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Unit No. 2

National Income

Que: Explain in brief the various concepts of national income

Introduction: The concept of national income serves as a useful yardstick to measure the annual performance of country's economy. The national income is also useful to the government to solve crucial problems of nations. The government can adopt number of economic policies as well economic planning to solve the problems like inflation, deflation, unemployment, poverty and so on.

Definition: Different economists define national income differently. The important definitions are as follows:

Dr. Marshall define National Income as, "The labor and capital of the country acting upon its natural resources, produce annually a certain net aggregate of commodities, material and immaterial, including of all kinds of services."

Indian National Income Committee defines it, "National Income as the value of commodities and services produced in an economy during a given period of time; counted without duplication."

Concepts related to National Income:

A) Gross National Product (GNP): The GNP is defined as, "the value of all final goods and services produced during a specific period, usually one year, plus incomes earned abroad by the nationals minus incomes earned locally by the foreigners."

In open economy the GNP includes:

1) The value of all currently produced consumer goods at market prices (C)

2) The gross value of all capital goods (I)

3) The value of government services (G)

4) The difference between value of Exports and Imports (X-M)

5) The net income earned abroad (R-P)

Hence, GNP= C+I+G+(X-M) +(R-P)

In closed economy the GNP= C+I+G only.

B) Gross Domestic Product (GDP): GDP can be defined as the sum total of values of all goods and services produced within the geographic boundary of the country without adding the factor income received from abroad.

C) Net National Product (NNP): NNP is defined as GNP less depreciation, i.e.

NNP = GNP – depreciation

D) Net National Product at Factor Cost: It refers to the sum of all incomes earned by resource suppliers for making available land, labor, capital and entrepreneurship for producing the net national output in course of the year. When we express the value of total national output at market price we must at once realize that market prices include indirect taxes. It is also true that if one hand the government imposes taxes on goods, then on the other hand it also provides subsidies to the producers to keep down their prices.

Therefore, to obtain the NNP at factor cost we must deduct indirect taxes and add subsidies to the NNP at market price.

NNP at factor cost = NNP at market price – Indirect Taxes + Subsidies

E) Personal Income: This is actual income received by individuals and households in the country from all sources. It denotes aggregate money payment received by people by way of wage, interest, profits and rents. Corporate tax, payment towards social security measured will not be available for individuals. So these amounts have to be deducted from it. Payments such as old age pension, widow pensions etc that received by people have to be added.

Personal Income= National Income - (Corporate tax+ Undistributed Profit+ Social Security Contribution) + Transfer Payment

F) Disposable Income: Disposable income means the actual income which can be spend on consumption by individuals.

Disposable Income = Personal Income – Direct Tax

G) Per Capita Income: Per capita income measures the average income earned per person in a country in a specific year. It is calculated by dividing the country's total income by total population.

$$\text{Per Capita Income} = \frac{\text{National Income}}{\text{Total Population}}$$

Que: Explain in brief the methods of measuring national income. Explain in brief the difficulties in accounting national income.

Ans: National income can be measured in three ways.

1) The Output Method: National income is calculated as the total value of goods and services produced during a period of time. In this case, a complete list of all the goods and services produced in a country has to be considered. It should be noted here that goods here refer to final goods. Final goods are those that are finally made available to the consumers. If the values of intermediate goods are estimated, it would mean that the same commodity has been valued more than once and it would give an inflated figure of national income accounting.

Double counting can be avoided by-

A) Taking into account only the values of final goods and services.

B) By summing up the value- added at each stage of production.

A) Final Goods Approach: Under this method, the value of final goods and services is computed in order to find out the value of the output.

B)The Value-added Approach: In this case, we do not consider the values of final goods and services but rather we count the value- added at every stage of production and finally sum up the values to arrive at the total value of the output produced.

2) The Income Method: In case of income approach we aggregate the income of all the factors of production. Such incomes may be in the form of wages, salaries, rent or profit, interest etc.

Following points should be noted while employing the income approach:

1) Transfer incomes like pensions, monetary benefits, student's grants etc are to be excluded.

2) Income earned by the government activities must be included.

3) All unpaid services such as the services of housewives etc. should be excluded.

4) The income received from exports should be added whereas the payments for imports should be deducted.

5) Direct taxes of the government as well as subsidies will have be deducted.

6) The undistributed profits of the companies as well as surplus of public enterprises should be added.

3) The Expenditure Method: By measuring total domestic expenditure we can measure the income of nation. Broadly, total domestic expenditure comprises two elements i.e. consumption expenditure of the household sector on goods and services and investment expenditure. Expenditure is said to be investment when it is used for making a fixed capital like building, machinery etc.

The comprehensive method of estimating national income via the expenditure approach is summarized as under:

a) This expenditure incurred by all the individuals and firms on consumption goods (C).

b)The expenditure of private individuals and firms on investment goods and services (I)

c) The expenditure incurred by the government on consumption and investment (G)

d)Expenditure incurred abroad by the residents (P) is excluded while expenditure incurred by foreigners in the country (R) are included (R-P)

e) Amount earned from Exports will be included whereas the amount spent on Imports will be deducted (X-M)

f) Having obtained the aggregates, the expenditures incurred on depreciation should be deducted (D)

Thus, the expenditure approach to compute the national income can be summarized as follows:

$$\text{National Income} = C+I+G+(R-P)+(X-M)-D$$

Difficulties in accounting national income: The difficulties in accounting national income can be broadly divided into two categories i.e. Conceptual and Statistical difficulties.

Conceptual difficulties:

1) Estimation of services: While estimating the value of services it is difficult to estimate the values of services rendered by mothers or house-wives to the family.

2) Transfer payments: While measuring national income through income method, transfer payments should not be included. What should be considered as transfer payment is another conceptual problems in measuring national income.

3) Illegal Income:

Finally, illegal incomes are not reported in national income accounts. In other words, illegal forms of economic activity and illegal activities that are not reported to the authority for the purpose of paying taxes are left out from national income accounts.

This is what is called underground or black economy. Gambling and drug trade are illegal forms of economic activities while people in power receive bribes but these people either underreport or do not report the bribed incomes that are illegal. In India, incomes generated in India's black economy are estimated to be around 40 p.c. of GDP. Such transactions underestimate the true value of national income of any country.

Statistical Difficulties:

1) Double counting: While calculating the National Income, we have to take only the value of finished goods into account, but it is difficult to find out which is final product and which is intermediate good. Hence, we may commit double counting in the estimation of national income.

2) Non-Monetized sector: Some of the goods produced are not sold for money. The producer himself may consume a part of the output. Sometimes, goods are exchanged for goods. Those goods that are not exchanged for money should be taken into National Income. But it is difficult to estimate and measure the value of output which does not enter into market for sale. In the economically backward countries, there is a large non-monetized sector. So, this problem is more difficult in the backward countries.

3) The Calculation of Depreciation:

The calculation of depreciation on capital consumption presents another formidable difficulty. There are no accepted standard rates of depreciation applicable to the various categories of machine. Unless from the gross national income correct deductions are made for depreciation the estimate of net national income is bound to go wrong.

4) Lack of Availability of Adequate Statistical Data:

Adequate and correct production and cost data are not available in our country. For estimating national income data on unearned incomes and on persons employed in the service are not available. Moreover data on consumption and investment expenditures of the rural and urban population are not available for the estimation of national income. Moreover, there is no machinery for the collection of data in the country.