UNIT 5

NATIONAL INCOME AND RELATED AGGREGATES – BASIC CONCEPTS & MEASUREMENTS **Marks : 7**

1. MEANING OF BASIC CONCEPTS
   Definitions of following concepts
   National Income, GDP, Private Income, Personal Income, Personal Disposable Income.

2. CIRCULAR FLOW OF INCOME – (2 SECTOR MODEL) (With Diagram)
   Money Flow and real flow to be explained with diagram .

3. **THREE METHODS OF MEASURING NATIONAL INCOME :-**

A) OUTPUT METHOD/PRODUCT METHOD /VALUE ADDED METHOD ;-

Product Method or Value Added Method is that method which measures national income in terms of **value added** by each producing enterprise in Primary sector, Secondary sector and Tertiary sector of the economy during an accounting year to avoid the problem of double counting .

The term **"Double counting"** means measuring the value of a good more than once. While calculating National Income, if care is not taken to avoid the problem of double counting, it will lead to over estimation of National Income.

Value added is equal to **value of output** minus the value of **intermediate consumption** ie. expenditure on raw materials.

(**No question to be asked on calculation of double counting)**

B) **Income method:** This is also called distributed share method or Factor payment method. The factor incomes generated within the domestic territory of a country during an accounting year are added up and to this net factor income from abroad is added to get the National Income of the country.

CLASSIFICATION OF FACTOR INCOMES (3 types of Incomes)

- **Compensation of employees:**It includes wages and salaries in cash and in kind , employer`s contribution to social security schemes , and pension on retirement.
- **Operating surplus:** It refers to income from property and entrepreneurship. It includes rent interest, and profit. Profit is further divided into:
  - Dividends: This is the part of profit which is distributed to the shareholders so it is also called distributed profit.

- Corporate Profit Tax: This is the part of profit which which is paid to the government.
- Undistributed: This is the part of profit which is retained by firms for future use. Particularly to meet some contingent expenses. They are also called 'Corporate savings'

- **Mixed income:**Mixed Income refers to the incomes of the self- employed persons using their own labour, land, capital and entrepreneurship to produce goods and services. These incomes are a mixture of wages, rent , interest , and profit.

C) <u>Expenditure method:</u>

EXPENDITURE METHOD OF MEASUREMENT OF NATIONAL INCOME

In this method the National Income is measured in terms of expenditure on the purchase of final goods and services produced in the economy. It consists of the following components.

- **Private final consumption expenditure (C)**

It refers to expenditure on final goods and services by the individuals, households and non-profit private institutions. It includes expenditure on consumer goods and services.

- **Government final consumption expenditure (G)**

It refers to expenditure on final goods and services by the government, like expenditure on the purchase of goods for consumption by the defence personnel.

- **Investment expenditure (I)**
    - Fixed Investment: This refers to expenditure by the producers on the purchase of fixed assets like plant and machinery.
    - Inventory Investment: it refers to change in stock during the year, that is the difference between closing stock and opening stock of the year.
- **Net exports (X- M)**

    Net exports refer to the difference between exports and imports during an accountingyear. Expenditure on domestically produced goods is included while that on foreign goods is deducted.

4) REASONS WHY GDP IS NOT A GOOD INDICATOR OF WELFARE.

- **Distribution of GDP:** If with every increase in the level of GDP, distribution of GDP becomes more unequal, welfare level in the society may not rise.
- **Composition of GDP:** If GDP rises because of increase in the production of defence goods there is no direct increase in the welfare of the masses.

But a strong defence provides a peaceful environment for production and indirectly contributes to the level of welfare in the economy.

- **Non-monetary exchanges:** Non –monetary exchanges exist in rural areas where payments for farm labour are often made in kind rather than cash. Such transactions are not recorded because they are outside the monetary system of exchange. The GDP then is underestimated, so it is not a proper index of welfare.
- **Externalities:** Externalities both Positive and Negative refer to the good as well as bad impact of any activity without paying the price or penalty for it. Hence there is no valuation of it in the GDP.