National Income Accounting

Ruchika Sharma

This reference book can be useful for

BBA, MBA, B.Com, BMS, M.Com, BCA, MCA

and many more courses for Various Universities

NEERAJ PUBLICATIONS
www.neerajbooks.com

Published by:

NEERAJ PUBLICATIONS

(Publishers of Educational Books)

Sales Office : 1507, 1st Floor,
Nai Sarak, Delhi-110 006
E-mail: info@neerajbooks.com
Website: www.neerajbooks.com

Typesetting by: Competent Computers

Terms & Conditions for Buying E-Book

- The User must Read & Accept the Terms and Conditions (T&C) carefully before clicking on the accept option for Buying the Online Soft Copy of E-books. Under this Particular Facility you may buy only the Online Soft Copy of E-books, no Hard Copy or Printed Copy shall be provided under this facility.
- These E-Books are valid for 365 days online reading only (From the Date of Purchase) and no kind of Downloading, Printing, Copying, etc. are allowed in this facility as these products are just for Online Reading in your Mobile / Tablet / Computers.
- All the online soft copy E-books given in this website shall contain a diffused watermark on nearly every page to protect the material from being pirated / copy / misused, etc.
- This is a Chargeable Facility / Provision to Buy the Online Soft Copy of E-books available online through our Website Which a Subscriber / Buyer may Read Online on his or her Mobile / Tablet / Computer. The E-books content and their answer given in these Soft Copy provides you just the approximate pattern of the actual Answer. However, the actual Content / Study Material / Assignments / Question Papers might somewhat vary in its contents, distribution of marks and their level of difficulty.
- These E-Books are prepared by the author for the help, guidance and reference of the student to get an idea of how he/she can study easily in a short time duration. Content matter & Sample answers given in this E-Book may be Seen as the Guide/Reference Material only. Neither the publisher nor the author or seller will be responsible for any damage or loss due to any mistake, error or discrepancy as we do not claim the Accuracy of these solution / Answers. Any Omission or Error is highly regretted though every care has been taken while preparing these E-Books. Any mistake, error or discrepancy noted may be brought to the publishers notice which shall be taken care of in the next edition. Please consult your Teacher/Tutor or refer to the prescribed & recommended study material of the university / board / institute / Govt. of India Publication or notification if you have any doubts or confusions before you appear in the exam or Prepare your Assignments before submitting to the University/Board/Institute.
- Publisher / Study Badshah / shall remain the custodian of the Contents right / Copy Right of the Content of these reference E-books given / being offered at the website www.studybadshah.com.
- The User agrees Not to reproduce, duplicate, copy, sell, resell or exploit for any commercial purposes, any portion of these Services / Facilities, use of the Service / Facility, or access to the Service / Facility.
- The Price of these E-books may be Revised / Changed without any Prior Notice.
- The time duration of providing this online reading facility of 365 days may be alter or change by studybadshah.com without any Prior Notice.
- The Right to accept the order or reject the order of any E-books made by any customer is reserved with www.studybadshah.com only.
- All material prewritten or custom written is intended for the sole purpose of research and exemplary purposes only. We encourage you to use our material as a research and study aid only. Plagiarism is a crime, and we condone such behaviour. Please use our material responsibly.
- In any Dispute What so ever Maximum Anyone can Claim is the Cost of a particular E-book which he had paid to Study Badshah company / website.
- If In case any Reader/Student has paid for any E-Book and is unable to Access the same at our Website for Online Reading Due to any Technical Error/ Web Admin Issue / Server Blockage at our Website www.studybadshah.com then He will be send a New Link for that Particular E-Book to Access the same and if Still the Issue is Not Resolved Because of Technical Error/ Web Admin Issue / Server Blockage at our website then His Amount for that Particular Purchase will be refunded by our website via PayTM.
- All the Terms, Matters & Disputes are Subjected to "Delhi" Jurisdiction Only.

CONTENTS

Sample Preview of The Chapter

Published by:

NEERAJ PUBLICATIONS

www.neerajbooks.com

NATIONAL INCOME ACCOUNTING

INTRODUCTION TO NATIONAL INCOME ACCOUNTING

National Income and the Economy

1

INTRODUCTION

In this chapter, we are going to discuss about the National Income of an economy. After reading this chapter, we also try to answer questions like why we need to know national income? What national income indicates? To answer these we need to know about the concepts of National Income.

CHAPTER AT A GLANCE

MEANING OF AN ECONOMY

A.G. Brown has defined an economy as "a system by which people get their living."

In simple words, an economy of a country can be defined as collection of economic activities of a country, i.e. production, consumption and distribution, undertaken by its citizens.

