross Mixed Incomes (G**MI**)
  - ✓ Net tax on **Production** (**t – s**)

  Σ PI = CE + GOS + GMI + (t – s)

- Secondary Income: purely nonproduction related, inflows and outflows of money, to and from institutional units, during a given financial year. These are merely 'Monetary Transfers', thus fail to represent any value addition, and are completely disregarded in estimating GDP.

Essentially:
the value of the **income flow** derived from a production process, is **equal** to the **value** of the **goods and services flow** resulting from the said production process.



Gross Domestic Income (GDI) OR **Gross Domestic Product (GDP)**
[GWS: at Market Price]

Also, Relevant [11]:

"Now let's try to briefly evaluate or understand the Components of Aggregate Primary Income (∑PI)"

[1] Compensation of Employees (CE or CoE)

All benefits: money or material, paid by employers, in return for services provided by labour units, more specifically parties who are employed in a formal context, ideally in a formal entity. CE generally comprises of elements such as:

✓ **Wages** or **salary**
[Including: bonuses and allowances on uniform, food, logging, travel etc]

✓ **Social security contributions** [EPF, ETF, Pension Fund] by the employer

✓ **Direct payments** or provision of funds from employers to employees: health benefits, compensations for ill-fated employees (work related injurious, work hazard, sickness), unemployment benefits (temporary production stoppage), certain direct payments at the point of retirement or voluntary cessation from work (Gratuity).

[2] Operating Surplus (OS)

Operating surplus is the income generated by entrepreneurs engaged in the **corporate sector** (or **incorporated** business).

Conceptually: Operating surplus is calculated by deducting **all costs of production** and **net taxes**, from the value of output.

Practically:

- Operating surplus is estimated and applied as '**Gross Operating Surplus'**
- **Gross operating surplus is the value of a firm's gross value added after deducting the values of compensation of employees.**

In the context of the income approach of national accounting income items of interest, profits or corporate profits and rent is termed as 'Property Income'.

Accordingly operating surplus consists of **'Property Incomes'** owing to factors such as **interest, rent/rental,** and **profits**. Essentially, **property income is the operating surplus** generated through the production process.

Technically Property income comprises of the following broad elements:

[**1**] Investment Incomes

- **Interest** [earned by providing financial funds for the use of other institutional units, by way of cash deposits, debt securities, loans]
- **Dividends** [earned by investing capital on equity of incorporated businesses]
- **Reinvestment income** [reinvesting retained profits of firm's setup through FDI]
- **Investment income payments** [returns earned by reinvesting funds by investment funds, pension funds, unit trusts, to parties who invest in such funds]

[**2**] **Rent/Rental Incomes**
[Income earned by offering **natural resources** such as land and mineral resources]

[3] Mixed Income (MI)

✓ Mixed income is the income generated by enterprises owned by households' sector (own account workers), partnership business and by similar unincorporated enterprises.

✓ A part of the income generated by such businesses should be technically considered as compensation of employees, even though an **actual payment** on **compensation of employees** is **not done** by such businesses. This is because the labour used in these businesses are provided by **unpaid family members**.

✓ Mixed income can be derived by **deducting** the **values of intermediate consumption (IC), all net taxes** and **all payments to salaried (waged) employees,** from the income/revenue earned by household enterprises.

✓ In the process of estimating GDP, mixed income is considered as Gross Mixed Income (GMI), which is a combination of the household enterprises sector's **Net Mixed Income** (NMI) and **Consumption of Fixed Capital** (CFC).

[4] Net taxes on production and Imports (t – s)

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- ✓ Taxes on products are charged based on the units of output, after producing such goods and services. Other taxes are changed by the government for engaging in the production process or being registered to produce a given product, rather than on the units of output.

- ✓ Other taxes essentially represent the income earned by the government for providing regulatory services, public services, and administrative services required within the production process.

- ✓ **Net taxes** on production are essentially, **taxes on production** [tax on products and other tax on production] **minus** **subsidies on production** [subsidy on products and other subsidies on production.

Tax Concept Flows:

Outline of Income Approach Concept Flows:

Also, Relevant [12]:

Descriptive Income Approach Concept Flow

[A] As stated previously, the sum (aggregate) of all primary income sources (∑PI) is equal to Gross Domestic Product (at Market Price).

$$\mathbf{GDP_{MP} = \Sigma\ PI\ \left[CE + (NOS + CFC) + (NMI + CFC) + (t - s)\right]}$$

Abbreviation Keys:

GDP_{MP}	-	Gross Domestic Product (at Market Price)
∑PI	-	Aggregate (Sum) of Primary Incomes
CE (or COE)	-	Compensation of Employees [Employment Income]
NOS	-	Nets Operating Surplus
NMI	-	Net Mixed Income
CFC	-	Consumption of Fixed Capital
(NOS + CFC)	-	Gross Operating Surplus (GOS)
(NMI + CFC)	-	Gross Mixed Income (GMI)
(t-s)	-	Net Tax on Production [Tax on Production – Subsidy on Production]

[B] In this context: GDP value at Market Price of an economy, is equal to the total value of incomes generated as CE, OS, MI and Net taxes on Production, by engaging in production activities within its **economic territory** by its residential institutional units, during a given financial year.

