National Income –concepts of national income - Gross domestic product, gross national product, net national product, net domestic product- national income at factor cost, personal income, disposable income.

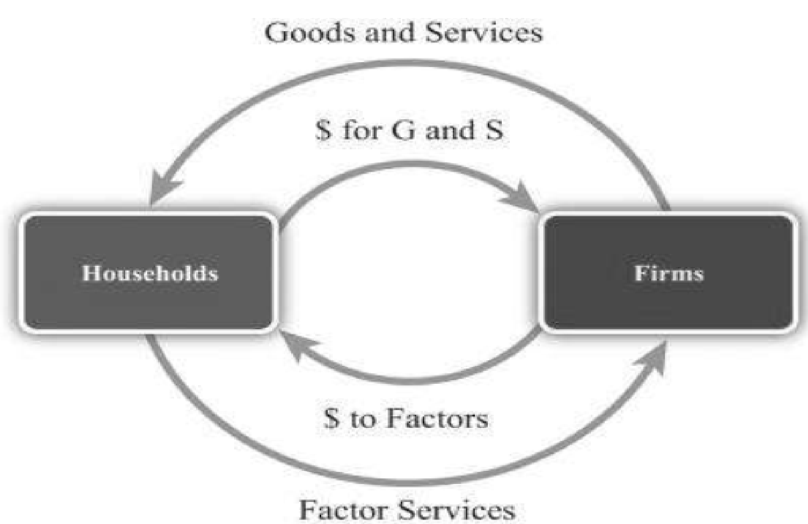
NATIONAL INCOME

Introduction

For understanding the concept of national income, it is necessary to know how an economy works. In any economy, its people are engaged in on productive activity or the other, whereby they earn income and spend their income on goods and services to satisfy their wants. The health and progress of an economy are to be judged from how much they are able to produce arid spend i.e. Country's total output, income and expenditure. Those aggregates of the economy are but different aspects of its national, income.

Circular Flow: The Wheel of the Wealth

In every economy there are households on the one hand and productive enterprises or firms on the other. The function of house holds is to consume goods and services for the satisfaction of their wants. Thus the household is the basic consuming unit in the economy. The function of productive enterprises (forms) is to produce goods and services for the satisfaction of the wants of households and thus the firm or productive enterprise is the basic producing unit in the economy. The household here may be family unit while producing unit (firm) may be grocery shop, factory etc. Besides, Government is another sector which occupies an important Position. It like households, purchases goods and services arid since it runs many public enterprises it act as, producing unit. Thus households, firms and government are the main components of the entire economic organization of a country which is know as an economy. Economy is the sum total of the operations of the households, firms and government.



In every economy there is always a circular flow (movement) of resource services (i.e. services of land, labour capital and enterprise) from the household to firms and the reverse movement of goods and services from the firms to the households. This is depicted in the diagram given below.
The inner circuit shows the real flows would take place only in barter economy where goods and services are exchanged for goods and services. But in the modern economy where use of money as medium of exchange is widely adopted

Households supply the resource services or factors to firms and receive in return payments in terms of money for goods and services they want. The firms sell goods and services for money and use the money so received to pay the households for their supply of resource services. Thus labour gets Wages; capital gets interest land gets rent and enterprise gets profits all in terms of money, this circular flow of money also known as **Wheel of Wealth.** This flow of money is not continuously at steady level. It may contract or expand when depression and prosperity occur, respectively in an economy. The diagram explains circular flow of closed economy where savings and role of Government is totally absent.

Definition of National Income

1) National Income is that part of objective income of the community, including income derived from abroad, which can be measured in money" - Pigou.
2) National income may be defined as the money value of the flow of commodities and services (excluding imports) reckoned at current prices less the sum of following/items, at current prices.

Money value of diminution in stocks

Money value of goods and services used up in the course of production

Money value of goods and services used to maintain intact existing capital equipments.

Receipts from indirect taxation.

Favorable balance of trade

Net increase in the country's foreign indebtedness.

In short, National Income is the aggregate factor income (i.e. earning of labour and property) which arises from the current production goods and services by the nation's economy. Here nation's economy refers to the factors of production Labour and property, supplied by the normal residents of the/ national territory. The national income has three interpretations

1) It represents a receipts total.

2) It represents expenditure total.

3) It represents a total value of production.

These three - fold interpretation arises out of fact that, every expenditure is at the same time a receipt and of goods and services purchased (bought) are valued at their sales prices. Thus

Value Received = Value paid = Value of goods & services

Concepts of National Income

The important concepts of National Income are:

1. Gross Domestic Product (GDP)

2. Gross National Product (GNP)

3. Net National Product (NNP) at Market Prices

4. Net National Product (NNP) at Factor Cost or National Income

5. Personal Income

6. Disposable Income

1. Gross Domestic Product (GDP): Gross Domestic Product (GDP) is the total market value of all final goods and services currently produced within the domestic territory of a country in a year.