Production activities comprises of producing both goods and services. e.g. work carried out in farm, factories, bank etc. consumption activities can be classified into two:

1. By Households: To satisfy the wants people spend money on food, house, clothing etc.

2. By Government: The main motive is to spend for people. Government usually spends on defence facilities, infrastructure development etc.

While production, investment needs to be done in raw material, stock, machinery etc. so that production can be carried out smoothly. Investment is the amount that adds to capital assets.

There are two types of economy: Open economy and closed economy. An open economy is an economy in which there are economic activities between domestic country and other countries, e.g. people, can trade in goods and services with other people in the world. In a closed economy there is no trade with other countries. The trade and finance of a country is confined only to its boundary.

MEANING OF NATIONAL INCOME

National income can be defined in terms of activities performed by an economy.

From production point of view, "National income is the sum of money value of net flow of all the final goods and services produced by normal residents of a country during a period of account."

From income point of view, "National income is the sum of factor incomes earned by normal residents of a country in the form of rent, wages, interest and profit in an accounting year."

From expenditure point of view, "National product is the net output of commodities and services flowing during the year from the country's productive system into the hands of ultimate consumers or into the net addition to the capital goods."

One point which needs to be kept in mind is that national income calculated by these three methods is same.

Here a resident means the person whose economic interest lies in the country. Factor incomes are the incomes earned by owners of factors (used in production) for rendering their products or services for production. e.g. owner of land get rent, capital get interest etc.

Now, production can be classified further into three sectors: primary, secondary and tertiary sectors.

Investment can be classified into domestic and foreign investment and consumption can be divided into household and government.

QUESTIONS ABOUT AN ECONOMY THAT INTEREST US

As a citizen of a country we want to know about the performance of our country, how much it is growing compared to past and other countries, about standard of living etc. the answers to all these can be made only after looking at data. Few questions which interest us as an student of economics about an economy and which can be answered by study of national income are as follows:

1. Is the economy growing?
2. Are all parts of the economy growing?
3. Are people getting more goods and services?
4. Are all sections of the people benefitting from growth?
5. Is the standard of living of the people rising?
6. What is the future of the economy?
7. How rich or poor is the economy in comparison to other economies of the world?
8. Is government spending enough on welfare activities?
9. How should funds be allocated?

Is the Economy Growing?

The rate of growth of economy is nothing but the rate of growth of national income. So, next time when you hear that Indian economy's growth rate was 7% last year, you should understand that it is the growth in national income of India as compared to base prices.

Rate of growth can be calculated by dividing the change in national income at constant prices by national income at constant prices during the previous year multiplied by 100.

Now what is constant price? If goods and services produced in a year are valued at fixed prices, i.e. prices of the base year, it is called national income at constant prices.

Are All Parts of the Economy Growing?

An economy can be categorized on the basis of occupation into three:

(i) **Primary sector:** It consists of units producing goods by changing or modifying the natural resources directly. e.g. farming, fishing etc.

(ii) **Secondary sector:** This sector transfers one good into another. e.g. production of car, machinery etc.

(iii) **Tertiary sector:** This comprises of production of services. e.g. banks, insurance, government department etc.

The contribution of all the sectors in growth of economy is essential since they are interdependent. The growth of one sector depends on the other. Suppose there is a slowdown in agriculture sector, then there will be a corresponding slowdown in production sector which use agricultural product as raw material. Therefore, government is always curious to know the individual growth of these sectors.

Are People Getting More Goods and Services?

"*Dil Maange More*", a very famous caption of a soft drink actually tells the psychology of human beings. As an individual more is preferred to less. A country wants its people to have more of goods and services every year. This can be measured by per capita income. It measures the average availability of goods and services to each individual during a given period. So, if per capita income raises it means that national income of the country is growing. But vice versa is not true. This happened in case of India in 1976-77 that although there was rise in national income by .9% the per capita income fell by 1.3%. This happened because population growth rate was much higher at rate of 2.2%.

Is Growth Benefiting All Sections of the Population?

Being a country for people, government cannot afford to neglect a section of society in pursuit of development. Each section, whether rural or urban, whether labour class or business class needs to be considered while taking any action. Therefore it's necessary for government to see that is the growth of country is equally distributed or not. If its not, then government will try to take some action to make it equal.

Is the Standard of Living of the People Rising?

Had you seen the new car she had bought? Her wardrobe is full of designer clothes. These are some statements which we generally discuss in our day-to-day life. This shows how interested we are in general standard of living.

Standard of living of a family can be determined by what family spends on satisfaction of wants. In same way standard of living of a country is depends on spending on consumer goods and services. An increase in per capita consumption expenditure shows that the standard of living rises. National income calculated by expenditure method is relevant for this section. As we divide expenditure into consumption expenditure and investment expenditure.