[C] Accordingly the sum of all primary incomes can also be considered as **Gross Domestic Income (at Market Price)** or **Gross Value Added (at Market Price).**

$$\mathbf{GDP_{MP} = \Sigma\ PI\ \left[CE + (NOS + CFC) + (NMI + CFC) + (t - s)\right] = GDI_{MP} = GVA_{MP}}$$

[D] If **GVA** value is to be estimated at **basic price** (BP), then the aggregate value of primary income (∑PI) should consist of CE,OS, MI and **only Net <u>Other</u> Taxes on Production** (i.e. Other taxes on production – other subsidies on production).

[E] **'Gross National Income (GNI)'** is derived by adding the value of **Net Primary Income from Rest of the World (ROW)** to the value of Gross Domestic Income at Market Price (GDI_{MP}).

$$\mathbf{GNI = GDI_{MP}\ (= GDP) + Net\ Primary\ Income\ from\ ROW\ [NPI_{ROW}]}$$

[F] When Gross National Income (GNI) is adjusted for **Net Foreign Current Transfers (NFCT)**, it is termed as **'Gross National Disposable Income (GNDI)'.**

$$\mathbf{GNDI = GNI + Net\ Foreign\ Current\ Transfers\ [NFCT]}$$

NFCT	=	FCT Inflows **–** FCT Outflows
FCT	**=**	Foreign Current Transfers

<u>Additional</u> Clarifying Note [5]:

Income Approach Concept Flows [Old Vs. New]

Old [SNA 1993]

Employment Income	XXX
Rent Income	XXX
Net Interest Income	XXX
Corporate Profits	XXX
Self Employment Income	XXX
Domestic Income [DI]	XXX
(+) NPIA	XXX
National Income [NI]	XXX
(+) Capital Depreciation [A]	XXX
Gross National Income (GNP @ **Factor Cost Price**)	XXX
(+) Net Indirect Taxes [B]	XXX
Gross National Income (GNP @ **Market Prices**)	XXX
(+) NFCT	XXX
Disposable GNI (DGNI mp)	XXX

New [SNA 2008]

1. **Compensation of Employees** (CE)		**XXX**
2. **Gross Operating Surplus** (GOS) [C]		**XXX**
2.1 Net Operating Surplus (NOS)	XXX	
2.2 Consumption of Fixed Capital (CFC)	XXX	
3. Gross Mixed Income (GMI) [C]		**XXX**
3.1 Net Mixed Income (MI)	XXX	
3.2 Consumption of Fixed Capital (CFC)	XXX	
4. **Other Tax** on **Production less Subsidy** (Net Other Tax on Production)		XXX
5. ∑GVA at **Basic Price** (GVA bp)		**XXX**
6**. Tax on Products less Subsidy** (Net Tax on Products)		XXX
7. **GDI** or **GDP** at **Market Price** (GDP mp)		**XXX**
8. Net Primary Income (NPI-ROW)		XXX
9. **GNI** at Market Price (GNI mp)		**XXX**
10. Net Current Transfers from ROW (NFCT)		XXX
11. **Disposable** GNI (DGNI mp)		**XXX**

[**A**] CFC should be added, since DI and NI are net values, CFC is not a factor-based income.
[**B**] Net Indirect Taxes should be added, income approach value is at FCP by default.

[**C**] Standard [CBSL] Method: [GOS = NOS + CFC] and [GMI = NMI + CFC]

[20] **Describe** the concept of **'Household or Personal Income'** and **'Disposable Personal Income (Yd)'**

Basic Answer Outline [Suggested Answer Input]

Practical Applications of Income Approach:

Gross National Income (GNI)

Additions (+)

Household Transfer Receipts (Net)

- Pension receipts
- Other social protection benefits
- GOV Interest payments
- Net foreign private current transfers

Deductions (-)

Income Not Received by Household Units
(Income earned, but not received)

- Retained profits of corporate
- Corporate income (profit) taxes
- Social security, pension fund contributions (e.g., EPF)
- Consumption of Fixed Capital (CFC)

Household (Personal) Income

Minus (-) **Personal Income Taxes**

Disposable Household (Personal) Income: Yd

A bit more clarification:

- ✓ Household or personal income is the amount of money or income actually received by all household on an aggregate basis, during a given financial year.
- ✓ There is a distinction between income earned by households and income actually received by households.
- ✓ As illustrated above, from national income we deduct 'income earned, but not received' during the year and add to national income 'income not earned by households yet received' during the year.
- ✓ It is also good to remember, while interest paid by the government on public debt and received by household units (for money invested by household units on public debt) is considered as a part of household or personal income, while NOT included within GDI and thereby GNI, during the year.