It measures the market value of annual output of goods and services currently produced. This implies that GDP is a monetary measure. All goods and services produced in any given year must be counted only once so as to avoid double counting. It ignores the transactions involving intermediate goods.

2. Gross National Product (GNP): Gross National Product is the total market value of all final goods and services produced in a year. GNP includes net factor income from abroad whereas GDP does not. Therefore,

GNP = GDP + Net factor income from abroad.

Net factor income from abroad = factor income received by Indian nationals from abroad – factor income paid to foreign nationals working in India.

3. Net National Product (NNP) at Market Price: NNP is the market value of all final goods and services after providing for depreciation. That is, when charges for depreciation are deducted from the GNP we get NNP at market price. Therefore, NNP = GNP – Depreciation

Depreciation is the consumption of fixed capital or fall in the value of fixed capital due to wear and tear.

***4.Net National Product (NNP) at Factor Cost (National Income)*:** NNP at factor cost or National Income is the sum of wages, rent, interest and profits paid to factors for their contribution to the production of goods and services in a year. It may be noted that:

NNP at Factor Cost = NNP at Market Price – Indirect Taxes + Subsidies.

5. Personal Income: Personal income is the sum of all incomes actually received by all individuals or households during a given year. In National Income there are some income, which is earned but not actually received by households such as Social Security contributions, corporate income taxes and undistributed profits. On the other hand there are income (transfer payment), which is received but not currently earned such as old age pensions, unemployment allowances, relief payments, etc. Thus, in moving from national income to personal income, the incomes earned but not received should be deducted and add incomes received but not currently earned. Therefore,

Personal Income = National Income – Social Security contributions – corporate income taxes – undistributed corporate profits + transfer payments.

Disposable Income: It is the amount of money available with the private individuals to spend. From personal income if we deduct personal taxes like income taxes, personal property taxes etc. what remains is called disposable income. Thus,

Disposable Income = Personal income – personal taxes.

Disposable Income can either be consumed or saved. Therefore,

Disposable Income = consumption + saving.

Methods of measurement of NI – product method, income method and expenditure method

<u>MEASUREMENT OF NATIONAL INCOME</u>

Production generate incomes which are again spent on goods and services produced. Therefore, national income can be measured by three methods:

1. Output or Production method

2. Income method, and

3. Expenditure method.

Let us discuss these methods in detail.

<u>1. Output or Production Method:</u> This method is also called the value-added method. This method approaches national income from the output side. Under this method, the economy is divided into different sectors such as agriculture, fishing, mining, construction, manufacturing, trade and commerce, transport, communication and other services. Then, the gross product is found out by adding up the net values of all the production that has taken place in these sectors during a given year.

In order to arrive at the net value of production of a given industry, intermediate goods purchased by the producers of this industry are deducted from the gross value of production of that industry. The aggregate or net values of production of all the industry and sectors of the economy plus the net factor income from abroad will give us the GNP. If we deduct depreciation from the GNP we get NNP at market price. NNP at market price – indirect taxes + subsidies will give us NNP at factor cost or National Income.

The output method can be used where there exists a census of production for the year. The advantage of this method is that it reveals the contributions and relative importance and of the different sectors of the economy.

<u>2. Income Method:</u> This method approaches national income from the distribution side. According to this method, national income is obtained by summing up of the incomes of all individuals in the country. Thus, national income is calculated by adding up the rent of land, wages and salaries of employees, interest on capital, profits of entrepreneurs and income of self-employed people.

This method of estimating national income has the great advantage of indicating the distribution of national income among different income groups such as landlords, capitalists, workers, etc.

<u>3. Expenditure Method</u>: This method arrives at national income by adding up all the expenditure made on goods and services during a year. Thus, the national income is found by adding up the following types of expenditure by households, private business enterprises and the government: -

(a) Expenditure on consumer goods and services by individuals and households denoted by C. This is called personal consumption expenditure denoted by C.

(b) Expenditure by private business enterprises on capital goods and on making additions to inventories or stocks in a year. This is called gross domestic private investment denoted by I.

(c) Government's expenditure on goods and services i.e. government purchases denoted by G.

(d) Expenditure made by foreigners on goods and services of the national economy over and above what this economy spends on the output of the foreign countries i.e. exports – imports denoted by

(X – M). Thus,

GDP = C + I + G + (X – M).

Difficulties in the Measurement of National Income

1. Prevalence of non monetized transactions in agriculture still lot of product does not come into the market, It consumed at farm level.
2. Illiteracy - Due to illiteracy it is not possible to keep regular account.
3. Occupational specialization is incomplete.
4. Lack of adequate statistical data.
5. Estimation of value of inventories i.e. raw material is very difficult.
6. Estimation of depreciation on capital goods and avoiding double counting is too much difficult.

Use of National Income data: It is very useful to measure economic welfare, determine standard of living of a community, similarly to assess economic development and for comparison purpose the national income is must.