What is the Future of the Economy?

As an individual, we usually save out of our current income and invest in financial instruments to make our future secure. Similarly, a country as a whole saves and invests. The investment is done to make more goods and services in future. More the investment, more flow of goods in future, probably much higher standard of living of society in future. Investment within economic territory of the country is termed as Domestic Capital Formation. Investment outside the country is termed net exports. Both of these investments together determine the future of society.

How Rich or Poor is the Economy?

Such question of relativity can be answered by comparing the national incomes of different countries with our national income. By comparing economies, we can say how rich or poor our country is in relation to foreign countries. e.g. the per capita income of India and USA in the year 1994 were 320 and 25880 US dollars respectively. The comparison of these figures show that an American was 80 times richer than an Indian. However this comparison is vague.

This comparison of national incomes is useful in international project. The expenditure on this project can be shared among countries according to the income levels.

Is Government Spending Enough on Welfare Activities?

The core functions of every government is to maintain law and order, provide basic amenities to citizens, health facilities, good roads, water supply etc. For these activities government incurs expenditure on hospitals, infrastructure, schools etc. More the expenditure more is the facilities. The data can be collected from expenditure method of estimating national income. This variable is called Government Final Consumption Expenditure.

How Should Funds be Allocated?

The decision of allocation of funds is taken by Planning Commission, or any other body appointed by government. It's not only how much to allocate to one sector and the other, but something more important is needed to be considered. The dependence of the sectors among each other is also need to be understood. While allocating funds to agricultural sector its dependence on producers of chemical fertilizers, water pumps, and pesticides etc. must be also taken care of. Supporting funds are needed to be allocated to these depending sectors also so that the targets can be achieved. For allocating funds it is necessary to know two things–from whom the sector buys inputs and to whom the sector sells outputs. The data is summarized in an account called input-output accounting matrix which is prepared from the data used in estimation of national income.

CHECK YOUR PROGRESS

Q. 1. What do you understand by "resident" in the context of an economy?

Ans. By resident, we mean the people whose economic interest lies within the country where they reside. Economic interest means the economic activities performed by economy: production, consumption and distribution. It also includes the people who although do not live in that country but their economic interest lies in that country.

Q. 2. Explain the four factors of production and the respective payments made to them.

Ans. The four major factors of production are: land, labour, capital and entrepreneur. These factors are provided by their owners to the production units to perform production activity. In return of the factor services, production units pay rent, wages, interest and profit respectively to the owners of factors of production. The sum total of all the factor incomes is the national income of the country.

Q. 3. What information can be revealed from expenditure method of estimating national income?

Ans. Expenditure method reveals the expenditure incurred by each sector. It is also useful to know the standard of living of the people, whether it is rising or not. The total expenditure of the country could be classified as consumption expenditure and investment expenditure. Private consumption and government expenditure both reflects the spending behaviour of the country and reflects the status of living enjoyed by its people. Expenditure approach is also useful in making the policy of future. The approach provides data on saving and investment which actually determines the future of the economy. More the investment and saving then more will be the growth in future.

Q. 4. How do we know that on an average people are getting more goods and services every year?

Ans. We can calculate the amount of goods and services an average person gets by calculating Per Capita Income. It is equal to total number of goods and services produced in a year divided by total population of the country. The estimate calculated will be the average of goods and services an individual has. e.g. if total number of products produced is 20000 and the population amounts to 100, then the per capita income will be 20000/100 which is equal to 200.

Q. 5. How do you know from national income data that government is spending enough on welfare of the people?

Ans. One can know about the government spending by studying the national income accounts. It is more clearly given when we calculate the estimates on the basis of expenditure method. In this method, expenditure incurred on goods and services produced within the territory is calculated. This expenditure method classifies the expenditure in two: expenditure incurred by household and expenditure incurred by government. The government spends money for the welfare of people only. To provide facilities and basic necessities to its citizens government spends. This expenditure is called government final consumption expenditure. If the share of government expenditure in national income is more it means that government is spending more on welfare of people and vice-versa.

Q. 6. How is national income data helpful in allocation of funds among different industrial sectors?

Ans. National income data provides the sector-wise distribution of national income. It helps the Planning Commission (or the organization formulating plans) to allocate sector-wise funds. What is important is the study of interdependence of the sectors. As the sectors have backward and forward linkages with other sectors, boom or recession in one sector will probably affect other sectors too. So, while deciding about the amount of fund to be allocated to a particular sector, the committee will also provide appropriate funds to its interlinked sectors so that the growth does not hamper.

■■