Normal Residents of a Country

A normal resident of a country is a person or institution that normally resides/located in a country and their economic interest lies in that country. It includes the following:

(i) Production units operating in the country;

(ii) Nationals and the foreign nationals who stay for more than a year in a country;

(iii) Nationals who have gone abroad but returned within a year;

(iv) Nationals working in the foreign embassies and international institutions located in a country;

(v) Students and patients of a country who have gone aboard and stay there even for more than a year.

However, the following persons/institutions are not included in the normal resident of a country:

(i) Foreign nationals who visit a country for purpose of conferences, tour etc and period of their stay in the country is of less than a year.

(ii) Crew members of foreign vessels, businessmen and workers whose stay is less than a year;

(iii) International organizations such as IMF, WTO, WHO, ILO, FAO etc located in a country;

(iv) Foreign national employees of international organizations, if they stay for less than a year;

(v) Foreigners who are employees of non-resident enterprises and who have come to the country for installing machinery etc and their stay are of less than a year.

Stocks and Flows

A stock is quantity measurable at a particular point of time whereas a flow is the quantity measurable over a period of time. Water in a tank at a particular point of time, say, at 9 am is a stock. And water flowing out from a tank over a period of time, say, between 9 am to 12 noon is a flow concept. Similarly, population of a country is a stock but number of births in a year is a flow.

Closed and Open Economy

A closed economy is one, which has no economic relations with the rest of the world. In other words, it is an economy that remains in isolation. It has no trade relations with any country, that is, no exports and imports take place in such an economy.

An open economy on the other hand is an economy which has economic relations with the outside world. In such an economy, export and imports are common. Exchanges of gifts and other transactions take place in an open economy.

National Capital and National Wealth

National capital is the total of all physical assets of a country that are helpful in further production. National capital consists of the following:

(i) Structures, which include residential buildings, commercial buildings and government buildings;

(ii) Equipment, which includes durable consumer and producers' goods and inventories;

(iii) Stocks of gold and silver with the governments as well as jewellery etc;

(iv) Net foreign assets, which is the value of our assets abroad less the value of assets owned by foreigners in our country.

National wealth is a broader concept than the national capital. It is the sum of all reproducible and irreproducible resources. National wealth is therefore the sum of national capital and natural resources.

Real and Financial Capital

Financial capital or assets refers to paper claims or paper titles such as debentures, bonds, national saving certificates, kisan vikas patra etc. These do not generate any new income. Therefore they are not included in the national income. Real capital is the physical capital or asset which helps in the production of goods. Machines, equipments, roads, inventories are the examples of real capital.

Investment

The excess of production over consumption when used for further production is called investment. Gross investment is the total investment made during a period. It includes inventory investment and fixed investment. Inventory investment is the investment made in the stocks of raw materials, semi-finished goods and finished goods. Investment made in fixed assets such as buildings, machines, equipments etc, is called fixed investment. Net investment is the gross investment less depreciation.

Category of Producers

In the study of national income accounting, it is essential to know different categories of producers. The three categories of producers are—household enterprises, corporate and quasi-corporate enterprises and general government.

Household enterprises are the consumer producers who produce goods and services for sale in the market. They are of three categories viz., unincorporated enterprises, non-profit institution serving households and households who render domestic services to other households. Unincorporated enterprises are the enterprises owned, controlled and managed by members of a family (producers of baskets, toys, retail traders, small shopkeepers etc). Non-profit institution serving households produces and extends services to households (charitable trusts, hospitals, trade unions etc). Households who render domestic services to other households such as domestic servants, cook, driver, gardener, watchman etc.

Corporate enterprises are large enterprises in public and private sectors which are set up under authority of law. All joint stock companies are corporate enterprises. Quasi-corporate enterprises are large unincorporated enterprises. Large-scale partnerships, sole-proprietorships, financial institutions and cooperative societies come under this category. Non-profit institutions serving business enterprises such as trade associations, chambers of commerce are also included in this category.

Government also organizes to produce and sell certain goods and services as private business enterprises. Such organizations/setups are called government enterprises. These include– departmental and non-departmental enterprises. Departmental enterprises are the enterprises operated by government departments such as railways, post and telegraphs, defence manufacturing etc, who get finance from government budget. Non-departmental enterprises are managed and controlled by government autonomous bodies. They do not get finance from the government budget. They are again divided into two categories—financial and non-financial enterprises. IFCI, ICICI, LIC, IDBI etc are financial non-departmental enterprises and ONGC, HMT, SAIL, BHEL etc are non-financial non-departmental enterprises.

The third category of producer is the general government. General government includes state and central governments which produces services of defence, law and order, street lighting, health, education etc. It does not sell its goods or services but provides to people either at very nominal price or free of cost.

Goods and Services

Goods are material things which satisfy human wants. Services are non-material goods that satisfy our wants. Services cannot be seen or touched and they do not have any shape. Table, chair, book, pens etc are goods while services of a teacher, a banker, a transporter, doctor, etc are the examples of services. There is a time lag between the production and consumption of goods. But services are instantly produced and consumed. For example, when a teacher delivers a lecture, students receive this immediately without any time gap. In case of goods, production takes time and consumption is not possible immediately. For example, making a cup of tea requires at least 10 minutes before it is consumed.

