1. Explain the procedure of derivation of national balance sheet. Explain the method of estimating national capital.

**Ans:** The national balance sheet is a measure of the national wealth, or total net worth. It shows the estimated market value of financial assets, for example, shares and deposits at banks and non-financial assets like dwellings and machinery. Market value is an estimate of how much these assets would sell for, if sold on the market. The estimates are used for international comparisons, to monitor economic performance and inform monetary and fiscal policy decisions.

Financial assets and liabilities include:
- means of payment, such as currency
- financial claims, such as loans

Economic assets, which are close to financial claims in nature, such as shares

Non-financial assets include:
- buildings and other structures
- machinery and equipment
- certain farming stocks, mainly dairy cattle and orchards
- intellectual property products, such as computer software and databases, and research and development inventories
- valuables, such as works of art and precious stones
- Non-produced assets
- contracts, leases and licences
- natural resources

Data sources include:
- Office for National Statistics’s (ONS’s) National Balance Sheet Survey
- Chartered Institute of Public Finance and Accountancy report on local authority assets
- annual reports of public corporations and major businesses
- industry publications
- other government departments and agencies

Where non-financial asset market valuations are not readily available, we use a proxy based net capital stocks data, modelled in the perpetual inventory method (PIM).

For central government, data are taken from returns made by government departments to HM Treasury.

Local authority housing is shown in the public non-financial corporations sector. This is because government owned-market activities are always treated as being carried out by public corporations, either in their own right or via quasi-corporations.

Different types of national capital are calculated using different methods. For produced capital, the net capital stock is calculated by taking the sum of gross investment minus depreciation, known as the perpetual inventory method. Financial and produced capital value is directly observable in the market. Natural capital is generally calculated as the net present value of the estimated stream of rent the capital can be expected to produce over an assumed lifetime. The calculation therefore necessitates assumptions about future prices, costs and rate of extraction, and the discount rate; for simplicity’s sake, it is often assumed that net price and level of extraction remain constant over time. The value of ecosystem services is generally excluded, as are the value of unpredictable natural resource revenue streams, such as fisheries. One major problem with the calculation is that there are few stock data available to use in the calculation of lifetime values. Environmental pollution is assumed to be reflected implicitly in lower total national capital, since it leads to lower labour productivity and negative health effects, which depress income. Human and social capital is generally not calculated directly, but instead is taken as the residual between total wealth and produced financial and natural capital.

2. Explain the flow-of-funds accounts in an economy. What is the procedure for constructing flow-of-funds accounts of a nation?

**Ans:** Flow of funds accounts are used to track the flow of money to and from various sectors of a national economy.

Flow of funds (FOF) accounts are collected and analyzed by a country’s central bank. In the United States, they are called Financial Accounts and are released by the Federal Reserve Bank approximately 10 weeks after the end of each quarter.

The release, which the Fed labels Z.1, shows the assets and liabilities of each sector of the economy at the end of the period in question. It also shows how each sector has served as a source and use of funds. It includes a times series of outstanding debt for each sector of the economy, the derivation of net wealth in the country by asset, and the distribution of gross domestic product (GDP).

Detailed statements for each account show how net capital has shifted to or from various sectors, allowing for a granular look at movement of funds within the economy, as well as into and out of it.

The FOF accounts are used primarily as an economy-wide performance indicator. The data from the FOF accounts can be compared to prior data to analyze the financial strength of the economy at a certain time and to see where the economy may go in the future. The accounts can also be used by governments to formulate monetary and fiscal policy.

The accounts use double-entry bookkeeping to track the changes in assets and liabilities in all sectors of the economy: households, nonprofit organizations, corporations, farms, the government (federal, state and local) and the foreign sector. A wide range of financial instruments is accounted for: Treasury assets, American deposits abroad, savings deposits, money market funds, pension funds, corporate equities and bonds, mutual fund shares, mortgages and consumer credits are just a few examples.