Goods may be economic or non-economic. Economic goods command price (payment of price is must) as these are scarce. Non-economic goods are available abundantly and freely. These goods are obtained without any payment. For example, air, water, sunshine etc are non-economic goods as these are freely obtainable. But bottled mineral water available nowadays are not available free of cost because mineral water is not abundant in towns and cities.

Again goods may be of single use or durable. Single use goods or perishable goods can be used only once while durable goods can be repeatedly used. Milk, food stuffs, etc are perishable goods and table, chair, car etc are durable goods. Clothes and shoes are semi-durable goods as do not lasts long.

Change in Stocks

It refers to the difference of closing stock and opening stock of producing units. It includes the following—(*a*) stocks of raw material, semi-finished goods and unsold finished goods with the produces; (*b*) stocks of food grains, and other important commodities; (*c*) livestock such as cows, goats, etc raised for slaughter by the producers.

Domestic Factor Income and its Components

Domestic factor income is the total income generated within the domestic territory by all producing units. The three components of domestic factor income are— ompensation of employees, operating surplus and mixed income of the self-employed.

Compensation of employees refers to all payments by producers to their employees in the form of wages and salaries both in kind and cash. It also includes social security contributions such as pension, provident fund, gratuity etc.

Operating surplus is the sum of income from property (interest and rent) and income from entrepreneurship (profits = dividend, corporate tax, and undistributed profits). Thus, it is the sum of interest, rent and profits. In other words, operating surplus is gross value of output less the sum of intermediate consumption, consumption of fixed capital, indirect taxes and compensation of employees.

Mixed income of the self employed is the income earned by self employed people like doctors, lawyers, chartered accountants, cobblers, barbers, shopkeepers, farmers etc. A part of their income is wage income and another part is property income. This is the reason that it is called mixed income.

15 MEASUREMENT OF NATIONAL INCOME—VALUE ADDED METHOD

MEASUREMENT OF NATIONAL INCOME

There are three methods of measuring national income. These are the following:

1. Net output method/Value added method/product method/industry of origin method,
2. Income method, and
3. Expenditure method.

These methods are explained as under:

Net Output Method/Value Added Method/Product Method/Industry of Origin Method

This method measures national income as the sum of net final output produced or net value added by all the firms in a year.

Steps to Estimate National Income by Value added/Product Method

National income by product method can be estimated using the following steps:

1. *Identification of production units and classifying them into industrial sectors:* The first step is to identify all the production units and classify these into three industrial sectors (*i*) primary sector, (*ii*) secondary sector, and (*ii*) tertiary sector.
2. *Estimation of net value added*: Net value added is estimated by estimating gross output produced by each enterprise, intermediate consumption, depreciation and net indirect taxes. Gross value of output can be measured by multiplying goods produced by the firms by their market prices. In other words, sales and change in stocks of all firms together gives the value of gross output. Net value added at market price is obtained by deducting the value of intermediate consumption (value of inputs that a firm obtains from other production units) and depreciation from gross value of output. Further, to get net value added at factor cost, we have to deduct net indirect taxes. Net indirect taxes is the indirect taxes less subsidies. The sum of net value added of all the industrial enterprises in the domestic territory of a country gives us net domestic product at factor cost.

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3. *Estimation of net factor income from abroad:* The final step is to estimate net factor income from abroad and add it to the net domestic product in order to get national income or NNP_{fc}. Net factor income from abroad is the factor income of the residents of a country earned abroad less the factor income of foreign nationals earned in the domestic territory of the country. Thus,

$$\text{National Income or } NNP_{fc} = NDP_{fc} + \text{Net factor income from abroad}$$

Precautions in the Estimation of National Income by Product Method

We have to take certain precautions while measuring national income by value added method. There are certain items which should not be included and items which are to be included while estimating national income.

Households construct residential buildings for their living and business sector constructs factory buildings for the production of goods. These are own account production of fixed assets, the value of which is to be estimated at prevailing market price and included in the national income. Similarly, certain items are produced for self consumption which do not enter the market. Their value is also required to be calculated at the prevailing price in the market. Imputed rent is rent calculated for owner occupied houses. Rent of owner occupied houses is generally not calculated. For the sake of measuring national income, it must be estimated at the prevailing market price.

Households, government and private sector sell those goods which are worn or torn out. These are second hand goods. Any transactions (sale and purchase) related to second hand goods are not included in the national income since their value has already been included in the year of their production. These do not involve any new production in the economy. However, we must not forget to include commission or brokerage earned out of such transactions (to be used in measuring national income by income method). Any transactions related to financial assets such as sale and purchase of bonds and shares are also not to be included in the measurement of national income. Such transactions do not generate any new income or contribute to the flow of goods and services. These are only paper claims transferred from one hand to the other. For example, when we buy shares of a company, money from our hand goes to company's hand without any new production taking place in this transaction. Finally, services rendered by housewives are also excluded from the measurement of national income as they render services out of love, affection and sense of duty to their family. Such transactions are useful but not economic as these do not involve generation of income.

The items that are included and not included are summarized in the table below:

Items to be included	*Items to be excluded*
1. Own account production of fixed assets.	1. Sale and purchase of second hand goods.
2. Food and other items for self consumption.	2. Sale and purchase of bonds and shares.
3. Imputed rent of owner occupied houses.	3. Services of housewives.